

Interest Rates Are Going Higher

We sometimes learn more from the sight of evil than from an example of good. When good news is so rare, as it has been in recent months, and evil is so common, it may afford the only opportunity for learning. The spectre of accelerating double-digit inflation and record-breaking interest rates presents a great opportunity.

During the last few months hardly a week has passed without the news of rising interest rates. At this writing the Federal Reserve System charges 12 percent, which is the highest rate in its 65 years of existence, the commercial banks demand 15 percent, and other lenders ask even more. By the time you read this, the rates may even be higher.

The American people are bewildered about this strange evil that forces them to tighten their belts another notch. As the costs of credit are soaring their standards of living are falling. They may have to forego, or at least postpone, the purchase of a new home or car, an appliance or other improvement. They are suffering in silence while the politicians are blustering, the planners are raging, and the President is lecturing on the urgent need for voluntary restraint. He is acting like the man who is rocking the boat himself, while trying to persuade the passengers that there is a terrible storm at sea.

Throughout this decade the federal government has been rocking the economic boat with massive deficit spending. The budgetary deficits rose from \$57 billion during the 1960's to some \$325 billion during the 1970's. With numerous new spending programs, such as socialized medical services and federal energy schemes,

still on the back burners of the Carter Administration, the deficits are destined to go even higher. Deficit spending is the politicians' favorite device to consume more economic resources than taxpayers are willing to yield. It is a tool of expropriation that shifts the burden of government to the capital markets. It consumes and depletes the people's savings and thereby encumbers their future for the benefit of government spending at the present. Rising interest rates are the capital markets' response to the insatiable government appetite for loan funds. They allocate the funds to the strongest bidder, the U.S. Government, and dispossess the weakest borrowers, primarily working people.

When the Fed creates money to facilitate the deficit spending, that is, when it resorts to inflation, it compounds the expropriation effects. It causes goods prices to rise and thereby forces most people to tighten their belts yet another notch. It impoverishes especially fixed income receivers, and sets into motion a vast redistribution process that benefits all debtors at the expense of creditors. In the end, it destroys the economic substance of the middle class that usually invests its savings in monetary assets, such as life insurances, bonds, savings accounts, pension funds, etc. The federal deficit financed by inflation inflicts immeasurable harm on society.

Rising interest rates reflect the soaring inflation rates. When the U.S. dollar is losing its purchasing power at a 13 percent rate and goods prices are rising at that rate, the lenders of funds, i.e. financial institutions and others, have no choice but to raise their charges by the depreciation rates. Government

regulation at times may prevent them from adjusting their rates, which inflicts losses on lenders. But without such interference by government most market rates of interest would probably approach 20 percent, consisting of a 13 percent inflation component plus a basic rate for time preference and risk-taking of 5 percent or more.

At the present rate of inflation, interest rates should be much higher. They are forcibly kept lower by usury laws and banking regulations that favor the borrowers at the expense of lenders. Moreover, the Federal Reserve continues to stoke the fires of inflation by creating ever more funds at the bargain rate of 12 percent. It is charging much less than is presently being paid for federal funds in the open market, which invites member banks to seek ever more accommodations. When the market rate for bank reserves is 14 percent, as it is at the present, the Federal Reserve discount rate of 12 percent is a "negative interest rate" that pays borrowers to borrow money. It is not surprising, therefore, that the demand for loans since March of this year has risen at an incredible 33 percent annual rate.

With the discount rate at 12 percent, the monetary authorities can point at "high" interest rates as "proof" that they are conducting a "tight-money policy." They now feel free to continue to inflate the quantity of money at double-digit rates and thereby stimulate the American economy during an election year. Therefore, in the coming months, we must expect goods prices to ascend ever faster, and interest rates to soar to lofty levels. Government officials probably will tell us that "high interest rates are

failing to restrain inflation," which allegedly demonstrates the need for new government controls. They may favor a "rationing" of credit to their favorite borrowers, or some other controls of the people. They may even want to impose comprehensive price and wage controls in order to hide the inflation. As such controls hamper economic production severely and cause shortages of goods and services, they create the conditions that breed hyperinflation in the end.

We doubt that the Carter Administration has the courage and fortitude to bring its financial house in order. After three years of intoxication with massive deficit spending and monetary stimulation it is difficult to walk the line. After all, the spenders know from experience that after so many years of joyful spending, a return to sobriety would immediately bring the depression. In desperation they prefer the inflation as long as it lasts.

Most Americans seem to agree with their elected representatives and officials. This is why the inflation with its frightening effects and symptoms is raging on. But, according to Shakespeare, "the miserable has no other medicine than hope." Looking at the bright side of things, the American people, someday, will learn the old economic lesson that political redistribution and plunder are evil even when agreed upon by majority vote.

Hans F. Sennholz