"The truth will set you free. But first, it will piss you off."[1]

—Gloria Steinem

Back in 2008, some economists considered the Bernanke-led Federal Reserve the dream team of policy because of the Chairman's extensive studies of the Great Depression. Who better to steer the ship when the United States faced a similar situation? The truth is Chairman Bernanke did a competent job of managing the crisis—if it had been the 1930s! The modern economy is dynamic and globalized to an extent that could not have been imagined during the early twentieth century. Leadership today must consider not only the direct effects of monetary and fiscal policy on the economy, but also the unintended consequences of these actions on the social and political fabric of the nation.

QE = WMD?

Warren Buffett called derivatives "financial weapons of mass destruction" (WMD) in the 2002 Berkshire Hathaway annual letter,[2] but he had not yet witnessed the impact of quantitative easing (QE) in the United States. Equating QE with WMDs may sound extreme, but taking a broad view, the comparison is accurate in several ways. The economic implications are clear; quantitative easing causes inflation, and inflation is a drag on growth. It was straightforward to anticipate that QE would depress the dollar, and when the dollar weakens, commodities priced in dollars increase. Even Kansas City Federal Reserve Bank President Thomas Hoenig has publically stated this fact.[3] Ironically, Governor Hoenig raises the link between policy and commodity prices as an example of why the Fed needs to acknowledge improving economic trends and raise interest rates. Instead, he should point to commodity price inflation as the reason that the Fed needs to acknowledge the errors of its past policies and correct them. Dallas Fed Governor Fisher went so far as to imply that inflation may soon seep into core prices: "Having done our job, I see many risks to the Fed overstaying its welcome."[4] He went on to say, "Inflationary impulses are gaining ground in the rest of the world . . . my gut tells me that this will result in some unpleasant general price inflation numbers in the next few reporting periods."[5]

Food Inflation = Hunger in the United States

A drag on GDP growth is not necessarily the most devastating effect of QE, however; the indirect social and political byproducts may prove much greater. These indirect consequences are often ignored because it is very difficult to quantify how much they will ultimately cost. The Fed's stimulative policies were piled onto an already shaky foundation for the average American. Access to credit had propped up consumers' lifestyles for a number of years, but income inequality has been growing in the United States since the 1970s. There are still some people who believe the Reagan-era fallacy of trickle-down economics, but history has proven that there is no such benefit to lower-income earners. An additional 3.7 million people in the United States fell below the poverty line in 2009, propelling the poverty rate to a 15-year high of more than 14 percent, as shown in Figure 13.1. The percentage of children under 18 years old below the poverty line hit almost 21 percent.

Escalating food prices on top of the lingering effects of the recession and deleveraging have only increased the burden on families struggling to make ends meet. In January 2011, almost three million people in New York State were receiving food stamps to help defray the cost of food. Figure 13.2 shows that food stamp recipients in the state jumped 34 percent since January 2009, which was when the commodity price rally began driving up global food prices. One might think, to paraphrase Kanye West, that the Federal Reserve doesn't care about poor people.[6]

Figure 13.1

Poverty Rate Hit a 15-Year High in 2009

Source: U.S. Bureau of the Census

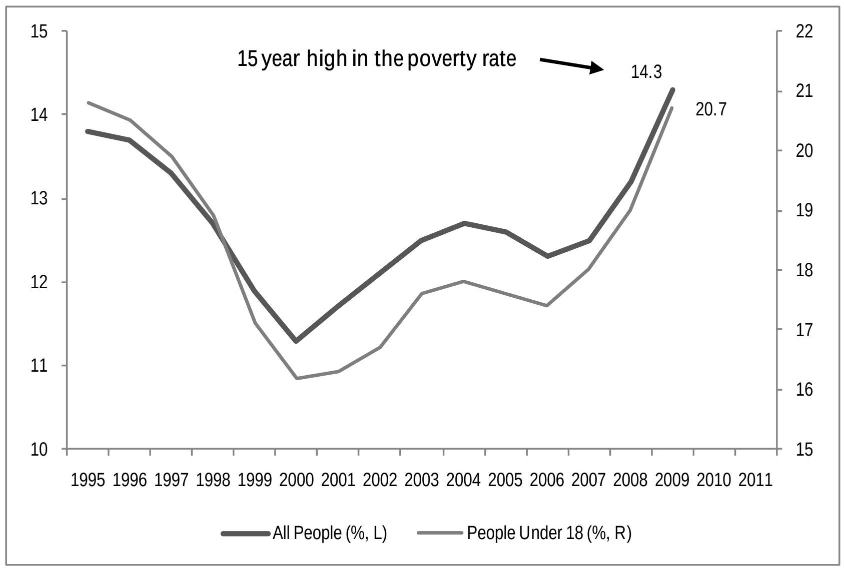
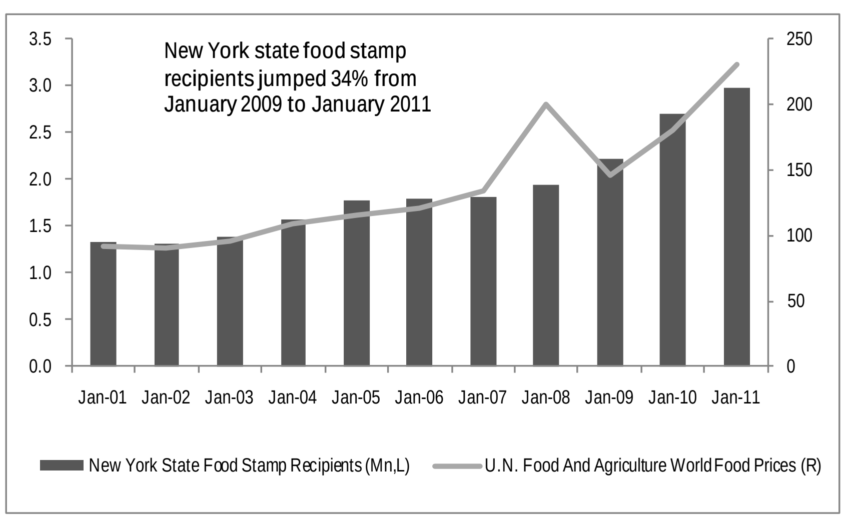


