Interest Rate Cuts Now Could Help Workers. But That's Not Who The Fed Serves.

Prof.dr. Gerald Epstein

08-26-2024 ~ *Progressive economist Gerald Epstein says the Fed is more sensitive to the needs of the wealthy few than the rest of us.*

The Federal Reserve hasn't changed interest rates since July of last year, after 11 hikes between March 2022 and July 2023 in the hope that higher borrowing costs would slow down consumer and business demand so inflation rates would drop. It kept the benchmark interest rate unchanged in its latest meeting ending July 31, 2024, but Federal Reserve Chair Jerome Powell said that the first rate cut in four years "could be on the table" in September. Nonetheless, the Fed has faced criticism for its refusal to lower rates, though inflation rates have moved steadily lower. By tightening monetary policy, the Fed hurts consumers' financial lives and even increases unemployment. So why has the Fed been so reluctant to cut interest rates?

The main reason, argues renowned progressive economist Gerald Epstein in the exclusive interview for *Truthout* that follows, is because the Fed is "more sensitive to the needs of the wealthy few than the rest of us." As such, the Fed's claim that it is an independent government agency is a complete myth. Epstein is professor of economics and co-director of the Political Economy Research Institute (PERI) at the University of Massachusetts Amherst, and author of the recently published book *Busting the Bankers' Club: Finance for the Rest of Us* (University of California Press, 2024).

C. J. Polychroniou: The Federal Reserve has generated a lot of controversy by deciding at the July Federal Open Market Committee meeting to keep its benchmark interest rate unchanged. Obviously, the central bank is determined to attain its 2 percent inflation objective even though its 23-year high interest rates are having a significantly negative impact on the economy and on consumers' financial lives. Indeed, the Fed's high interest rates are counterproductive. They drive up housing prices, including rent; make it more difficult for people to pay down their debts; and even the unemployment rate has started to tick up. What's going on here? Why is Fed Chairman Jerome Powell refusing to cut the short-term interest rates even as inflation falls?

Gerald Epstein: You are right. For quite a while, the Federal Reserve's high-interest rate policy has been harmful for most people and even counterproductive in terms of its ostensible objectives: reducing the cost of living for most Americans. These high interest rates are also interfering with other important needs. For example, as Jen Harris wrote in *The New York Times,* they are discouraging important investments in green energy such as wind power projects, because these projects tend to have large up-front costs and long-term pay-offs. So, the question is: Why has the Fed kept rates up so high and for so long? A key reason, at least until recently, is that these high rates have had big pay-offs for banks and other financial institutions that have been able to charge higher interest rates while reaping rewards from big capital gains in the stock market. At this point, however, with the major drops in inflation and the weakening state of the economy, even big financial institutions have been calling for rate cuts. So why has the Fed refused to cut rates? Probably the main reason is that they fear a backlash from their major constituents, big finance and the wealthy top 1 percent, if they lower rates too quickly. In other words, they are much more sensitive to the needs of the wealthy few than to everyone else. Compounding this bias is the fact that the Fed's policy is informed by a profoundly mistaken economic theory: Their view, shared by most mainstream macroeconomists — such as former Fed Chair Ben Bernanke and former Treasury Secretary Larry Summers — is that the Fed controls inflation to a large degree by influencing the "public's" expectations of inflation, and that they do this by their inflation fighting "credibility." And what determines this credibility? Their willingness to hurt workers if they try to raise their wages too much. It is a sort of central bankers' "macho" contest that Jerome Powell and other central bankers want to win. A major problem with this, from a theoretical point of view, is that there is very little, if any, evidence that expectations — credible or otherwise — have much impact on inflation, especially at the relatively low levels at which it is occurring these days.

To what extent does the stock market influence the real economy of goods and services? And should the Fed be blamed for the stock market rout in early August?

In principle, the stock market can influence the "real economy" in a couple of ways. The market can affect decisions that investors make as to how much and where to invest in the real economy — in plants, equipment and technology. And second, the value of the stock market can affect how "rich" people who own stocks feel. This so-called wealth effect can impact how much people are willing to spend on goods and services, or how much they are willing to borrow to do the same. Of course, since it is rich people who own most of the stock (though middle-class Americans also have some of their pensions and other savings in the stock market), this wealth effect will mostly impact the consumption of the wealthy. Thomas Ferguson and Servaas Storm have argued that, in recent years, this wealth affect has had a powerful impact on consumption demand, and indirectly on inflation.

Donald Trump warned Powell in mid-July not to cut rates before the election. Obviously even Trump himself understands that cutting interest rates would boost the economy and the Democrats' odds of a victory in November. Is the Fed an independent government agency or a political institution?

The Fed is of course a political institution, and the claim that the Federal Reserve is inherently "independent" is a commonly stated attempt to obscure this fact. The Fed is political both formally and informally. It is formally political because it is a "creature" of Congress. The U.S. Constitution allots to Congress the power to manage the U.S. "coinage" and currency and, by founding the Fed in 1913, the Congress delegated various powers of monetary management to the Fed. But, since the power lies with Congress, they can expand, curtail or change these at any time.

Similarly, over time, the president has been given by Congress the power to make appointments to the Federal Reserve governing body. So, the president has been delegated certain powers over the Fed by Congress. None of these, however, have formally given the Fed any political independence whatsoever. As such, the formal independence of the Fed is a complete myth — one, however, that the Fed and others are obsessed with promoting. The process by which the Fed promotes its independence demonstrates the second, informal sense, in which the Fed is highly "political." As I show in my recent book, *Busting the Bankers' Club: Finance for the Rest of Us*, the Federal Reserve cultivates powerful constituencies to expand and protect its "independence" from the government. This constituency consists primarily of the big banks and other financial institutions and their mouth pieces in the press and business. They are very successful in promoting this idea. It is not unusual to hear from pundits that the Federal Reserve is mandated to be "independent." But the reality is that the Fed is highly political, dependent on big finance for support, and, in turn, the Fed is incentivized to give big macroeconomic and regulatory support to these banks. This is a political quid pro quo on a massive scale.

The claims about mandated Federal Reserve independence have become louder recently since Donald Trump has occasionally announced that, if he becomes president again, he will get rid of Fed independence. Of course, if Donald Trump got control over the Fed … he would certainly try to use the Fed to do his bidding at the expense of the rest of us. But the same would be true of the Defense Department, or the Environmental Protection Agency or the Commerce Department. The response is not to say that these all should be independent. The response should be to say that these agencies should be staffed by experts who have mandates to carry out laws in the public interest.

Fed Chair Powell has said that a September rate cut is on the table. How likely is that to happen, and would it have any impact on mortgage rates and rent prices and on consumers' financial lives in general?

At this point, it is very likely since, as I said before, with inflation now tamed and the economy slowing down, even banks and other financial institutions are urging the Fed to cut the interest rate. When they speak, the Fed surely listens. And yes, mortgage rates would come down … in fact, we are already seeing them fall in anticipation of such cuts. As for rental prices, that is a more complex story. As long as private equity firms and other big financial companies can buy up rental properties and use algorithms and other mechanisms to keep rents high, a simple interest rate cut will not broadly work to lower rates or increase sufficiently the availability of rental housing. Here, bolder and more real economy interventions will be necessary to make a dent in this major problem.

This interview has been lightly edited for clarity.

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