

## CONTAINING THE COMING DEPRESSION

By Louis O. Kelso and Patricia Hetter Kelso

Asking whether there will be another depression is like asking, 50 years before the discovery of microorganisms, “Will there be another plague?” Almost six decades after the Great Depression began, the economics establishment is still unable to explain its cause. We know only what ended that catastrophe — a second catastrophe, World War II. The intervening years also have exposed the costs of the Keynesian measures the New Deal introduced to stave off economic collapse. This country, which for three-quarters of a century was the world’s largest creditor nation, suddenly became — in 1987 — the world’s largest debtor. What we have hailed as ever-rising prosperity is, in fact, the hollowing out of the economy — a process which, if not interrupted, must end with the collapse of the shell.

Since 1932 we have kept the U.S. economy running by jacking up income redistribution each year in an attempt to enable consumer purchasing power to support the economy’s production. Over half of all state and federal taxes are levied upon those who earn income in order to give it, through transfer payments, to those whom government deems to “need” it.

Taxpayer resentment of welfare led to Ronald Reagan’s election and reelection. But as *The New York Times* pointed out in an article on Reagan’s seven-year budgetary legacy, the president who promised and still ceaselessly advocates balanced budgets and fiscal integrity has “overseen the creation of more new debt than the combined deficits of all previous presidents.” The president who promised to reduce big government’s size and scope has seen the federal civilian workforce increase by 150,000 to more than 3 million. The president who pledged to reduce government spending has seen it rise by \$321 billion to more than \$1 trillion.

The surge in military spending from \$157 billion in 1981 to \$282 billion this year represents not a change in principle, but a deliberate enlargement of welfare disguised as “defense” production. Conservatives accept redistribution more willingly when, as they say in Congress, it is “wrapped in the flag.”

Regardless of which political party is in power, more income redistribution is an indispensable part of the U.S. economy. This continues to be true because from the beginning of the Industrial Revolution, business and government have focused exclusively on enlarging the production and improving the quality of economic output. Meanwhile, the other side of the economic equation has been ignored — we have failed to increase the earning power of consumers. Who will consume the ever-rising flood of goods and services that technology enables the private sector to produce is apparently not a concern of business or government. Nor does business ask or care about where or how its customers get the money to purchase goods. It leaves that question to government and labor unions, whose idea of a solution is the technologically obsolete national economic policy of full employment — a policy more appropriate to the Stone Age than to an

advanced industrial economy where technology has transformed the nature of work from labor-intensive to capital-intensive.

In pre-industrial times, full employment of mature labor power was not only a practical and moral necessity, it reaped as high a level of production from the economy as was possible. Originally, economic power was labor power. Each consumer, equipped with brains, limbs, and muscles, was capable of being a producer. Furthermore, this innate productive power was so integrated with the physical person that it could not be taken away without enslaving or killing the owner. Since people differ considerably in their labor power endowments, this distribution was not egalitarian. But it was democratic — individual and personal, not collective. From this primordial economic arrangement emerged private property and democracy — the foundation of economic and political freedom.

### GAPING INCOME GAPS

But the Industrial Revolution, as historian Arnold Toynbee said, marks a change in the way people produce goods and services — a change from labor-intensive to capital-intensive production. This change affects the dynamics of a free market, with its automatic distribution of income (purchasing power) to those — and only to those — who take part in production, either as labor workers or as capital workers. As production grows more capital-intensive, it follows that capital workers produce more and receive more income, unless wage and salary costs are “administered,” rather than set by free-market forces. If the markets remain free and competitive, labor workers produce and receive less. As technology widens the income gap between capital workers and labor workers, redistribution becomes necessary to subsidize labor worker consumption and to provide welfare for the growing numbers who cannot earn an adequate living solely through labor. For those nonproductive and underproductive millions at the bottom of the income pyramid, depressions do not come and go — they are ongoing and permanent.

Economic depression is largely a middle-class phenomenon. The rich are above it; the poor hardly know the difference. *The Wall Street Journal* reported that shortly after the 1987 stock market crash, 80 percent of respondents, asked by a Democratic pollster to rank the crash on a list of six national problems, put it last. Only two percent ranked it first and second. The same article cited a 1985 New York Stock Exchange study estimating that only 20 percent of the U.S. population directly holds any stock or mutual funds, with only one percent to three percent of the population having portfolios of \$50,000 or more.

Will we have another depression? Yes, because the gap between the economy’s production and the power of a mere segment of consumers to earn adequate incomes on a pay-as-you-go basis has reached its limits of sustainability, and so has income redistribution. The stock market gyrations merely evidence the confusion resulting from the sterilization of the mighty purchasing power of the rich (much of whose income cannot be used to purchase consumers goods and services thanks to a lack of desire to consume more), along with the inability of the solely labor- and welfare-dependent

masses to earn enough to live well. Pension funds are in the same predicament, because they do not equip either present or prospective pensioners with effective capital ownership; the full earning power of the underlying assets.

Can the depression be averted? Possibly — if we seriously commit ourselves to reconnecting the economy's vast stock of capital with the 95 percent of individuals and families now disconnected from ownership of non-residential capital and its earning power. This would necessarily involve restoring full private property to capital stock so that each stockholder would fully collect the "wages" of his or her capital (at least a 90-percent payout of corporate net earnings). This vast job will require switching from conventional finance of capital transactions, which merely makes the rich richer, to binary methods. Through the use of one or more of the eight financing techniques built on the logic of the ESOP, all families and individuals can purchase capital and pay for it out of capital's own earnings instead of labor income.

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