Dēmos

MILLIONS TO THE MIDDLE *SERIES*

FEDERAL RESERVE MANDATE FOR FULL EMPLOYMENT

SUPPORT FOR GROWTH, JOB CREATION, AND CAREER DEVELOPMENT

Widely shared middle-class prosperity has made the United States the most hopeful and dynamic country on earth and is a foundation of strong democracy. Yet today, America's middle class is in trouble: the traditional routes into the middle class have become more difficult to travel and security has eroded for those already in the middle class. Major economic and policy changes over the past three decades have widened economic inequality and reduced mobility in ways that go far beyond the impact of the recent recession. Too many people who play by the rules and do everything right find that they cannot climb into the middle class—or stay there. To meet this challenge, Millions to the Middle offers dramatic public policy initiatives to rebuild and grow the nation's middle class.

POLICY IN FOCUS

FEDERAL RESERVE MANDATE FOR FULL EMPLOYMENT

The Federal Reserve should explicitly adopt metrics relating to full employment as the basis for monetary policy in the U.S.

We aim to accomplish two broad interrelated goals: to ensure that all Americans have a chance to move into the middle class and, second, to ensure greater security for those in the middle class. The 14 policies we offer are rooted in mainstream American values and able to command strong public support over the long term. Together, they go beyond the confines of the current policy debates and are of sufficient scale to firmly establish a middle-class America.

Our policy agenda is based on the three broad pillars of middle-class opportunity and security: investments in human capital and education; support for growth, job creation, and career development; and helping Americans build assets. This policy is part of the **Support for Growth, Job Creation, and Career Development.**

POLICY: FEDERAL RESERVE MANDATE FOR FULL EMPLOYMENT

Use monetary policy to explicitly promote full employment.

POLICY RATIONALE

From its establishment in 1913, the Federal Reserve has had a clear dual mandate to minimize inflation and maximize employment.[1] Over the last several decades, however, the Fed has overwhelmingly prioritized its commitment to combating inflation while allowing the pursuit of full employment to take a back seat. As a result, while creditors benefitted from low inflation, Americans who could have been working instead remained unemployed. We believe these anti-inflationary priorities are fundamentally incompatible with the advancement of an economy that promotes widely-shared prosperity and broad access to the middle class.

In recent decades, the Federal Reserve has operated on the theory that "full employment" is an impossible condition to achieve through management of the monetary supply.[2] According to this theory, there is a "natural" rate of unemployment that invariably arises in the labor market, and once this level has been achieved, monetary policy should be devoted solely to reducing inflation. But the Federal Reserve's experience with expansionary monetary policy in the late 1990s suggests otherwise – illustrating that a genuine full employment agenda can be pursued without devastating consequences of high inflation.

Consider the facts. Although the recession of the early 1990s peaked in March of 1991, unemployment continued to increase until the middle of the following year, when it began to decline and reach its pre-recession level of 5.5 percent in January of 1996. Many who believe in the existence of a "natural" rate of unemployment expected the unemployment rate to level off at 5.5 percent, but contrary to their expectations, unemployment continued to decline steadily, reaching a three-decade low of 3.9 percent in September 2000.[3]In other words, the economy of the late 1990s demonstrates that unemployment can diminish without setting off an ever-increasing inflationary spiral. As Jared Bernstein and Dean Baker observe, the country as a whole "benefited enormously from the fact that the Federal Reserve Board was willing to allow the unemployment rate to remain below the estimates of the [natural rate of unemployment] and to wait and see what happened."[4]

The benefits of declining unemployment were enjoyed most by those experiencing the greatest exclusion from economic prosperity: From 1995-2000, real hourly earnings for low-wage male workers grew 1.5 percent annually after a twenty year period of falling by 1 percent each year; earnings for low-wage female workers – which were flat for the previous 20 years – grew by 1.8 percent annually from 1995-2000. Unemployment levels dropped at much faster rates for African Americans and particularly African American teenagers than the rest of the economy as a whole.[5]

Needless to say, these trends did not continue, and economic inequality has only increased over the last 10 years. While the Great Recession clearly contributed to the reversal of these gains, monetary policy also played a role. The process had already started once the Fed resumed its contractionary monetary policy at the beginning of the last decade.[6] In order to boost employment over the long term and strengthen the middle class, the Federal Reserve must prioritize its mandate to pursue full employment and maintain low interest rates accordingly.

It is important to note that, as of late, the Federal Reserve has adopted a considerably more expansionary monetary policy, reducing interest rates to the lowest levels in decades and implementing "quantitative easing" policies to expand credit availability.[7] These policies are a welcome shift from the blind spots that marked the Fed's pre-recession focus on inflation, when, despite their mandate to promote economic stability, staff and leaders failed to notice the rise of an $8 trillion housing bubble or to consider the spillover effects of its collapse. With the benefit of hindsight, it is clear that the Federal Reserve must take a broader view regarding the fundamentals of economic health. Current policies aim to mitigate that earlier failure, but they are intended largely as short-term stimulus measures to address the recession rather than long-term commitments to promoting full employment.

Our call for the Federal Reserve to embrace its mandate for full employment must be understood as a long-term priority rather than a singular proposal for spurring job growth in the wake of the current economic downturn. Inflationary targets are not enough for a responsible central bank. While aggressive expansionary policy must be maintained by the Fed in order to stimulate job growth in the short-term, it is important to emphasize that our call for full employment is a new framework for strengthening the labor market and expanding the middle class through Federal Reserve policy.

POLICY DESIGN

Full employment will always be relative to the particular dynamics of the current labor market. The Federal Reserve should explicitly adopt metrics relating to a high employment-to-population ratio, low numbers of discouraged workers, low numbers of involuntary part-time workers, and a high ratio of job openings to applicants as the basis for monetary policy in the U.S., supplementing its historic focus on inflation rates as the primary object of its attention.

ENDNOTES

1. "Federal Reserve Act," Board of Governors of the Federal Reserve System Website, Accessed March 4, 2012. http://www.federalreserve.gov/aboutthefed/fract.htm
2. This theory was initially proposed by Milton Friedman in 1968: Milton Friedman, "The Role of Monetary Policy," The American Economic Review 58 (1968), Accessed online March 4, 2012. http://www.aeaweb.org/aer/top20/58.1.1-17.pdf
3. Jared Bernstein and Dean Baker, "Full Employment: Don't Give It Up Without a Fight," Economic Policy Institute Working Paper (January 2002). http://www.epi.org/publication/workingpapers_full-employment/
4. Bernstein and Baker, "Full Employment," January 2002. http://www.epi.org/publication/workingpapers_full-employment/
5. Ibid.
6. Thomas Palley, "Reviving Full Employment Policy," Economic Policy Institute Briefing Paper #191 (June 2007). http://www.gpn.org/bp191.html
7. "Why are interest rates being kept at a low level?" Board of Governors of the Federal Reserve System Website, Accessed online March 4, 2012. http://www.federalreserve.gov/faqs/money_12849.htm

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