Low Rates Are Socially Regressive

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"There is no such thing as a free lunch" — Milton Friedman

Central bankers in most advanced economies still work on the assumption that maintaining abnormally low interest rates is a good thing for economic growth. From this springs the related idea that low rates must be favorable for the poorest in those societies.

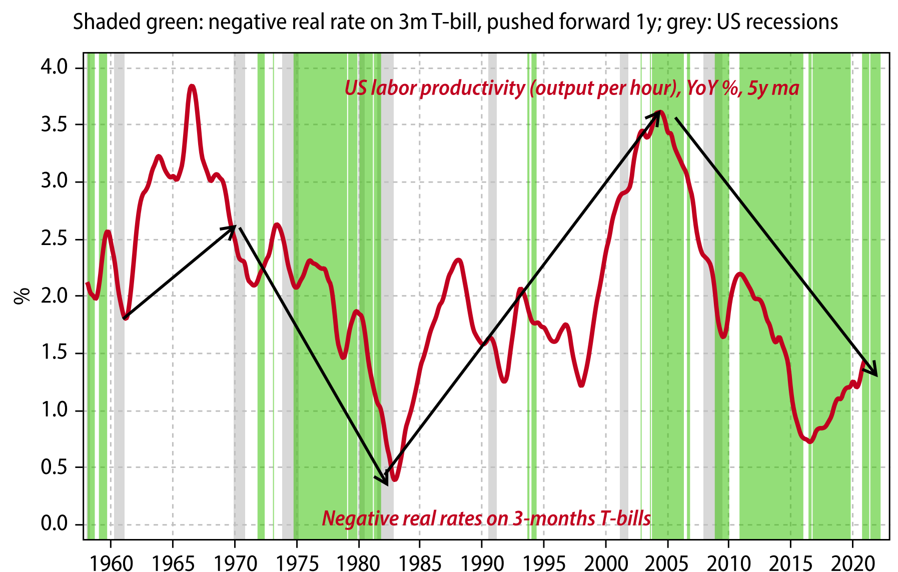
For reasons argued a decade ago, I consider such notions to be fallacies (see **The High Cost Of Free Money**). My argument then was that abnormally low policy rates must lead to falling productivity, accompanied by rising asset prices due to financial engineering that will increase if long rates also stay low. The result will be reduced investment in *new* capital, which makes the rich get richer, as they own the stock of *old* assets. Workers will get poorer as weak productivity growth militates against rises in real incomes.

Negative real interest rates always create a cycle leading to a collapse in productivity

The reason is simply that low interest rates are a tax on savings that ultimately causes the savings rate to fall. This situation always leads to less capital spending, ensuring a shrunken capital base and with it lower productivity. Thus, relying on low rates to stimulate structural growth is about as smart as imposing rent control as a way to boost housing supply. I first showed the chart below, which links the fate of US productivity growth and real rates, in 2011 and the ensuing decade has not detracted from the thesis. It should be noted that the same dynamic is seen in other economies.

Negative real rates and US productivity

Shaded green: negative real rate on 3m T-bill, pushed forward 1y; grey: US recessions



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Policymakers persistently think that they know better than the market

It always amazes me when policymakers think that by manipulating market prices, they can help an economy achieve better returns. This is especially true in the case of interest rates, which are a pricing link between the present and the future, which is, by definition, unknowable.

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In 2014 and 2015, I broadened my argument out to show how abnormally low interest rates depress the "real" earnings of the working class (see **Poverty Matters For Capitalists** and **Poverty Still Matters For Capitalists**). Not only do these policies lead to lower economic growth, their propensity to hit low-end workers the hardest is unacceptable in political, social and moral terms, at least according to the late US philosopher John Rawls. A "just" society is one in which the poor see their standard of living rise consistently, he argued, and as a result they are comfortable with the rich also getting richer. But if they see the rich get richer while they get poorer, politics can become difficult.

In the US, I define abnormally low interest rates as the yield on three-month T-bills being negative in real terms. There are two direct ways that this makes the poor poorer.

