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The Fed's Ruinous Course

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The financial shamans at the Federal Reserve, America's central bank, are hiking interest rates at a record rate, intent on slowing growth, throwing millions of workers out of work, and suppressing wage increases. If the Fed holds its course, it will drive the economy into a recession or worse, add to poverty and inequality in the United States, trigger a debt crisis amid growing hunger across the world—and quite likely help elect Donald Trump or whatever gelded MAGA stand-in Republicans end up nominating in 2024. Yet, faithful to the gospel of central bank independence, neither the president, nor Democratic congressional leaders, nor, with few exceptions, progressive legislators have questioned the Fed's ruinous course.

The Fed's goal isn't a threat: It's a promise. In the delicate language of Fedspeak, Jerome Powell, the head of the Fed, vows, "We will keep at it [hiking interest rates] until we are confident the job is done," and that will produce "some softening of labor market conditions," and "some pain." The slowdown will ensure that "wage pressures move back down," rectifying the "real imbalance in wage negotiating." The Fed will cost you your raise, if not your job.

The early effects are already apparent. The stock market has tanked. The dollar has soared, making exports less competitive and imports cheaper, and stoking debt crisis fears across the world. Companies are already laying off workers in anticipation of slowing growth. With central banks across the world tightening, the World Bank, Wall Street bankers, corporate CEOs, and establishment economists all raise alarms about the coming downturn.

The Fed is kneecapping workers in order to curb rising prices and roll inflation back to the Fed's arbitrary target of 2 percent. Rising prices are cruel, particularly for already strapped families who must scramble to cover necessities—food, gas, health care, heating, affordable housing. In the past year, the cost of health insurance has increased a record 28 percent, rent has increased 7 percent, and groceries have increased 13 percent.

But hiking interest rates to treat this malady is the economic equivalent of doctors' using leeches for bloodletting in the Middle Ages. Despite its dual mandate to provide for maximum employment and stable prices, the Fed is laying waste to employment and wages to prove its credibility on controlling prices. The paragon is legendary former Fed Chair Paul Volker, who slayed the inflation dragon of the 1970s by hiking interest rates to 20 percent. Expectations changed as the cost of the worst recession since the Great Depression and a global debt crisis forced Volker to back off. In an interview at the CATO institute, Powell was challenged: "Volcker was the man. Do you have what it takes?" "Yes, he was," said Powell, "And yes I do."

The Fed pursues this ruinous course to ensure that companies and workers don't lock in expectations of price inflation. But, as J.W. Mason noted, it could choose to anchor a different set of expectations. If the Fed's emphasis were on sustaining a full-employment economy with rising wages, companies would move to invest in labor-saving technology and become more efficient. The higher productivity could cover rising wages and profits, limiting price increases.

Moreover, today's inflation is very different from the stagflation of the 1970s. Then, labor unions were strong; now, they are nearly extinct. Wages aren't keeping up with rising prices, much less driving them. Even Fed officials admit that today's inflation is driven largely by the notorious supply chain disruptions attending the rapid opening of economies from the Covid shutdown, by the war in Ukraine and Russian sanctions that roiled gas and food supply, by the ravages of extreme weather, including droughts across the US and China—and by corporations' using the crisis to pocket record profits. An analysis of the Economic Policy Institute showed that profit markups accounted for more than half of price hikes and wage increases less than one-10th.

A sensible response would address the causes directly. The short-term supply chain issues—like the backlog at the ports—are already sorting themselves out. Chronic disruptions—from contagion and climate, tensions with China, failures of our feckless trade policy—require a serious industrial policy. Biden's push to rebuild our infrastructure and subsidize green technology and advanced technologies at home is a start.

Accelerated transition to alternative energy and greater energy efficiency would reduce dependence on the global oil market. Rampant corporate profiteering requires aggressive antitrust action and windfall profits taxes like those instituted in Europe.

Democrats passed the first steps toward curbing obscene drug company prices. Mark Zandi of Moody Analytics estimates that the war in Ukraine is the biggest driver of current inflation. A US recession won't stop the war. Its disruptions, particularly on gas and food prices, might best be met with targeted price controls for the emergency—as they have been in prior wars. Extending the child tax credit, which gave families up to $600 a month, would help make ends meet while these measures took hold.

Moreover, the Fed's 2 percent inflation target is both arbitrary and inadequate to the challenges we face. As the economist Brad DeLong notes, when an economy faces massive transitions, greater leeway for inflation is necessary to ease the way. Over the next years, the United States will deal with rising resource costs, the energy transition, climate and contagion calamities, the economic reordering with the rise of China, and the need to redress obscene inequality.

The Fed pursues its ruinous course shielded by the doctrine of an "independent central bank" and the mysteries of money. But the Fed doesn't wield a set of arcane algorithms that foretell the future. The record shows the Fed isn't very good at prophecy or prescription. As Nouriel Roubini observes, since World War II, whenever the Fed has tightened with inflation over 5 percent and unemployment below 5 percent, it has driven the economy into recession.

While the Fed's Open Market committee wrestles with technical issues and complexities, they are also making value choices. Give priority to stable prices or rising wages? Full employment or a strong dollar? Wall Street or workers? The Fed is insulated from elected officials to serve as the bankers' bank. When state legislators from distressed farm states met with Paul Volcker to seek relief from ruinous interest rates, William Greider reports in his magisterial book on the Fed, *Secrets of the Temple*, Volcker replied, "Look, your constituents are unhappy, mine aren't."

Joe Biden says that "inflation is the Fed's job," declining thus far to criticize its course. The White House maintains that the economy is strong enough to avoid a recession, even as the Fed moves to cause one. With a few exceptions like Elizabeth Warren and Katie Porter, politicians say little about the Fed. As this and future administrations address turbulent change, however, coordination of fiscal and monetary policy will be essential.

The doctrine of Fed independence was a centerpiece of the neoliberal conservative era that is bankrupt. It is bizarre that the single most powerful economic agency is constructed to be more responsive to Wall Street than to democratically elected leaders. At the very least, Democrats should be challenging the Fed's course, exposing its assumptions and mistakes, and calling on it to stop before it brings down the economy. It's time to take the gloves off.