Anti-inflation measures equal pro-unemployment — and bad — policy

By Byron A. Ellis

In order to manipulate the economy, policy-makers use fiscal and monetary policies. Fiscal policies, such as tax rates and government spending, are executed by Congress and are usually initiated by the executive branch of government. Monetary policy, on the other hand, is controlled by the Federal Reserve System (the Fed). The Fed executes monetary policies by influencing the supply of money and the interest rate, in addition to exerting some controls over the banking system.

Both fiscal and monetary policies affect aggregate demand. Aggregate demand is the total demand for goods and services produced in the economy. And, as the total demand for goods and services increases, unemployment decreases. That is, more jobs are created.

On the fiscal side, high tax rates tend to reduce the demand for goods and services while much government spending tends, in the short run, to increase the demand for goods and services. On the monetary side, increases in the money supply and low interest rates tend to increase the demand for goods and services. Conversely, decreases in the money supply and high interest rates tend to reduce the demand for goods and services.

Policies that cause the demand for goods and services to increase create jobs. Unfortunately, increased job creation may be accompanied by rises in the general price level, i.e. inflation. Hence some policy-makers are inclined to trade inflation for unemployment. That is, they assert that some unemployment must exist in order to control inflation.

The Fed, with the tacit support of the current presidential administration, appears to be pursuing the inflation-unemployment trade off policy. Thus, it has determined that high interest rates will prevent future perceived inflation and has proceeded to raise the interest rates. Higher interest rates, however, restrict economic growth and hence employment. Therefore, such policy, which prevents job creation in order to mitigate perceived inflation, does not appear to be in the best interest of regions or ethnic groups with historically high unemployment levels.

Clearly, the intent of the Fed is to slow the rate of growth of the economy. The result of this slowdown, however, is higher unemployment than would otherwise exist in the absence of Fed intervention. In essence, the Fed is sacrificing the jobs of millions of Americans (mostly young Blacks) to eliminate what it perceives to be future inflation. Such tinkering, however, has seldom achieved the intended results and has led to unwanted outcomes, such as recessions.

Historically, the cost of trading inflation for unemployment has affected the Black community disproportionately. Blacks are often the last to reap the benefits of economic expansions and the first to endure the cost of economic contractions. Hence, policies that restrict economic growth are not in the best interest of the disenfranchised, Blacks in particular.

Therefore, the trade-off between perceived inflation and real employment ought to be in the forefront of the Black agenda, because it is no secret that the illness of the Black community stems from lack of employment opportunities — high unemployment. Lack of employment opportunities is the root cause of community crime, sexual promiscuity, housing decay, and the death spiral that engulfs the community.

Hence, the deliberate policy of unemployment is immoral and robs the unemployed of dignity and self-respect. Moreover, in the long run the chronically unemployed and their offspring are no longer vested in the community fabric and become detached. The cost of this community detachment plus the cost of unemployment (in output foregone), must be weighted against the cost of inflation. In the case of unemployment, it is clear that potential output is being wasted. And, more often than not, this wasted output returns in the form of additional costs. Therefore, the taxpayer incurs several costs as a result of the Fed unemployment policy: the crime cost, incarceration cost, transfer payments cost (from taxpayers to welfare recipients), and the cost of wasted output. On the other hand, in the case of inflation, there is no obvious loss of output. As a matter of fact, inflation implies that the output produced is insufficient to meet the current demand.

The Fed drive to rid the economy of perceived inflation by maintaining a certain level of unemployment will only perpetuate the permanent recession endured for years without end by the Black community. Ironically, the outcome of the Fed policy is well understood by Black politicians, yet few have raised their voices in opposition. Why? Are they not elected to advance the interest of the community?

Blacks and the disenfranchised must empower themselves to redefine full employment and thus the so called "natural rate of unemployment." Currently, full employment is defined at approximately 95 percent of the labor force. Thus the natural rate of unemployment is approximately 5 percent. But Blacks, especially young Blacks, are disproportionately represented in this group. Moreover, if the artificially induced natural rate of unemployment is 5 percent of the labor force, then, as the labor force grows, a constant unemployment rate implies a higher pool of unemployed. For example with a labor force of 60 million, 5 percent unemployment is 3 million. With a labor force of 90 million, 5 percent unemployed is 4.5 million. Clearly, the constant unemployment rate is deceptive, and does not reflect the pain and the agony of those left out.

Certainly some natural rate of unemployment will always exist in the economy, due primarily to labor force mobility, individuals moving in and out of the labor force. Nonetheless, the belief that this natural rate should be artificially induced to reduce inflationary pressures is bad policy.

Perhaps if policy-makers were more adept at supply management the economy could expand without the inflation unemployment trade-off. Because inflation is basically too many dollars chasing too few goods, many of the needed goods could be produced in areas of high unemployment, such as the inner cities, Appalachia, and many southern rural areas. By utilizing unemployed resources, wage increases would be somewhat mitigated. Certainly, scarcity of factors of production will affect supply management in the short run, but, over time, adjustments are always possible.

Byron A. Ellis lives in Maryland and writes frequently on financial issues.