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A Full-Employment Economy, A Federal Reserve That Works For Working People

How the Biden Administration Can Challenge the Fed's Leadership to Embrace Growth and Equity

A Fed Up Campaign Position Paper

The leadership of the Federal Reserve is falling short, and the Biden Administration will squander an important opportunity unless it challenges the Fed's leadership.

The Biden Administration has laid out a historically ambitious fiscal policy agenda¹ that is already delivering important and immediate benefits for working people and the economy as a whole. But the Administration has so far failed to lay out an ambitious monetary policy agenda that would have equally important long-term benefits for working people. How the Federal Reserve manages the economy must be part of the Administration's policy vision as it decides who will lead the central bank.

It is hard for the general public to get past the Federal Reserve's thick economic policy jargon, but everyone feels the impact of those policies. The Fed has a core "dual mandate" to balance the interests of price stability and maximum employment as it pursues economic growth.² How the Fed chooses to implement that mandate shapes who benefits from economic growth and who gets left behind. If the Fed emphasizes price-stability over maximum employment, for example, and implements policies that slow the economy while it still has the potential to absorb more workers, that choice relegates millions of people to unemployment and underemployment, keeps the gap between Black and white unemployment high, and allows wages to stagnate by undermining bargaining power for low-income workers³.



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The impact on our communities is severe, stripping wealth and opportunity for generations. This is especially true for Black and Brown communities that often do not feel the benefits of economic growth until we get close to true maximum employment.

To put it bluntly, unemployment is an attack on working people, unemployment is racism, and unemployment is, in many ways, a Fed policy choice. The leadership of the Federal Reserve must pursue an ambitious agenda and use every policy tool at their disposal to get their mandate right. For the Biden Administration, the personnel choices it makes in the coming year for the Board of Governors, including the Chair, are important policy decisions.

The Federal Reserve has recently taken some significant steps in the right direction. After a disastrous but all-to-typical decision in 2015 to raise interest rates just as the economy was emerging from the Great Recession - a move which is seen as having stopped the benefits of the economic expansion for low-income workers⁴ - the Federal Reserve began to reevaluate parts of its core policy framework. The outcome was a decision in 2020 to rebalance implementation of the dual mandate with a new, longer-run inflation target and an emphasis on improved unemployment indicators⁵. The resulting tilt toward maximum employment is real progress, and for the moment Chair Powell has correctly backed it up with ongoing policy statements⁶.

But there is much more that the Federal Reserve can and should do. The leadership has been content to simply adjust its existing set of macroeconomic tools. But what policy tools the Fed decides to use is not just a technical choice, it can also be a policy choice that shows who's interests the Fed sees as being legitimate. To truly fulfill the dual mandate by equally pursuing maximum employment, the leadership of the Federal Reserve must embrace new policy tools that they have left by the wayside.

These six policy changes are ambitious but realistic. They would fix the structure of the dual mandate, add new macro-economic, credit-policy, and regulatory tools to the Fed's quiver and strengthen the Fed's leadership appointment process so it is more accountable to the public. If embraced by the Biden Administration and implemented by the Federal Reserve's leadership, these policies would make improvements to our long-term monetary policy that are as consequential for working people as the Administration's immediate fiscal policy.

- 1. Fix the Monetary Framework by Adding a Maximum Employment Benchmark:** If you care about rising wages and racial and economic equity, making sure that the Fed gets its core monetary framework right is the name of the game. The Fed's recent decision to

adjust its primary benchmark, and its commitment to keeping its foot on the economic pedal until we get there, was a good first step. But it must not be the only step because the dual mandate is structurally flawed and should be fixed.

Here's the problem: there are two parts to the Fed's dual mandate – maximum employment and price stability – but the Fed only uses a single public benchmark about price stability to measure its progress on both issues. The Fed's new 2% average inflation benchmark is an improvement over its old inflation target⁷, but the Fed is still only measuring one half of the dual mandate. As the saying goes, you get what you measure, and the lack of a specific employment-related public benchmark leaves Fed policy far more at the mercy of personnel choices and political winds.

In fact, the Fed does not publicly define what maximum employment is or how we will know when we get there. This makes it hard for elected officials and the general public to understand the true impact of the Fed's policies, let alone make their opinions heard. This state of affairs is actually an improvement over the Fed's recent history, when it used a harsh estimate of a “natural rate of unemployment” that kept unemployment targets far higher than they needed to be, especially for Black and Brown communities⁸.

