



Written by [Brian Farmer](#) on January 27, 2009

Study Claims Interest Rate of Zero Is Too High

As Goldman Sachs' chief U.S. economist Jan Hatzius put it in a research note, "We are entering a world with interest rates that are far too high for the economy's good." One can't help but wonder how an economist can seriously make such an argument, especially since it was inordinately low interest rates which contributed to the present economic crisis in the first place!

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That economic argument involves the concept of "real" rates, which is the interest rate adjusted for inflation. When the economy slows, the Federal Reserve can attempt to stimulate economic activity by reducing short-term interest rates to a level below the rate of inflation. For example, if inflation is running at five percent a year and interest rates are at three percent, then the "real" rate would be negative two percent. Negative real rates encourage people to borrow and spend, rather than save and invest, because inflation is eroding the purchasing power of their savings, and borrowed money can be paid back with the so-called "cheaper dollars" that result from an inflating money supply.

The problem comes when the inflation rate drops to zero, which many economists expect to happen in the near future, as the economy continues to soften. With short-term interest rates already at virtually zero, the Fed finds itself in a bind: dropping interest rates below zero means that the Fed could borrow some amount of money now and pay back less than the borrowed amount later! But then no rational saver would put his money in the bank under such circumstances.

The solution, according to the economists, is for the Fed to raise the rate of inflation to a level significantly above zero. The obvious way to do that would be for the Fed to create lots of money out of thin air and then spend it on everything from those toxic mortgage-backed securities that banks are holding to the infrastructure projects that President Obama keeps talking about.

But even if hundreds of billions of dollars are created out of thin air, there is no guarantee that the money will turn up as loans to businesses and consumers. The hundreds of billions already spent by the federal government on the Troubled Asset Relief Program simply disappeared into the banking system, papering over the losses which the banks incurred on bad loans. To put it bluntly, a bunch of desperate and greedy Wall Street bankers used fear to get the federal government to rescue their jet-set lifestyles





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with our money. Is it any wonder that the blatantly self-serving Goldman Sachs report claims that the solution to all of our economic problems lies in the federal government giving them more money, or am I just being too cynical here!?

We are told that we are in a crisis and that the federal government must act, before it's too late. But shouldn't we take at least a little bit of time and look at history, to see if we can learn from the experiences of others who may have faced similar problems? Are there no precedents to guide us? In fact, there are, and within living memory there is a precedent right here in the United States.

The Obama administration wants to mimic the FDR administration of the 1930s and increase the role of the federal government in the American economy. The conventional wisdom would have us believe that FDR's New Deal programs ended the Great Depression. In fact, they caused the U.S. economy to falter for years longer than was necessary. After almost a decade of economic pain, FDR's Treasury Secretary made this 1939 entry in his diary, concerning FDR's New Deal economic policies: "We have tried spending money. We are spending more than we have ever spent before and it does not work.... After eight years of this Administration we have just as much unemployment as when we started.... And an enormous debt to boot!"

It appears that we have not learned the lessons of history. We are now creating and spending money in almost unfathomable trillion-dollar chunks. The federal government is assuming enormous new powers, deciding which businesses will be allowed to fail, and which will be bailed out. The free-enterprise system that made the United States the wealthiest nation in history is being suffocated. We are being frog-marched toward socialism. And like the frog in the slowly heating pot that doesn't realize that it's being cooked and doesn't jump out to save itself, the bulk of the American public is oblivious to what is really happening.

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