The Extreme Partisan Divide Hurts all Americans
By Byron A. Ellis – August 26, 2013

The partisan divide between Democrats and Republicans adversely affects optimal decision making and leads to extreme divisive positions and dissonance. It also reduces investors' expectation of potential revenue flows and hence investment and employment

Community investment is essential for economic growth and employment. Bank credit is necessary for investment to occur. However, some politicians see economic growth as a political tool and blame bank credit for economic recessions.

However, without credit, investment, demand, and employment will remain low. Thus, credit is critical for increasing community capital stock and employment.

The political narrative that too much credit is bad for the economy, causes banks to restrict credit, limiting demand, and potential investors' revenue expectations. Low revenue expectation adversely affects investment and jobs.

High revenue expectations create incentives for investments. High revenue expectations require a large cross-section of community members with relatively high disposable income. Rising community disposable income creates a high demand for goods and services, and hence investment and employment.

Rising disposable income results from increases in community capital stock. Community capital stock increases when banks provide credit to entrepreneurs, merchants, and consumers. Thus, credit is the growth engine of community economies.

Credit as an engine for economic growth, however, is an abstract concept for many politicians. It is also a tool in the partisan political economy.

By preventing the party in power from improving voters' standards of living, the party out of power can argue that the ruling party failed voters. Thus, they use obstructionism as a ploy to gain political power. Some opposition politicians ardently argue that less credit (money) in the economy creates growth and employment.

Their malicious narratives have led many well-intentioned policy-makers to view credit expansion as a bad, rather than the growth engines of depressed communities. These politicians even rail against the expansion of the money supply and bank lending in recessionary periods.

Nonetheless, even Milton Friedman,[1] a conservative economist, argued that it is the supply and curtailment of credit (money) that causes business cycles of booms and busts.

When we examine the federal funds rate, the interest rate set by the Federal Reserve (Fed), it is clear that high federal funds rate precedes every US recession, see Fig. 1 below; recessions are the shade areas.

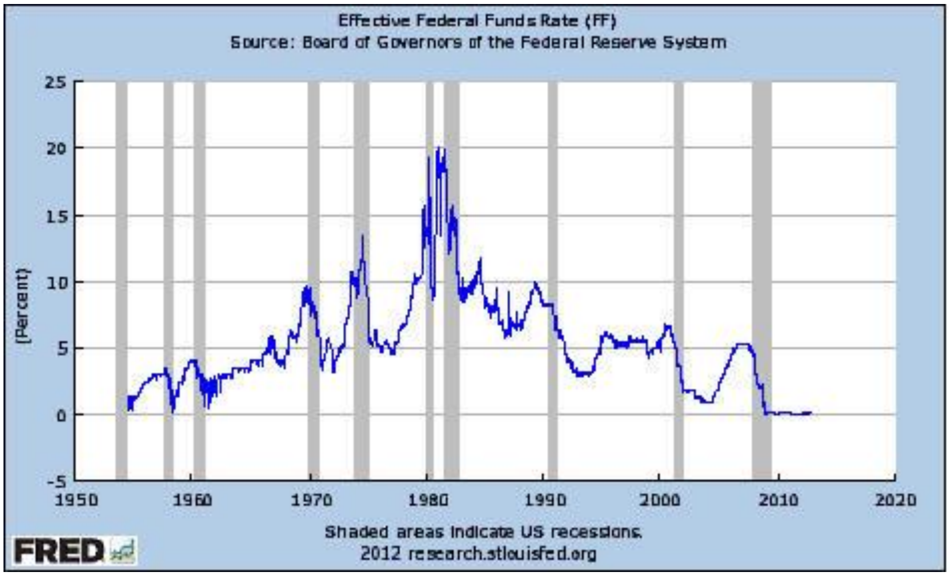

Figure 1 – Federal Funds Rate

A high federal funds rate implies that the Fed is selling securities to the public, reducing the money in circulation. Less money in circulation results in fewer purchases of goods and services and hence inventory accumulation and unemployment.

Rising federal funds rate reduces spending in interest-sensitive sectors, such as housing and business investment.[2]

Under the Constitution, however, Congress is responsible for determining monetary policy. Congress, nonetheless, transferred that responsibility to the Fed, which allows Congress to informally control monetary policy while dissociating itself from the unpleasant consequences of monetary policy.

However, if the public was aware that it is the responsibility of Congress to manage the economy and create full employment, the partisan divide that they have created would not hold.

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1 Friedman, M. (1956). The Quantity Theory of Money-A Restatement. In M.G. Mueller (Ed.), Readings in Macroeconomics (pp. 146-160). Hinsdale, IL: Dryden Press.

2 Bernanke, B. S., and Gertler, M. (1995). Inside the black box: The credit channel of monetary policy transmission. *Journal of Economics Perspectives*, 9(4), p. 27-48; Kahn, G. A. (1989). The changing interest sensitivity of the U.S. economy. *Economic Review*, pp. 13-34.