The Nation.

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Squeezing the Have-Nots

William Greider

The country is overloaded now with explosive political preoccupations, too many to keep straight, but there is one more potential disaster lurking behind the headlines--the economy. Not to worry, say the newspapers. The White House assures us the Bush economy is going great. The Federal Reserve agrees. Notwithstanding the tempest that flattened the Gulf Coast, the Fed is worried that the economy is expanding *too* strongly--it might provoke price inflation. So, trying to slow things down, chairman Greenspan keeps on raising interest rates. Most economic forecasters say nothing's changed: Growth will slow down in the second half of this year and then pick up again smartly in early 2006, as factories reopen and reconstruction spending stimulates new production and jobs. Democrats have little to add, beyond raging righteously as usual against the President's tax cuts and budget deficits.

Meanwhile, back in the real world, the economic news is not cooperating with the official optimism. Folks in the bottom half of the economy are already squeezed hard. They will be bloodied and bankrupt if economic policy inadvertently induces a recession.

There are ominous signs. Consumer spending plunged dramatically in August (the sharpest one-month decline since 9/11) and so did personal incomes. The storm-driven collapse of New Orleans immediately wiped out nearly 300,000 jobs, a number likely to grow much larger as more people find their way to the unemployment office. Even more worrisome is the negative savings rate that emerged for American households before the big storm but amid already soaring gasoline prices. In July families spent, at an annual

about
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rate, $101 billion more than their disposable income. This "dissavings" continued in August: "certainly the worst since the banking crisis of 1933," economic consultant Charles McMillion observed. If consumers now pull back from spending to rebuild savings--many will have no choice--this retrenchment may converge with other negative forces and could "easily develop into a downward cycle leading to recession," McMillion warned.

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Given these fragile circumstances, the prevailing currents of official thinking are all pushing the economy in the wrong direction. Economic policy is often decided as an unpleasant choice among various bad outcomes--which consequence would be the worst for the country? Swelling federal deficits can have deleterious effects on the future, but right now America actually needs larger federal deficits to get through this storm--government-injected economic stimulus that will quickly generate higher incomes and more jobs. A bout of price inflation would disrupt planning and profits for business and finance, but that is a small matter compared with the devastation a recession would impose on wage earners and debt-soaked families in the bottom half of the economy.

The Federal Reserve's single-minded obsession with inflation--intended to preserve Greenspan's reputation as he approaches his retirement--is the most wrongheaded and potentially most harmful policy. In the annals of US monetary policy, a reliable sign of recession ahead is the central bank's raising interest rates on short-term borrowing higher than the rates on longer-term credit. The Fed is perilously close to creating that unnatural condition known as the "inverted yield curve." If Greenspan persists with two or three more rate increases, the yellow warning light will be flashing.

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Democrats, meanwhile, are still smitten with the Rubinomics they learned in the Clinton years, and they yearn to win respectability in financial circles by preaching fiscal rectitude. Wrong economics and bad politics too. Repealing the Bush tax cuts is a noble (though unlikely) goal. But under the present conditions, moving toward a balanced budget is harmful, especially when the Federal Reserve is tightening credit. The Democrats should concentrate instead on how to spend money--lots of it--in smart, socially useful ways that help struggling wage earners. Rebuilding schools and homes to "green" standards, for instance, could become a progressive multiplier in storm-battered New Orleans--a major employer for local residents, a dramatic reform that cleans up the notorious petrochemical pollution, an economic anchor that raises local property values for working-class and poor neighborhoods. With brave exceptions, though, Democrats no longer think like this. They think like uptight bookkeepers.

George W. Bush's new rhetoric makes him sound like Mr. Born-Again Big Spender, but predictably he intends to give the money to the wrong people--and in ways that lack immediate economic impact. Keeping the economy on track would be easier for the President if Greenspan were cooperating, but Bush must prevent his frothier colleagues from making things worse by reducing federal spending. The GOP's "deficit hawks," who want to whack Medicare and Medicaid to pay for Gulf Coast reconstruction, are--how else to put it?--out of their minds.

In the basic design of American capitalism, recessions always deliver the most pain and severest losses in reverse order--punishing the weak and less affluent first. Thorstein Veblen called it "the slaughter of the innocents," a nasty ritual that sacrifices the lambs for the benefit of the lions. The rest of us may have to pull back a bit, but our lives are not greatly disrupted by recession. If we have wealth, it will be protected from inflation and possibly even enhanced in value. Businesses typically use a recession as an opportunity to reorganize, trimming surplus workers. If they were asked, many citizens would perhaps choose recession as the least-bad risk. Evidently so do our current leaders. The economy is not governed with the bottom half in mind.

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