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Statement by

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before the

Committee on Banking, Housing and Urban Affairs

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I appreciate this opportunity to present the views of the Federal Reserve Board on the Full Employment and Balanced Growth Act--known popularly as the Humphrey-Hawkins bill. This proposed legislation would amend the Employment Act of 1946 by setting forth specific economic goals and by providing explicit roles in the economic policy planning process for the President, the Congress and the Federal Reserve.

The several, somewhat different versions of the Act now under discussion in Congress contain substantial improvements over the earlier bill on which I testified before this Committee in the Spring of 1976. Particularly welcome is the increased emphasis of the current bills on the need to reduce inflation as well as unemployment. The Federal Reserve strongly supports this change, as the more specific recognition of the goal of price stability addresses a major inadequacy of both the 1946 Act and the amendments to it proposed in earlier versions of the Humphrey-Hawkins bill.

We are encouraged also by deletion of some of the major inflationary features of the previous bill. The Board had been especially concerned by the provisions that would have required the Federal government to become the employer of last resort, and by the very high wage standards mandated for such Federally funded jobs. The new versions of the bill require that all special programs which provide job opportunities to the hard-core unemployed be designed to avoid drawing workers from private employment, and the wage rate provisions appear to be more reasonable than those of the earlier bill.

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The bills under discussion today also no longer contain those provisions that would have unduly restricted economic policy by requiring a comprehensive policy planning process directed toward the achievement of a 3 per cent unemployment rate goal, with no regard for any inflationary consequences until that goal was reached. That earlier structure would have stripped monetary policy of its ability to respond flexibly to changing economic conditions.

These improvements in the current bills are clearly all to the good. However, the Federal Reserve continues to have reservations about some of the provisions that still remain. I would emphasize in particular that the unemployment goals to be attained within five years are extremely ambitious. The goals established by the bill--3 per cent for workers aged 20 years and over, and 4 per cent for workers aged 16 years and over--were last achieved only during the 1966-69 period, when the U.S. economy was suffering from demand-pull inflation stemming from the military manpower requirements and heavy spending pressures of the Vietnam War.

The historically low unemployment goals, moreover, tend to ignore the significant changes that have occurred in the composition of our labor force over the past decade or so. Due to changes in the age distribution of our population and to increases in the participation rate for certain groups, the numbers of teenagers and adult women in the labor force have grown dramatically. For example, in the last 10 years, total population has increased by about 9 per cent, while the numbers of adult women and teenagers in the labor force have risen by 42 and

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40 per cent, respectively. If the unemployment rate for the first quarter of this year were to be adjusted to take account of this change in labor force composition, it would have been nearly one-half percentage point lower than the 6.2 per cent rate that was reported.

Efforts to keep our rapidly expanding labor force fully employed have been further complicated because those seeking work have often lacked the skills required to handle the jobs available. Also, the job markets in which opportunities occur have often been at locations far distant from the persons in search of work. These structural problems, I believe, can be attributed partly to the higher skills required by a technologically advancing society, and partly to geographical shifts in population and job opportunities--broadly from north to south, and also from central cities to the suburbs. Moreover, in the case of unproved workers, such as unskilled teenagers, the unemployment problem has been aggravated by increases in the minimum wage. Such increases have tended to mean that marginally productive job applicants become unemployable on an economic basis at the going wage.

In our present circumstances, therefore, it is unlikely that macroeconomic policies alone can achieve the low unemployment goals of the Humphrey-Hawkins bill without running the grave risk of substantially exacerbating the inflation problem. If sole reliance were to be placed on general economic policies to reach these very ambitious unemployment rate objectives, certain critical labor skills could be expected to come into short supply and some industries would be

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pressed above practicable capacity limits, well before aggregate demands had risen sufficiently to absorb the more marginal types of workers.

It seems to me abundantly clear, therefore, that any hope of attaining the Humphrey-Hawkins unemployment targets without escalating price pressures will depend on a major effort to develop special employment programs. These are needed to make our unemployed more employable, to put the jobless in touch with available jobs, and to generate employer interest in taking on marginal workers--perhaps at an initially subsidized wage cost that makes their employment economically attractive. Moreover, although our structural employment problems are aggravated by business cycle downturns, they appear also to be growing over time, so that their correction is likely to require more than the countercyclical programs contained in Title II of the proposed bill.

Apart from training and other programs for the hard-core unemployed, careful consideration also needs to be given to the recent shortfall in business investment spending and to the effects this is likely to have on the creation of new job opportunities. Unfortunately, during the past five years, growth in the nation's stock of capital has been slowing relative to growth in our labor force. If this trend persists, it may mean a slower creation of new jobs relative to our employment needs as well as a slower increase in the general productivity of our economy. Thus, there is an important stake for all of us in finding effective means of encouraging

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more investment in productive plant and equipment, through stronger incentives for business and perhaps some structural revision in the tax laws.

In addition, the Board is deeply concerned that the emphasis and organization of the current bills still appear to place the objective of controlling inflation in a role distinctly subordinate to that of reducing unemployment. Although the reduction of inflation is mentioned in one way or another 5 or 6 separate times in the bills, the prescription for moderating inflation is quite vague. Moreover, in the House-passed version, the President is not even required to report on progress or plans for controlling inflation until the third year of the program.

