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LABOR CENTER REPORTER

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Number 190
September 1986

THE POLITICS OF THE FEDERAL RESERVE

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If your high school civics class was like mine, you were told that the U.S. has three branches of government: the Congress, the President, and the Supreme Court. What my civics teacher didn't tell me was that there is a federal agency that could be called a fourth branch of government, the Federal Reserve Board (Fed).

The Fed has as much power over our economy as anyone in Washington. This means they are key decision-makers on who works, who doesn't, who eats and who goes hungry. The Fed has power over whether industries start or expand and how many jobs they will provide. They lead the setting of interest rates including rates on home mortgages and car loans. Through their influence over these rates, they affect how many houses are built, how many cars are assembled and, consequently, how many jobs there are in these industries. The 1982 recession was evidence of effects of the Fed's control over money supply and interest rates. In spite of the Congress' expansionary tax cuts and increases in military spending, the economy plummeted that year because the Fed was on a tight-money experiment recommended by some of our more reactionary economists. The Fed's power over money supply and interest rates may be the greatest concentration of power held by any group of people in our country.

How the Fed Gets Its Clout. The Fed was set up in 1914 as an independent agency to regulate the banking industry. Its independent status is supposed to prevent politics from unduly influencing the money supply and interest rates. The Fed exercises its power over interest rates primarily through what are called "open market operations." (See also LCR #177) In these operations, the Fed can decide when to buy the bonds the Treasury Department must sell to pay for the national debt. The Fed and the Treasury are two separate operations. The Fed doesn't have to buy the bonds the Treasury sells. If the Fed buys bonds, it automatically increases the money supply and makes money easier to get. Since the supply of money is greater, the price of borrowing money, interest rates, is lower. If the Fed sells bonds, it takes in money, decreases the money supply and raises interest rates. As a huge buyer and seller of government bonds, the Fed has a profound influence on money supply and interest rates.

The Fed's power over the economy gives it indirect influence over who we elect to office and therefore who gets appointed to the courts. By pursuing recessionary policies in 1979, the Fed set the stage for Carter's defeat in 1980. It was the Fed's policies which led to the 20% interest rates in 1980, the year the Republicans won the Senate as well as the White House. After the economic debacle of 1982 (when the U.S. economy took its worst dive since the Depression), the Fed assured Reagan's re-election by reversing their recessionary, tight-money policies in time for 1984 election. By giving Reagan such a major boost in his election and reelection, the Fed's policies may be an influence on the Supreme Court, a majority of whom Reagan is expected to appoint before leaving office. Supreme Court justices and Presidents may owe their positions to the Fed as much as anyone.

Who Rules the Fed. Who are the governors of the Fed and who are they accountable to? Even though they have so much to say about running our economy and lives and about creating union or anti-union climates, they are only remotely accountable to the people of the U.S. The Fed is ruled by a seven member board of governors in Washington, appointed by the President to staggered 14 year terms. (The only exception is the chairman of the Fed, Paul Volcker, appointed to a four year term.) A 14 year term means a Fed governor appointed by Reagan today will hold office until the year 2000. The Fed does not depend on Congress for its budget and gets most of its money from interest paid on its portfolio of Treasury funds. The governors are free to choose expansionary or recessionary policies; in fact they are free to choose any economic policy they and their friends on Wall Street and in academia want. They did not even have to state what they planned to do until required to do so by the Humphrey-Hawkins Act in 1978. When they do state their intentions, their remarks are so vague that they are not useful. The Fed is not only one of the most powerful groups in the country, it is also one of the most secretive.

The seven governors of the Fed come from an elite of bankers and professors. Paul Volcker was a vice president of the Chase Manhattan Bank before he became a member of the Fed. Outgoing Vice Chairman Preston Martin was on the board of directors of Sears, Roebuck and Co. Nixon appointee Henry Wallich was a Yale economics professor before his appointment. Carter appointee Emmet Rice was a senior vice president of the National Bank of Washington. Reagan appointee Martha Seger was vice president of the Bank of the Commonwealth in Detroit; Reagan appointee Wayne Angell was director of Hume Bank, Hume, MO and president of the Kansas Baptist Convention; and Reagan's most recent appointee, Manuel Johnson, comes from the Heritage Foundation and played a major role in the design of the 1981 ERTA tax-break giveaway to corporations. The Fed represents only the few Americans at the top of our economic pecking order.

What Can Be Done? The AFL-CIO would like to see this situation changed. At its convention last year, the AFL-CIO called for a restructuring of the Fed. The AFL-CIO's resolution stated the Board of Governors should include representatives of labor, agriculture, small business, and consumers. These groups are some of the forces that would have to join together in order to make the Fed accountable to the public.

There have been several legislative initiatives before Congress in recent years regarding the Fed. Bills have been introduced to make the composition of the board more representative of the U.S. population. Another bill proposed new requirements on interest rates. The bill would have (1) set target interest rates for the Fed to attain rather than leave rates to the Fed and its banking pals to decide; and (2) provided the Fed with guidelines for the allocation of credit. (The current credit policy of the Fed has been to extend credit to large corporate failures like Continental Illinois and let desperate farmers go broke.) Labor and consumer groups were the two primary supporters of these bills. Due to the overwhelming power of big business in the government today, the bills did not even get out of committee. Organized labor will have to be part of a broader alliance to challenge the banks' control of the Fed.

Meanwhile, Reagan will appoint a new member to the Fed (to replace Martin) who he hopes will promote policies designed to favor the Republicans in the 1988 elections. Reagan's next appointee will give his people a 4 to 3 majority on the Board of Governors and this majority can be expected to put more money into the economy and create more jobs in mid-1988. The Republicans are pinning their hopes for election victory on this scenario.

The AFL-CIO would like to see the Fed represent all of us, not just the banking and academic establishment. To date, most Americans don't know about the enormous control the Fed exercises over our economy and our lives. Only public awareness and pressure from organized labor and its allies will make the Fed accountable to the public.

- Ramon Castellblanch