The Fighting Fed:

Some newspapers today (March 2023) suggest that the U.S. Central Bank (the Fed) must walk a fine line between the battle against inflation and the battle to maintain the public's trust in their nation's banking system. These news sources acknowledge that central bank policies addressing inflation (increasing interest rates and restricting access to credit) can be detrimental to commercial banks' balance sheets.

According to these news sources, accounting rules can hide banking losses "on paper" unless certain types of assets must be sold, in which case the losses become real, if interest rates have increased since their purchase. If too many customers withdraw too many deposits, then these assets must be sold and a commercial bank's financial viability may be threatened. This is true even of a financially-sound commercial bank. The question is – which banks are sound under normal circumstances, and which could or should have been better-managed?

Recently, the emergence and persistence of inflation has confounded some analysts. Annie's theory offers a simple explanation for this inflation-confusion – one policy-size does not fit all in the world of economics and finance. Ideas that work for money-magnets may not work so well for resource-losers. Have the challenges of resource-losers gone under policy-makers' radars for years? If so, has the cumulative effect become (as Annie suggests) quite damaging across the whole system?

Is it possible, today, that the money-magnet world remains robust, while the resource-challenged world approaches breaking-point? Is it possible that the money-magnet world is still spending (feeding demand-pull inflation, bidding up prices) while important businesses become dysfunctional for lack of staff (causing supply-constraints and loss of variety in products and services)? Metrics usually measure things present, not things absent. "Zero" wages, for work needed but not done owing to lack of staff, do not find their way into measured prices.

Could the financial world be recognizing business reality on the one hand (pulling money out of some aspects of the real-world economy), while trying to hold onto its money on the other (insisting that the financial world keep going, with bank bailouts and subsidies if necessary)?

Can anything be done? First, Annie says, acknowledge the likelihood of this problem – instead of "win some, lose some," which theorists might think balances out in the end, we have "winners win more and losers lose more," and it gets worse over time. Then, find data to explore Annie's suspicions regarding **how this happens*. (If the information is in data that we have already, we should save time relative to building and referencing a new "study"). Then policy-makers might recognize how their ideological disagreements can be reconciled. That is, attempts both to promote and to correct the free market are involved in *the same inequities that both sides (left and right) deplore,* albeit from different perspectives. Then, they could develop policies that can satisfy both the need for some measure of equity, alongside support for personal freedom and responsibility.

Annie is not a policy insider, but she suggests we could *all* start by re-examining beliefs about money and its role in an economic system. Using theories based on the idea that "real things" are the most important economic variables – abstracting from money – probably does not cut it; especially not for entities in the money business, such as banks, including central banks.

(Annie's essay on "real stuff" and money in economic theory will be posted soon.)

*This is technical information. Annie hopes that general readers will try to understand her conclusions anyway! In brief, the *how* hinges on a technical term called "elasticity of demand." There are various versions of demand elasticities, and Annie says economists should (if not already) be exploring their role in financial feedback loops.

If any economists are reading this, please note that the "small firm" or "small country" assumption glosses over the likely entry or exit of firms to a market when prices change, which Annie thinks you will find depends on the elasticity of demand for the product of the market, or industry. (That is, considering one industry by itself, relative to its own demand.) You should also realize that assuming an infinite price elasticity of demand confounds an investigation of the long-run impact on the industry of its income elasticity of demand.

(You likely assume that a small firm, or small country, is a price-taker and need only decide how much product to make and sell. You may further assume that declining prices go along with better production techniques in competitive markets, and that this is nothing to be concerned about. I invite any economists who make this second assumption to please re-visit it. Suppose for example, that as prices decline, quality products, personalized services, and one-of-a-kind solutions are squeezed out of the market because they are not price-competitive. Consumers who cannot see quality but can see price may make a choice they later regret. If this error is common, the society may lose its connection to quality and become ill-equipped to solve unusual challenges. Annie thinks we can do better with the framework of the system, without re-thinking it entirely. For example, we might allow price-collusion in resource-challenged industries but not in money-magnet industries.)