Figure 13.2

Rising Food Prices Force More People to Use Food Stamps

Source: New York State Office of Temporary and Disability Assistance, United Nations



A national hunger survey conducted in February 2011 found that 24 percent of Americans are "very or fairly concerned about being able to afford food at some point in the next year, while 31 percent are slightly worried."[7] Anecdotal evidence of the societal impact of food inflation is apparent across the country. A recent study of hunger at the county level found that hunger exists in every county and congressional district in the country.[8] A food bank director in Alabama was quoted by CNN as saying, "If prices go up any more, you are going to see more people here and other food banks . . . People that used to give us food are now asking for it."[9] Survey data from Maryland show that the hunger problem is spreading beyond urban centers to the suburbs, and into income brackets well above the official poverty line.[10] A suburban Baltimore human services center now helps feed people with incomes of $50,000 to $60,000. The center opened a satellite food bank to keep up with demand from families and professionals whose incomes are too far above the poverty guidelines to qualify for federal assistance.[11] The program coordinator at the center said, "We've been getting folks from the [information technology] industry, folks in the human services area and the medical field—nursing assistants." This is not the sign of a society that is doing well.

The drain on income from higher food prices can become a drag on other areas of the economy the government hopes to stimulate, like housing. Table 13.1 shows how many of the 37 million Americans served annually by the hunger-relief charity Feeding America must choose between paying for food and other necessities.

Table 13.1

Households Have to Choose Between Paying for Food and Other Essential Services

Percent of Households Having to Choose Between Paying for Food and Other Services	Other Services
46	Utilities or Heating Fuel
39	Rent or Mortgage Payment
35	Transportation
34	Medical Bills

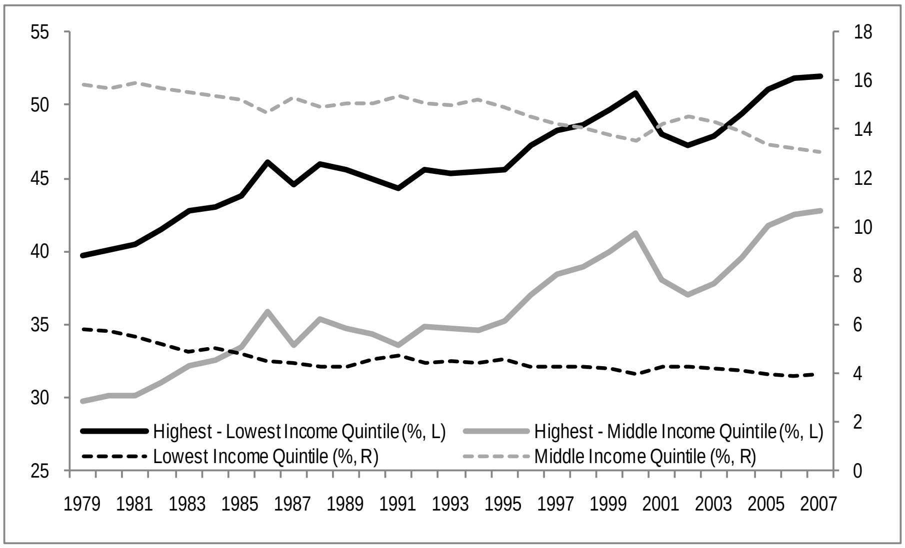
Source: Hunger in America 2010, Feeding America

Although more and more Americans are worse off than they were a few years ago, conditions are not deteriorating across the board; the divide between the top earners and everyone else is widening, as shown in Figure 13.3. People with incomes in the highest quintile have been taking an increasingly larger share of the total pie, while the share for those at the bottom and in the middle has declined. From a societal perspective, the implications of widening inequality are even worse than those of poverty alone. The feeling of falling behind encourages people to live beyond their means and hope that their incomes catch up. The world recently witnessed how living on credit to keep up with the Jones' can have an impact well beyond a family's finances.

