Political economy
By Byron A. Ellis – December 14, 2011

The Republican narrative that the rich are job creators is pure nonsense. Consumer demand, and not the rich, create jobs. Jobs cannot be created, and sustained, in the absence of consumer demand. And, maintaining adequate consumer demand requires a given level of consumer income.

Rising consumer income depends on central bank policies. Unfortunately, for the past two decades, Western central banks embarked on price stability through inflation targeting and ignored economic growth.

They argued, erroneously, that price stability would create growth. However, it created a prolonged recession.

Inflation targeting is a monetary strategy, introduced in New Zealand in 1990 and over 20 industrialized and non-industrialized countries have used it.

Its principal feature is an announced numerical inflation target. However, some central banks do not publicly announce the inflation target.

If inflation is above the target, central banks increase the interest rate by draining money from the banking system.

When central banks remove money from the banking system, banks limit lending and money supply contracts. As a result, demand, gross domestic product, and employment are adversely affected.

The existing income inequality and the recession of 2008 are a product of erratic central banks policies.

The Federal Reserve (Fed), as indicated by the graphs below, restricted money stock, M1, from 2003 to the fourth quarter of 2008.

From the money stock graph on the left, it is clear that whenever the money supply remains flat for an extended period, recessions occur. The red vertical lines are U.S. recessions.

The graph on the left and right are correlated; increasing the federal funds rate, draining money from the banking system leads to a flat or decreasing money supply and recessions.

The Federal Reserve is an independent government agency. Thus, politicians do not implement or directly control, Fed policy. However, it is the Fed policy that determines economic growth and employment.

Nonetheless, Democrats and Republicans politicians pretend that they can create economic growth. And, the Fed pretends that it cannot create economic growth.

The pretension is due to political economy, where manipulating the money supply could ensure political outcomes.

For instance, the Fed can cause economic slowdowns and high unemployment to imperil the incumbent party or could implement policies to increase economic growth to ensure the incumbent party's reelection.

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