

## Reporter

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MONETARY POLICY:

## Part II

by Bruce Poyer

During Paul Volcker's term as Chair of the Federal Reserve Board, Americans came to accept the widespread loss of jobs, homes, farms, and businesses, because of a policy based only on an abstraction. William Greider, in "Secrets of the Temple" (*New Yorker*, November 9, 16, and 23, 1987; later published by Simon and Schuster, 1988), describes this abstraction as the *threat* of a *potential* loss to investors, who feared that their wealth would not breed more wealth as fast as it would with more stable prices.

The threat arose primarily because of "incoherence, intellectual confusion, and evasion" in the Reagan administration's economic policies. Reagan's 1981 expansionist tax cuts brought "a profound change in political values," and interest rates went higher from the moment of the tax bills' enactment. The Fed and the bond markets reacted not only to fears of the inflationary potential of Reagan's budget deficits, but also to the President's dubious budget projections, and money supply numbers that didn't add up. The net result was to enhance the stature and the power of Paul Volcker and the Fed. Once again, as at the end of the Kennedy-Johnson expansion period, "when the elected politicians refused to restrain through fiscal policy, then the nasty chore gravitated to monetary policy and the Federal Reserve."

## The Losses From Fed Policy

Greider's account of the losses in the 1981-1982 contraction, and who absorbed them, is worth remembering at this point of political change:

"The 1981-1982 recession dealt out personal rewards and punishments like an inverted pyramid of economic justice: the least suffered most, and vice versa. At the height of the

suffering, in December of 1982, twelve million Americans were out of work . . . The contrast in economic fortunes was stark: while personal income from interest grew by sixty-seven per cent, industrial production shrank from its 1979 peak by nearly twelve per cent. The real economy was languishing and finance was flourishing—not just financial intermediaries like banks, but wealth holders generally, and especially the ten per cent of American families that owned eighty-six per cent of the net financial wealth held by individuals."

In the summer of 1981, Volcker and the Fed took the real price of money to a higher level than it had been for 50 years. All rewards were now altered. There was less for labor and more for capital; there was a smaller share for work and a larger one for money. Ever since the 1940s, wages and salaries made up two-thirds of personal income; by 1984, this share shrank to 59.9%, the lowest level since 1929. Financial assets flourished; investors turned to bonds and financial instruments, and away from factories and real assets. "Among other things, the transformation of market values engineered by the Federal Reserve directly encouraged the frenzy of corporate raids and takeovers that became commonplace in the nineteen-eighties." One result of this speculative frenzy was to convert corporate equity into corporate debt on a vast scale. Another was to displace or downgrade or terminate altogether the employment of millions of American workers.

The distribution of the nation's aggregate economic loss in the 1981-1982 contraction is still not widely recognized:

"Of the nation's \$570 billion loss in output, fifty-eight per cent was absorbed by wage earners, twenty-five per cent by declining corporate profits, and thirteen per cent by farmers and small business. Thus, about three-fourths of the sacrifices were made by people typically described as 'little guys'—the workers, farmers, and entrepreneurs whom Andrew Jackson had celebrated as the 'real people,' the 'bone and sinew of the country.'"

## The Impact on Farmers and Trade

What the Fed launched in 1981 was a "rolling liquidation" that continued long after the general recession was over, suppressing the prices and the wages of the producers of real goods. The farm crisis was typical. As commodity prices fell, the collateral on which farmers had borrowed was downgraded. The farmers had to borrow and pay back in "harder" dollars. "These failing farmers were widely described as inefficient, but nothing about

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their efficiency had changed except the price they paid for their loans and the price they received for their commodities."

Before the Fed began to slow the economy with Friedman's "pure" monetary policy, the weakening dollar had given American exporters an edge in competition with foreign producers, which improved U.S. output and the job market. Fed efforts to strengthen the dollar then removed this edge, and also gave foreign imports a positive advantage in American markets. Thus, foreign goods sold here for less, and imports rose by 66% in four years; U.S. goods sold abroad for more, and exports declined by 16% in four years. The inflation control policies of the Fed created the huge trade imbalances that have not yet been overcome—though special efforts have since been taken to devalue the dollar in international trade (and appear now to be having a positive effect).