Figure 13.3

Share of Income Rises at the Top but Falls for the Bottom and Middle Segments

Source: Congressional Budget Office, Pre-Tax Income



Inflation and inequality also has played a role in the civil unrest unfolding around the globe. The protests should serve as an example to the United States. The negative psychological impact from struggling to feed one's family contributes to a backdrop of social instability. The surge of Tea Party-type groups that stand for little else than less government is a clear indication of the frustration people feel as a result of stagnant or deteriorating economic quality of life. Growing unrest domestically is not out of the question, particularly with the encouragement of partisan television news personalities fueling the fire.

High Oil Price Equals Transfer Payment to OPEC

The upheavals in the Middle East and North Africa are the consequences of a perfect storm of economic, social and political turmoil. The longer-term implications of these nations rising up against authoritarian rulers will not be known for some time, either politically or economically. Even before the protests began, however, oil was on an upward trajectory and generating some unintended political consequences for the United States. The International Energy Agency (IEA) stated in the Financial Times that

OPEC will reach $1 trillion in oil export revenues in 2011 if crude oil prices remain above $100 a barrel.[12] Fatih Birol, the Chief Economist of the IEA, said that, "It would be the first time in the history of OPEC that oil revenues have reached a trillion dollars. It's mainly because of higher prices and higher production."[13] Many of OPEC's largest producers are using the elevated revenues to increase public spending, and may become dependent on them. In an effort to stave off the protests spreading through the region, Saudi Arabia passed two financial support packages in early 2011 totaling nearly $130 billion, almost 30 percent of the Kingdom's gross domestic product.[14] In order to meet greater spending needs, Saudi Arabia will require an oil price of $83 per barrel to balance its budget in 2011. Saudi Arabia is essentially creating potential structural problems similar to those of western countries by spending through the "good times". When the next global growth slowdown arrives, the government will not have the money to buy peace and social stability.

"The more they earn, the more they tend to spend. So the oil price they need is ratcheted up."

—Leonidas Drollas, Chief Economist at the Centre for Global Energy Studies in London, *Financial Times, March 29, 2011*

Russia, the world's top oil producer, saw the cost of its credit default swaps hit a nearly three-year low as oil passed $111 per barrel in New York and $124 per barrel in Europe in April 2011. The weak dollar has provided a transfer payment from the American consumer to oil-producing nations in the form of higher revenues. According to United Press International, Iran exported more than 844 million barrels of oil in the 12 months from March 2009 to March 2010.[15] The spot price of Europe Brent crude oil nearly doubled from about $46 per barrel on March 31, 2009 to over $80 per barrel on March 31, 2010.[16] At an export rate of 844 million barrels per year, the change in price equates to an additional $29 billion in annual revenues for Iran. It is beyond comprehension that the United States Congress would approve a $29 billion payment to one of the world's most dangerous regimes, but in essence that is exactly what was done by the Federal Reserve. If the Defense Department fully considered the unintended national security consequences of the nation's monetary policy, the Chairman would likely be out of a job.

End Notes

Chapter 13

1.http://thinkexist.com/quotation/the_truth_will_set_you_free-but_first-it_will/207998.html

2. Berkshire Hathaway Inc., 2002 Annual Report, Warren Buffett, February 21, 2003.

3. "Hoenig Says Fed Shares Blame for Higher Commodity Prices; Urges Tightening," Vivien Lou Chen, Bloomberg News, March 30, 2011.

4. Federal Reserve Bank of Dallas President Richard Fisher, Society of American Business Editors and Writers 2011 Annual Conference, April 8, 2011.

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7. Survey conducted by Hart Research Associates, commissioned by the Food Research and Action Center (FRAC) and Tyson Foods.

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9. Community Market director Elsie Lott, "Rising food prices could drive up rates of hunger," by John Sepulvado, CNN Radio, March 16, 2011.

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12. "OPEC set for $1,000bn in export revenues," Sylvia Pfeifer, Javier Blas, and David Blair, Financial Times, March 29 2011.

13. Ibid.

14. "Saudi Arabia Keeps Wary Eye on Domestic Inflation," by Yousef Gamal El-Din, CNBC.com, April 6, 2011.

15. "Iran oil exports top 844 million barrels," UPI.com, June 17, 2010.

16. U.S. Energy Information Administration.

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