The poor tend to keep whatever savings they can muster in cash, and so are hurt by negative real rates

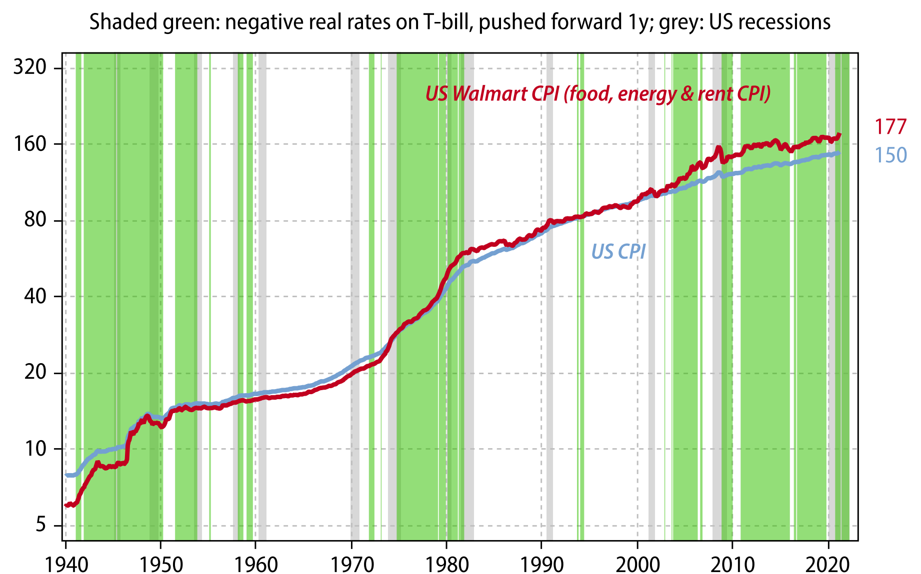
First, unlike the rich, the poor tend to keep whatever savings they can muster in cash. Hence, by depressing short rates, savers are deprived of legitimate income. The rich, of course, take steps to avoid the "euthanasia of the *rentier*", and get out of interest-bearing instruments and into alternative reserves of value such as commodities and real estate.

The poor are also hurt by inflation in food and energy prices caused by abnormally low interest rates

Second, since I spent my student days and early working life with limited means, I know from personal experience that the poor spend most of their money on food, energy and rent. Hence, as hot money drives up the price of commodities and energy, the price of staple items is pushed up, including rent. To show this point, consider the chart below which compares the inflation rate for the average US citizen (the US consumer price index) to a narrower measure comprising food, energy and rent, split equally in one-third proportions (I call it the Walmart index).

The "Walmart CPI" and the US CPI

Shaded green: negative real rates on T-bill, pushed forward 1y; grey: US recessions



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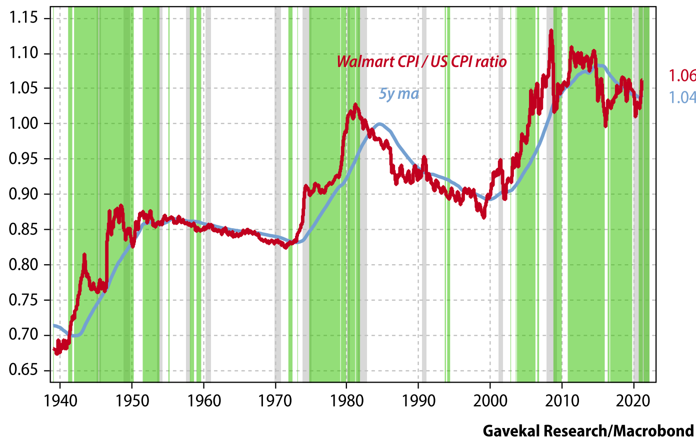
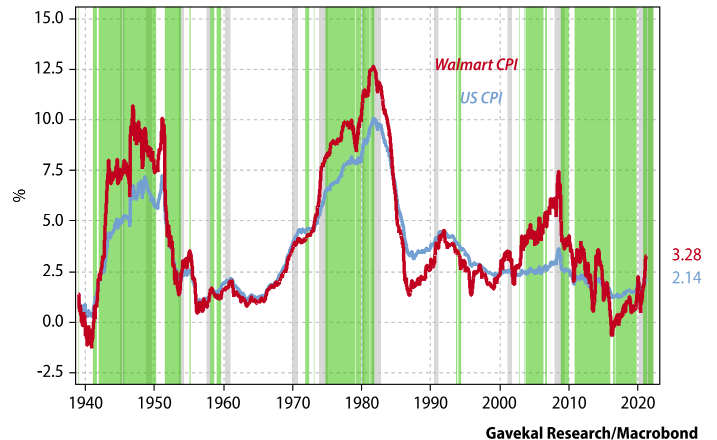
From the chart, it can be seen that each time the US has had negative real rates, the Walmart index rose far more than CPI, with the reverse happening when savings were normally remunerated. Next, consider the ratio between the two price indexes as shown in the two charts overleaf.