The victims of the 1981-1982 contraction, which continued as a "rolling liquidation," were the same, Greider relates, as in the 1920s—and in the same way, their economic predicament was ignored by the rest of the nation. In both decades, the Federal Reserve was the central engine of control which imposed these terms. The fundamentals of money did not change in four generations, despite the sophisticated theories of Friedman and the monetarists and the government economic managers. The lever for halting inflation was still a traumatic increase in the price of money, forcing business activity to subside, forcing unemployment rates to rise, and forcing surpluses to accumulate. The accompanying destruction, it was argued, was the necessary prelude to long-lasting prosperity.

### Is Anything New in 1988?

Treasury Secretary Mellon, in 1930, put the Fed's major inflation-control policy in the most righteous and Puritanical terms: "Liquidate . . . it will purge the rottenness out of the system. People will work harder and live a more moral life." To his credit, Greider puts the moral question much more cogently: is it morally defensible, he asks, for the Fed and/or the government to protect the few with policies which inflict broad economic damage on the many, when there are less brutal ways to restore or maintain economic stability?

In its "Pastoral Letter on Catholic Social Teaching and the U.S. Economy," the Catholic Church answers No, it is not morally defensible, and goes on to define new economic rights of workers. Organized labor endorses this position, for example, in the statement by New York City's Central Labor Council on "Human Rights for Working People." Greider's book will bring new intellectual converts to this position, and Reagan has personally converted many workers—usually by denying that they have any economic rights at all (most recently, even the right to 60 days notice of loss of their jobs).

These notable educational efforts still do not come close to the mass-education potential in a presidential election year. But

well-defined differences in the positions of the major parties are an essential condition for effective political education. That condition did not exist in the election year of 1984. The Fed was doing business as usual then, avoiding risks to long-term lenders, and in the process authorizing other kinds of economic loss, including lost jobs and income, lost production and opportunity, and lost equity in society. Its primary objective was fully endorsed by both political parties.

What is different in this election year? First, Greider and many other economists assert that the economy has performed no better in the 1980s than it did in the inflationary 1970s—except, of course, for the few. For the many, it performed much worse, because the Fed's reliance on scarce and usually high-priced money continues to feed what was once called "the great suction-pump" of maldistribution. With the Fed controlling the main economic action, the rich get richer more quickly, and the poor get poorer more quickly.

We also live now with a growing psychosis about inflation. When the economy strengthens and unemployment declines even slightly, the Fed finds more reasons to edge interest rates higher to constrict activity. Reflecting the fears of lenders that good times will bring higher prices and wages, the Fed now has many more lenders to serve. Fed policies to control inflation have failed to keep the nation from getting mired in excessive debt, which is the real Reagan legacy. Everyone now borrows more, and those who loan to them increase their demands for price stability, regardless of economic damage to other groups in society.

It remains to be seen whether the Democrats can consolidate in their platform and their campaign the varying positions of their pre-convention candidates on managing the economy. However, it is clear that their candidate will sharply attack the economic performance of the Reagan administration, and that after the conventions, each candidate will be obliged to articulate the policy priorities more precisely.

Education about the politics of monetarism is important at every level. It should take root from the outstanding efforts of William Greider in "Secrets of the Temple," and the Catholic Pastoral Letter, and it should blossom out like the New York Central Labor Council's statement on "Human Rights for Working People." Education should develop more understanding of those "less brutal ways to restore or maintain economic stability," which Greider mentions but does not elaborate. And education should seek to develop more fully our understanding of the parallel fiscal policies that can both enhance and control inflation. A series by Professor Bert Gross on this subject has begun in *LCR*.

Labor Center Reporter also solicits your comment and reactions about these issues, which we believe should be more fully defined by the political candidates, by the media, and by educators in this significant election year.

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