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Eye on Washington by Nicholas F. Benton

Tight money fanatics criticize the Fed

Constituting themselves as the "Shadow Open Market Committee" of the Federal Reserve Board, an eight-man committee of economists held a press briefing following their annual pow-wow in Washington last month to blast the Fed and its chairman, Alan Greenspan, for leading the nation down the road to economic ruin.

The committee's most prominent member is Beryl Sprinkel, who is listed as "on leave for government service" for the time being. He is the chairman of the President's Council of Economic Advisers.

Ironically, it is Sprinkel's job to come before the White House press corps periodically with stacks of charts and graphs to rebut the "doomsayers," as he always calls them, and boost the so-called "Reagan recovery."

This occurs even as his dour colleagues of the "dismal science" on the Shadow Committee warn of catastrophe, unless their own economic formula seizes the agenda at the Fed.

With Sprinkel on leave, the group is led by Prof. Karl Brunner of the William E. Simon Graduate School at the University of Rochester. Professors and bank economists make up the rest of the group.

One of them, Brown University's Prof. William Poole, took the point in attacking Greenspan's policy of monetary crisis management at the Fed. By operating from month to month in an effort to "fine tune" the economy, he said, the Fed has caused "wild swings" in the money supply, ranging from an 11.7% growth in June to 3.5% in August.

"This has created a destabilized environment of expectation both here and abroad," he warned. He added that the U.S. policy of "being willing to destabilize the domestic economies of its allies" by forcing higher interest rates and currency devaluations in order to manipulate exchange rates, is "unfortunate" and a political time bomb.

All these criticisms were true enough, as far as they went, but coming up with effective solutions to the problem is another matter. Especially with this bunch. They revealed themselves to be a cadre of tight-money fanatics, who insist that the ogre of hyperinflation can only be slain by holding down growth of the money supply to a flat 3%.

When I inquired what effect such a policy would have on the economy, given the estimated $10 trillion in public and private debt obligations currently outstanding, I was told that "there is no way to avoid certain adjustments, but the choice is between whether you act decisively to correct the situation or you allow conditions to worsen even further."

In a word, these "experts" have accepted the inevitability of a worldwide deflationary crash.

The blinders of ideological dogma

What amazed me was the apparent complete inability of these economists to grasp a fundamental concept about economics that comes from outside their ideological dogma, from the American System tradition of economics.

For example, I suggested to Professor Brunner that an expansion of the money supply needn't be inflationary, if the money is used in a particular way.

This idea caused a most perplexed look to come over the face of Professor Brunner. I tried to explain how, if credit is directed toward areas of productive, as opposed to non-productive, investment, it will not be inflationary. It can even have a long-term deflationary effect, if it is used for advances in applications of technological innovations that lower the unit costs of production.

I tried to use an example. I cited the case of agricultural production, noting how improvements in production, increasing the yield per acre on a farm, lower the cost of food.

It follows, then, I argued, that the relationship between growth in the money supply and inflation is simply a function of how that new money is invested. If it is used only to repay outstanding debt and for other non-productive purposes, such as fueling speculation in real estate and junk bonds, then it will be hyperinflationary. But if there is legislation that directs the use of new money into productive areas, fostering modernization and build-up of new markets, then the relation between money supply and inflation tends actually to move in the opposite direction.

Simple? The concept seemed to elude Professor Brunner completely, which I do not blame on his personal mental powers, so much as on the blinders that he has accumulated from so many years of digesting the hocus-pocus of the Mont Pelerin Society and related monetarist institutions.

This is a common malady in Washington, D.C., where bureaucrats and politicians have become bridled by the constricts of dogmas they commonly confuse with reality. Whatever the issue is, if it does not conform with their party or factional line, they find a reason to protest.

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