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THE TENTH PILLAR OF SOUND MONEY AND CREDIT

THE PRINCIPLE OF PRODUCTIVITY OF LABOR AND CAPITAL

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A Venetian Tale

Once upon a time a man by the name Shylock was the Public Treasurer in the prosperous city of Venice. The finances of the city state deteriorated grievously under his stewardship. Foreign entanglements and the mindless substitution of public largesse for private charity were to blame for the sorry state of the public purse. Shylock issued Treasury bonds supposedly paying interest at the usurious rate of 15 percent, not bothering to ask how payments of principal and interest, when they fall due, would be met.

Before he became Treasurer, Shylock was a heartless usurer on the Rialto, where other merchants, in particular one by the name of Antonio, openly reproached him for his covetousness. Thus there was great enmity between the two men and, although Shylock would bear the scorn with seeming sufferance, he secretly meditated revenge. His chance came when the combination of high tax and interest rates forced Antonio's business into receivership, and himself into the debtor's jail.

When the day of his trial arrived. Antonio's counselor, an unknown young lady doctor by the name Portia appeared before the Duke and his senators, while the Treasury was *represented by Shylock himself. With the Duke's permission, Portia started the proceedings by addressing herself to Shylock. Admitting at once that he had the right, by the laws of Venice, to deprive Antonio of his property and personal freedom, she spoke sweetly of the noble virtue of mercy and how tax-forgiving was a double blessing, as it blessed the state that gained a future taxpayer, and the taxpayer that gained a chance to reorganize his business. But neither her reason nor her passionate pleas softened the heart of Shylock, who reiterated his demand for selling Antonio into servitude.*

Portia gravely responded that the law once established, must not be bent. Hearing this, Shylock exclaimed: "0 learned and upright judge, I honor thee! A Daniel is come to judgment! Prepare. Antonio: we must not trifle time."

"Wait," said Portia, "Before you sell Antonio into servitude, you must understand that his price shall cover not only his past but also his future tax liabilities. Otherwise you shall personally assume the burden." Hearing this. Antonio's friends in the audience cried out: "0 wise and upright judge! Mark the word, Shylock, a Daniel is come to judgment!"

Shylock, who would not for a moment think of assuming the future tax liabilities of Antonio under the tax laws of Venice which he himself fashioned for the discomfort of his rival, conceded defeat, saying: "Let me go in peace."

"Not so fast", said Portia. "The laws of Venice protect her taxpayers against conspiracy and vindictive use of high public office. In driving up tax and interest rates to heights unheard of in the history of this city, you have attempted to exact a pound of flesh from every honest merchant of Venice. I plead with the Duke to deprive you of your high office as an exemplary punishment, for the edification of future generations."

The Duke, after considering the evidence, gave Shylock a dishonorable discharge from his duties as Public Treasurer. The tax and interest rates in Venice soon returned to a low and stable level. Labor and capital were no longer crucified on the cross of the public debt. Venice continued to prosper. And even today jurisprudence talks about the Shylock doctrine, when it refers to the natural law forbidding the exaction of payment for debt from a debtor in excess of the productivity of labor and capital.

(Adapted from: *Tales from Shakespeare,* by Charles and Mary Lamb, London, 1807.)

The marginal worker

The pupils in a classroom can be ranked according to academic achievement, as measured by their marks. If the passing mark is 50%, then the marginal student is the one with the lowest mark above 50%; any student with a lower mark is sub-marginal. If the teacher now changes the passing mark from 50% to, say 65%, then this change would render a number of additional students submarginal, even though there was no deterioration of industry or aptitude on the part of these students.

The situation in the national economy is entirely analogous. Labor and capital can be ranked according to productivity. The worker with the lowest productivity rating above the rate of interest is called the marginal worker (and his tools, the marginal capital). Workers whose productivity ranks below that of the marginal worker, are sub-marginal. They are earmarked to be laid off as soon as their tools, the sub-marginal capital, will complete their amortization cycle. Indeed, no prospective employer would hire a sub-marginal worker if he could invest his funds and earn interest at a rate in excess of the rate of productivity of sub-marginal labor.

If the rate of interest goes up, there is an immediate effect of rendering additional labor and capital sub-marginal, regardless of whether or not the productivity of individual laborers has declined. Thus we see that the maximum rate of interest determines the marginal productivity of labor and capital. It arbitrarily decides who can keep his job and who shall lose it, which capital equipment can stay in production, and which shall be doomed to the scrap-yard. The Principle of Productivity of Labor and Capital asserts that the maximum rate of interest must be low enough to allow all those, who are eager to earn wages, to find employment; and also low enough to allow new capital goods to begin their amortization cycle.

Depreciation premium

The carefully concealed truth is that interest rates are high today (1985) because they incorporate a large depreciation premium, designed to compensate the lenders of funds for loss of purchasing power due to the depreciation of the dollar. In fact, all regimes of irredeemable currency in history have pushed interest rates into outer space, as these currencies succumbed to their inevitable fate of accelerating depreciation. And as the rate of interest rose, so did unemployment widen; so did the destruction of capital spread.

Class war

One of the most powerful arguments in favor of a gold standard is that it alone can make the marginal productivity of labor and capital low enough, so that all those eager to earn wages can find gainful employment, and so that capital will be accumulated and adequately maintained. No sooner is the gold standard removed than the Shylock syndrome will appear, rendering a large part of the labor force and a large part of the capital park of the country sub-marginal, and hence, unemployed. As the workers and the owners of capital goods are pitted against the lenders, social harmony and cooperation gives way to class war and social unrest. The only solution is the resumption of a gold standard. There are two ways to resume; targeting prices, and targeting interest. Targeting prices aims at a price level prevailing before suspension, and it involves *increasing* the metallic content of the monetary unit, while leaving interest rates alone. By contrast, targeting interest aims at a level of interest rates prevailing before suspension, and it involves *decreasing* the metallic content of the monetary unit, while leaving prices alone.

Solon 's Seisachthea

Historically most resumptions were of the first type, causing economic contraction characterized by declining prices accompanied by declining interest rates. As a result, many observers concluded that the gold standard was deflation-prone.

The fact, however, is that there need not be any painful deflation, if the second type of resumption is carried out, Prices should be left alone, while interest rates are reduced overnight. This is what one of the greatest social reformers of all times, Solon (640-559 B.C.), Athenian law- giver, merchant and poet accomplished with his Seisachthea (in literal translation, disencumbrance). According to the historian Plutarch, he lowered the metallic content of the monetary unit. the drachma, to 73% of the original, and simultaneously reduced the rate of interest on the outstanding debt by law. There was great relief across the land, and Solon recorded his own deed in verse as follows:

"The mortgage stones that covered her, by me
Removed: the land, that was a slave, is free...
...Such power I gave the people as might do.
Abridged not what they had, nor lavished new:
Those that were great in wealth and high in place
My counsel likewise kept from all disgrace.
Before them both I held the shield of might.
And let not either touch the other's right."
(The Dryden translation)