But a much better approach would be to have a benchmark with a functional definition of maximum employment that sets a minimum standard for the Fed to seek. Setting a single, static number has failed in the past but there are better approaches that involve using a balance of indicators. For example, one way that has been suggested to define maximum employment⁹ is when wages at the lower end of the economic spectrum are showing a sustained rise above the combined rate of increase in both inflation and worker productivity¹⁰.

The asymmetry of how the Fed measures and implements the mandate is stark, and so is the impact on working people. Because the Fed only measures its progress against one half of the dual mandate, when conditions begin to change and inflation hawks push their policies the Fed is structurally more likely to err on the side of stabilizing prices because it has only an inflation-related benchmark to measure itself against. For a historical indication that the structure of the dual mandate does not work equally, look at the fact that the mandate was created by law in the late 1970's, the exact moment that the Federal Reserve began its decades-long swing towards an unforgiving emphasis on stable prices at the expense of employment and wage growth. While many economic and political factors contributed to this swing, the structural asymmetry of the mandate is one important reason.

If there is a quantitative benchmark for inflation there must be one for maximum employment to better equalize implementation of the dual mandate. Defining maximum employment is complex and would require a

dashboard of indicators to arrive at a benchmark. But defining stable prices is also complex, and Fed economists successfully created a dashboard of indicators to arrive at its 2% average inflation benchmark. The Fed can do the same for maximum employment.

The Fed should be required to develop a maximum employment benchmark so that both halves of the dual mandate are equally anchored regardless of personnel choices and the political winds.

- 2. Target the Racial Unemployment Gap:** The Black Lives Matter protests this past summer led to a push for policies that can make a difference in racial and economic equity for Black and Brown communities. The Fed's 2020 policy framework shift towards an emphasis on maximum employment will have a positive impact for all working people. But with our country's devastating and persistent racial unemployment gap¹¹, we won't make enough progress until we actually achieve a full-employment economy. This must be a long-term goal. But the Fed must also find additional, immediate policy tools to directly address racial equity.

One important policy proposal¹² is to require the Fed Chair to report at the twice-yearly Congressional monetary policy oversight hearings on the extent of racial employment and wage gaps and what steps the Fed is taking to address them. The legislation¹³ doesn't instruct the Fed on what steps it must take, but it would make an important difference by requiring the Fed to center the problem in their research and to publicly justify the outcomes of whatever goals they choose.

The Fed should be required to implement this approach to targeting the racial unemployment gap.

- 3. Embrace FedAccounts:** Widening support for automatic fiscal stabilizers is one important idea coming out of the COVID economic crisis. Powerful program models that would be triggered by early recessionary signals include strategic safety net expansions, infrastructure spending expansions, and direct individual payments. These can be a far more effective way to combat an economic downturn than the current slate of fiscal and monetary tools. But each of these program models is hobbled¹⁴ by the current disbursement systems which are poorly designed, or were never designed to do that job.

The Fed can play an important role by embracing the creation of universal "FedAccounts." The ability to disburse payments under any of these fiscal stabilizer program models¹⁵ through a FedAccount would make the

programs smoother and quicker, which is essential to the automatic fiscal stabilizer concept. Support for these programs¹⁶ and for FedAccounts is gaining steam in Congress¹⁷. In addition, some FedAccounts models such as Postal Banking¹⁸ would create a safe, affordable option for the many low-income communities that are trapped in high-cost financial services because they are unbanked.

The opportunity to pursue this policy has increased in recent months as Chair Powell has spoken about a Fed-backed digital dollar model that needs a FedAccount-like mechanism. And, he has said that he might need specific legislative authorization from Congress¹⁹ to create these accounts. But the plan for a digital dollar will take time to develop, and FedAccounts cannot wait.

The Fed should be required to implement FedAccounts quickly to bring all their benefits, including a stronger fiscal stabilizer mechanism and more fair access to banking.

- 4. Credit Policy to Support the Real Economy:** The Fed has credit policy tools at its disposal but it does not deploy them to support the real economy. In contrast, the Fed made creative use of both its monetary and credit policy tools to support financial markets in its response to the COVID crisis. This was most glaring when the CARES Act authorized the Fed to create crisis-facilities to provide much-needed lending to state and local governments, but the Fed imposed unnecessarily harsh lending terms²⁰ that made the program all but irrelevant. This obstructiveness wasn't a surprise; the Fed often draws an artificially bright line between its role in supporting financial markets and supporting the real economy. The consequence during the COVID crisis was to deprive state and local government of much-needed support at an essential moment, which deepened the impact of the crisis²¹.

