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The Fed’s Immiseration of People Who Live on Interest Earnings

ROBERT HIGGS

Given the Federal Reserve System’s policy during the past five years of, first, driving nominal short-term interest rates down almost to zero and, more recently, undertaking Operation Twist, with the intent of driving longer-term interest rates down to levels that in real terms equal or fall below zero, we might well wonder whether Chairman Ben Bernanke and his colleagues consciously decided to give a shove to the wheel of history that John Maynard Keynes longingly anticipated in order to bring about what he called “the euthanasia of the rentier” (1936, 376).

In any event, no one can dispute that people who rely on the interest earnings of low-risk invested funds to support themselves—such reliance being a situation in which many retired persons in particular find themselves—are now in severe difficulty. Bank savings accounts are paying interest rates of 1 percent or less (“Online Savings” 2014). Certificates of deposit are paying 0.40 percent to 1.33 percent, depending on the term to maturity (“Nation CD & Investment Rates” 2014). U.S. Treasury bonds with terms to maturity of five to thirty years are yielding in the neighborhood of 1.6 percent to 3.6 percent, the higher rates being for the long-term bonds (U.S. Department of the Treasury 2014).

In short, the highest yield available to ordinary investors who seek a simple, low-risk investment of their funds is, at best, roughly equal to the rate of overall price inflation—and then, for a bond with a thirty-year term to maturity, only with

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substantial risk of capital loss if interest rates should rise. To put the matter another way, nearly all ordinary investors are now being progressively impoverished because the nominal return on their investments is too small to compensate for the loss of the dollar’s purchasing power during the term of the investment. Getting a positive real rate of return is effectively impossible for the proverbial widows and orphans. Only investors who know how—and are willing—to invest in risky equities, precious metals, crude commodities, and other such esoteric assets stand any chance of earning positive real returns and then only with great risk of substantial capital losses.

As figure 1 shows, personal interest earnings rose substantially—from 2004 to 2007–2008 and then dropped precipitously after the Fed’s new policies took effect in the last quarter of 2008. During the past three years, such earnings have more or less stabilized in the neighborhood of $1.2 trillion. This amount is only about 10–12 percent greater than the amount that was earned in late 2000 and early 2001—almost fourteen years ago.

These data, however, are given in nominal dollars whose purchasing power has declined substantially over time. Between late 2000 and late 2013, the price index for personal consumption expenditures rose by approximately 28 percent. Therefore, at the latter date the flow of personal interest income, though greater in nominal terms, had a purchasing power equal to only about 88 percent of the

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1. For the interest-income data, see U.S. Department of Commerce 2014b.
2. For the price index, see U.S. Department of Commerce 2014a.
purchasing power of the personal interest income earned at the former date. Of course, the decline since the peak in 2007 has been much greater—in the neighborhood of a 20 percent drop in real terms.

Another way to see what the Fed’s zero interest-rate policy (ZIRP) is doing to people who rely on interest earnings for their income is to examine the yield on Treasury inflation-indexed securities. Many retirees have invested in these securities in an attempt to insure themselves against the risk of being wiped out if future rates of inflation should turn out to be unexpectedly high. Figure 2 shows that from 2003 to 2007 the yield on these securities varied in the 1–3 percent range. With the onset of the financial panic in 2008, the yield became volatile, but from early 2009 to late 2012 it tended steadily lower. Although it recovered somewhat in late 2013, it remained in the negative range, where it had been nearly all the time since September 2010. In short, the Fed’s ZIRP has “succeeded” in keeping the real return on a low-risk, five-year Treasury security negative for years on end, in effect allowing the Treasury to reap a real return from those who bought its bonds rather than compensating them for their lending.

The Fed’s defenders historically have argued, among other things, that central-bank monetary policies have a sort of neutrality: they affect aggregate demand, the overall price level, and other macroeconomic variables, but they do not attempt to carry out the kind of micromanagement of the credit market or the overall

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3. For these yields, see Board of Governors of the Federal Reserve System 2014.
economy that Soviet-style central planning attempts. This argument has always been bogus because monetary policy was never—indeed, cannot be—neutral. It always has differential effects on investment projects of differing life spans, on different classes of people, and on different sorts of economic activity, depending in part on who receives the infusions of newly created money first, second, and later in the process and on how these persons’ actions affect ongoing real economic processes. Nonetheless, the central bank’s defenders might have argued that at least the Fed did not attempt in any direct way to bring about definite changes in the distribution of income, either personal or functional.

Such defenses now ring unmistakably hollow. Even apart from the Fed’s entry into clear credit-allocation activities (e.g., conducting open-market policies by transacting in mortgage-backed securities rather than in Treasury securities alone), it is plain that the Fed is acting in a way that impoverishes a definite class of persons—those heavily dependent on interest earnings for their income—and, moreover, that a policy of keeping nominal interest rates on low-risk assets near zero while inflation continues must eventually wipe out such persons’ incomes completely by continuously diminishing the real value of their earnings and by destroying the real value of their financial capital. In that event, people who worked and saved over a working lifetime, taking personal responsibility for guaranteeing their self-sufficiency during their elderly, nonworking years, will be able to survive only at the mercy of the providers of private and public charity.

This problem is not a trivial matter: for the next sixteen years, about ten thousand members of the huge Baby Boom cohort will turn sixty-five each day (Cohn and Taylor 2010). Small wonder that during recent years, when the labor-force participation rate has fallen for every age group from sixteen to fifty-four, it has risen substantially for persons fifty-five and older, from 34.5 percent in 2002 to 40.5 percent in 2012.4 Aware of their grim economic prospects, with Social Security pensions in jeopardy because of the government’s fiscal irresponsibility and private retirement incomes being eaten away as a result of Fed policies, many of these elderly people have concluded that they will have to work until they drop.

The link between the Fed’s ZIRP and its effect on the income of interest recipients is too direct and obvious for anyone, including the Fed’s managers, to overlook or misunderstand. We may only conclude, then, that the Fed’s managers either (1) want to wipe out the retirees and others who rely heavily on interest earnings or (2) consider these people’s immiseration an acceptable price to pay in order to achieve other objectives. It is also apt to note that the Fed’s ZIRP punishes the responsible people in order to reward the irresponsible ones—namely, the leaders of the U.S. government and the managers and owners of AIG, Fannie Mae, Freddie Mac, and the big commercial and investment banks, whose mismanagement

4. For labor force participation rates, see U.S. Department of Labor 2014.
of their institutions, along with the Fed’s own mismanagement, brought on the economic troubles that surfaced during the panic of 2008 and whose legacies have plagued the U.S. and world economies ever since.

The politicians constantly bark about their solicitude for those who are helpless and in difficulty through no fault of their own. Yet scores of millions of people who saved money to support themselves in old age now find themselves progressively despoiled by the very officials who purport to be their protectors. There are many reasons to oppose the Fed’s ZIRP. One of them, its euthanasia of the nation’s small savers, deserves far more attention than it has received to date.

References