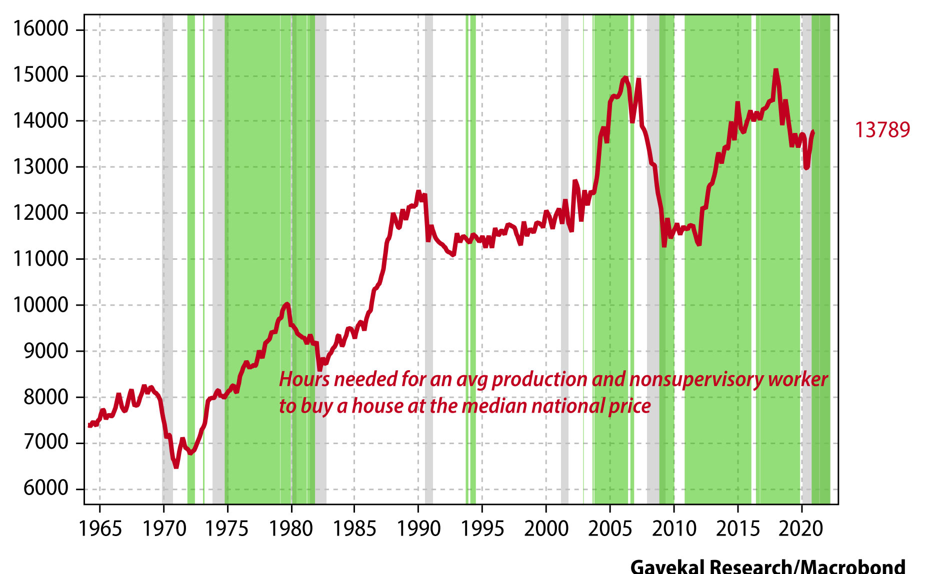


It can be seen in the left-hand chart that the Walmart CPI has consistently outpaced the US CPI since the early 2000s. That pattern was interrupted last spring by the big fall in oil prices, but the Walmart index now seems to be back on a track of rising faster than the US CPI.

The right-hand chart above shows the average annual rate of change for both indexes over five years. On this basis, the rate of inflation faced by the US poor is 3.3% and rising, a level that is 50% more than that faced by the average US citizen. For those interested in the 12-month rate of change over the last year, the Walmart CPI is up 6.32% versus 3.31% for the US CPI.

The impoverishment of the poor can be seen in the number of hours they have to work to buy a house

One sign of the relative impoverishment of the poor can be seen in the number of hours that hourly-paid workers must toil in order to buy a house at the median market price. The chart below shows that the cost of this piece of the American dream has doubled since 1967 for hourly-paid workers, with most increases taking place in periods of negative real rates.