If we want to pursue a full employment economy and achieve other important policy goals, the Fed must make use of all the potential tools at its disposal. In crisis conditions, this means that Fed lending facilities for the real economy should be designed to actually increase liquidity in the real economy, not just backstop existing markets.

Under non-crisis conditions, the Fed's balance sheet should be made available to back sensible new lending models that provide credit in strategic areas where the private market will not. These include independently-managed infrastructure investment proposals such as the National Infrastructure Development Bank²², National Climate Bank²³, and Recession Insurance Bonds²⁴. While mostly funded by the Treasury, the National Investment Authority²⁵ proposal, for example, calls on the Fed to stand

behind their bonds to create a safe and liquid market. The Fed's refusal to use any credit policy to support the real economy is no longer acceptable.

When crisis facilities are established, the Federal Reserve should be required to manage them with the goal of actually bringing additional credit to the real economy. And, the Fed should be required to allow its balance sheet capacity to be used to back sensible infrastructure investment models.

- 5. Stronger Prudential Regulation to Protect Against Asset Bubbles and the Specter of Inflation:** The Fed has committed itself to a sustained expansionary policy. But the monetary hawks are pushing back, using fears of inflation as an argument against a drive for maximum employment. The possibility of problematic inflation can't be dismissed entirely, but the Fed shouldn't consider pulling back until it actually is a problem. After the Great Recession, the Fed made the serious mistake of reacting prematurely to inflation fears by implementing an interest rate increase in 2015 that slowed economic growth and led to years of a "jobless recovery" that harmed marginal communities most²⁶.

The specter of asset bubbles is being raised in some quarters²⁷ as a leading indicator of inflation risk, tying those bubbles to the Fed's expansionary policy. Powell has correctly said that asset bubbles are dangerous for consumers and are a matter for prudential regulators to guard against, but should not be an excuse to slow the economy. But Powell has also supported the weakening of some prudential financial sector regulations²⁸, including areas of stress testing, bank liquidity rules, and the scope of the Financial Stability Oversight Council.

The Fed should be required to support stronger regulatory oversight of the financial sector, including an expansion of oversight of "shadow bank" lending in key sectors, to keep abuses from undermining the Fed's drive for economic growth.

- 6. Make Fed Senior Leadership More Diverse and more Accountable to the Public:** The Federal Reserve has a diversity problem²⁹. Its senior leadership – Governors and regional bank Presidents - are overwhelmingly white. As a result, the Fed is hard-pressed to truly understand the interests of the general public it is supposed to represent. While the Fed has made some progress, this has mostly been in the area of gender, not racial diversity. This is no longer acceptable.

Another crucial Fed diversity problem is the background of the members of the boards of directors of the regional Fed banks³⁰. This matters because the Federal Reserve is required to represent the interests of the broad public, not just the banking and financial sectors, and the boards have the important power of choosing the President of the regional bank. For this reason, the boards are designed to have a majority of members selected to be representatives of the general public, not the private commercial banks in the region.

But the private commercial banks are gaming the board appointment system to quietly dominate the process for appointing regional bank presidents. Specifically, the local boards of directors are comprised of three classes of directors. One class represents the private commercial banks and is named by those banks. One class represents the general public and is named by the Board of Governors. And, one class represents the general public but is named by the private commercial banks. This class subverts the intent of the system because the private commercial banks are naming directors who are nominally public, but because of their professional background are more oriented towards the financial sector and big-business. In effect, the private commercial banks are taking advantage of a loophole to dominate two-thirds of the regional boards. This allows the selection of regional bank presidents who are more oriented in their policy choices towards the interests of the financial sector.

To address this diversity and public-accountability problem, the Fed must create an appointment system for senior leadership that is structured to address the lack of racial and sectoral diversity. One proposed legislative solution³¹ creates a “Rooney Rule” for Presidential appointments. This can be a good start, but a real solution must go further.

The Federal Reserve Act must be amended to eliminate the power of private commercial banks to name non-bank directors, and the Fed should be required to implement a new process to make the appointment of regional presidents and directors a more transparent and publicly-engaged process.

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