

When credit is tight (loanable funds are scarce in relation to demand in the economy), this becomes glaringly apparent. For example, there is really little in a long-standing customer relationship to tell a bank that a prime depositor has a particularly meritorious project. Yet, at times of credit stringency, he is given credit on favorable terms while other applicants with excellent projects are rationed out of the market for considerations that are perfectly logical to the bank. If markets functioned with perfect economic efficiency, this would not happen.

For the economy in general, the most important effect of high interest rates has been to restrict the flow of funds to the housing market as the bond market has attracted funds that in other times were deposited in mortgage lending institutions (due to legal interest rate constraints and the slow turnover of assets at these institutions).

Because real resources move slowly, this failure of credit to flow to its most efficient point constitutes an important stabilization problem. It is difficult to move labor geographically or to retrain a plumber to be an engineer. Also, unions can halt entry of new labor into the market just as monopoly and oligopoly halt entry of new businesses. Given this lack of real factor mobility, a temporary shift of credit may cause structural unemployment. It also may in the case of housing lead to an inflationary rise in rents and the cost of living if the supply of residences lags demand. It may be true that the resources would move given enough time. But the length of time required is much longer than is practical for the business cycle, and the reallocation is neither perfect