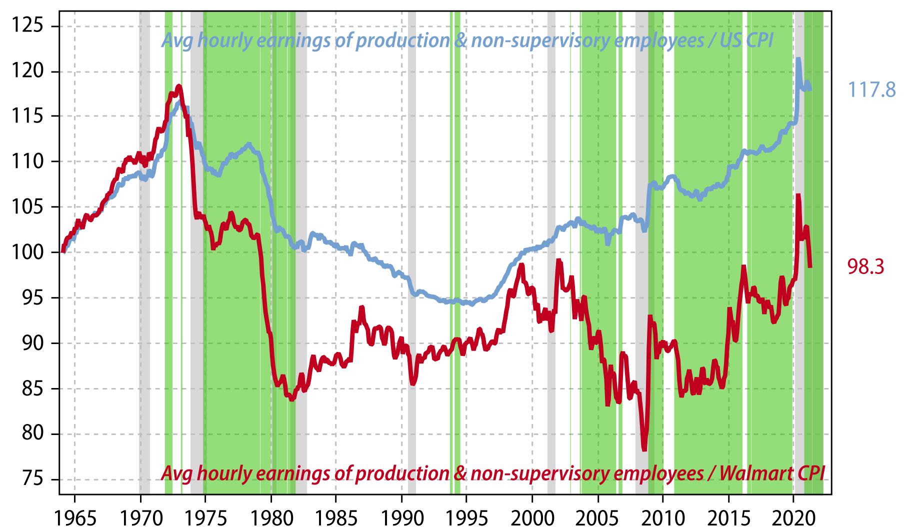


In every "Keynesian" period the poor have done badly in outright terms

Lastly, consider the real income of the median US household when deflated by the US CPI and also that of the average hourly-paid worker when deflated by the Walmart index. It can be seen that in almost every "Keynesian" period of negative real interest rates, the real income of the poor fell in outright terms. On this basis, the standard of living for the lowest-paid has fallen since 1964, with all of the declines occurring in such Keynesian periods.

The "euthanasia of the rentier" is bad news for poor workers

Shaded green: negative real rates on T-bill, pushed forward 1y; grey: US recessions



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Cultural conclusion

At the very least, Keynesian monetary policies can be seen to fail John Rawls's test, as the result is the poor continually getting poorer. Alas, for the downtrodden in the US and Europe, things may get worse still as policy settings are presently more extreme than they have ever been in the past. I thus suspect that the Walmart index will continue to zoom upwards.

The question is: why do policies that have been shown to work so badly still get used so regularly?

But why are policies that have never worked still in use? To answer this question I will use a typology devised by the Italian economist Vilfredo Pareto. He said that an economic theory should be judged two ways: (i) does it work, and (ii) is it popular? As such, a theory can be one of the following:

1) **Popular and not working**: Marxism a few years ago in France, but not in the Soviet Union, where it was never popular.

2) **Popular and working**: Capitalism, in China now, or in the US a few decades ago.

3) **Unpopular but working**: Capitalism in France, as the French prefer to be wrong with Jean-Paul Sartre than right with Raymond Aron, whose most famous book asserted that Marxism was the opium of French intellectuals. France's government spending is now at 61% of GDP and capitalism in the country is about to disappear.

4) **Unpopular and not working but kept by a tyrannical political power**: Cuba and Venezuela come to mind, and California may be next.

I have long maintained that Keynesianism is to Marxism and Socialism what diet cola is to the real sugary beverage. Hence, it falls neatly into the *popular but not working* category. As noted already, Keynesian policies have never really worked for the "little people", but they have worked jolly well for those whom Joseph Schumpeter in the 1940s dubbed "false intellectuals". These were folk made rich by an educational boom that had been funded by American capitalism, yet they ended up biting the hand that fed them.

Intellectuals have an inbuilt bias for socialist systems

Most intellectuals have a "socialist" bias, as in socialist systems they are paid what they think they are worth, not their market price. Moreover, Keynesian theory grants "false intellectuals" political power that lets them stay rich enough to drink champagne and eat caviar, even if the poor get poorer. We are seeing this across the West, as the recipients of elite education try to destroy their own economic system. It is perhaps not surprising, as universities built by the Catholic church have for centuries attacked that very church. It follows that the system of universal education created by capitalism now aims to destroy both capitalism and democracy.

Investment conclusion

- **Invest in Asia**. Confucius did not approve of children killing first their mother (religion) and then their father (laws governing property). Confucian societies still believe in educating children to become responsible adults.

There are places that are resisting the madness taking over much of the Western world

- **Invest in Northern Europe and in Switzerland**. Intellectuals in these generally small countries are thin on the ground, and they have never managed to capture political systems.
- **Invest in countries that have the Queen of England on the money**. I lived in the UK for 25 years and quickly realized that being an intellectual is not considered "proper" in good society (being a "character" is good).

Investing elsewhere could be dangerous, especially if the "educated yet idiots" (thanks Nassim Taleb for that one) are in the process of taking over political systems. As Ronald Reagan quipped: "The nine most terrifying words in the English language are 'I'm from the government and I'm here to help.'" So as western governments spread their tentacles into every aspect of life, it feels that our systems face the kind of threat that Russia's *ancien regime* did in 1917. Unfortunately for me, I live in one of the countries most at risk.