The amendment introduced by Senator Proxmire seeks to redress this relative imbalance in objectives by adding an explicit goal for reducing inflation to 3 per cent or less, on the same timetable set forth for achieving the unemployment rate goals. The Federal Reserve supports the inclusion of a specific interim inflation rate objective, though we believe that greater flexibility for revision should be provided than the amendment contemplates. A possible approach would be to permit the President to recommend modification in the inflation rate goal and/or the timetable for attainment, starting with the third Economic Report after the law becomes effective. This alternative would provide parallel treatment for both the inflation and the unemployment goals.

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The Board would urge also that every effort be made to reduce or eliminate the many inflationary biases that are at work in the economy, some of which are a result of long-standing Federal programs. We are encouraged by recognition in the Humphrey-Hawkins bill of the need for structural measures to combat inflation--including the removal or modification of governmental restrictions that have anti-competitive effects or add needlessly to costs, and the effective enforcement of the anti-trust laws. But there is a need to reexamine the relative costs and benefits of other Federally mandated programs as well, such as the Davis-Bacon Act, the minimum wage for teenagers, extended unemployment insurance, and the full indexing of public retirement benefits. Also, we would recommend that the inflationary costs as well as the potential benefits explicitly be taken into account in setting our environmental quality goals, particularly at the outer margins of the improvements specified. Meaningful progress in reducing the overall inflation rate will require a comprehensive attack on the problem, program by program, in the public as well as the private sector.

Let me turn now to the specifics of the Humphrey-Hawkins bill that apply to monetary policy. The procedures currently contemplated for evaluating and monitoring the role of the Federal Reserve in economic policy planning and coordination have substantially improved upon the rigidity of the earlier bills. The Federal Reserve would now be required to provide

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an independent statement setting forth its intended policies for the year ahead, along with an explanation of their relationship to the economic goals presented in the Economic Report of the President.

In the House-passed version of the bill the role of reviewing the intended policies of the Federal Reserve remains appropriately with the Banking Committees of the Congress. The Board believes that this assignment is consistent with the quarterly oversight procedures now in place, and would benefit from the accumulated experience and familiarity of these Committees with the Federal Reserve and the major issues encountered in the formulation of monetary policy. And to the extent that the Congress determines that action may be called for in order to ensure the consistency of monetary policy with the purposes of the bill, the Board would favor a provision that assigns principal responsibility to the Banking Committees.

In order to provide further consistency with the current procedures for Congressional review of monetary policy, the Board supports the inclusion of the last sentence of Section 2A of the Federal Reserve Act, as appears in H. R. 50. Section 2A provides that the Federal Reserve not be required to adhere strictly to its intended policies for the year ahead if the Board and the Federal Open Market Committee should determine that these policies, as reported to the Congress, cannot or should not be achieved because of changing conditions. That language was wisely included in the Federal Reserve Reform Act in order to preserve the flexibility

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essential to the proper conduct of monetary policy. Its inclusion in the Humphrey-Hawkins bill would avoid the statutory inconsistency that might otherwise occur.

One potential problem inherent in the planning for general economic policies designed to control both unemployment and inflation is that trends in employment tend to respond more quickly to changes in policy, including monetary policy, than do trends in prices. Actions that stimulate a general expansion in spending for goods and services tend to generate needs for additional workers fairly early in the process. While this step-up in demands for workers and the materials they use may exert some immediate upward pressure on wages and prices, the full impact of the stimulus is likely to be stretched out over a fairly extended period. Some wage and price adjustments are delayed until the expiration of existing contracts, or until the strengthening trend develops sufficient upward momentum. But when these contracts are eventually adjusted, they often generate additional catch-up demands for further adjustments in other sectors of the economy. Because of this long trail on inflation, public policies are in danger of giving insufficient weight to potential inflationary pressures unless they focus on a planning horizon that looks beyond the next year or two.

Thus, the inclusion of inflation as well as unemployment rate targets to be attained on the same timetable 3 to 5 years out would be a desirable addition to the Humphrey-Hawkins bill. Policymakers would then be guided by both these longer-range economic goals, and the undue

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focus on short-term objectives which can occur would tend to be moderated. It must be recognized, of course, that the linkages between current policy actions and the performance of the economy over a longer horizon are quite tenuous. Moreover, since current economic conditions can often change in abrupt and unexpected ways, appropriate adjustments in short-term policy goals may require revisions in longer-range policy plans as well. But so long as the longer-range unemployment and inflation rate goals are not considered rigid absolutes, it would be preferable to make adjustments in short-term policy with an eye to their implications for the timing and attainability of longer-run objectives, especially with respect to price developments.

In conclusion, I want to assure you that the Federal Reserve fully shares the desires of Congress and the Administration to achieve conditions that will foster the creation of jobs for all of our people who are able and willing to work. Since the passage of the Employment Act in 1946, this has been an explicit objective of national economic policy to which the Federal Reserve has subscribed. The economic history of this and other countries in the postwar period, however, has amply demonstrated that our performance with respect to inflation has a critical bearing on the chances for actually achieving meaningful and sustainable full employment. High and rising rates of inflation, quite aside from the inequitable consequences they bring to our people, tend to distort economic decisions, sap consumer purchasing power, and lead to conditions that are likely in time to reduce rather than enhance employment prospects. We must

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be on guard also to avoid the higher Federal expenditures and therefore larger budget deficits that might follow from mechanical efforts to achieve the employment objectives of this bill.

While the current versions of the Humphrey-Hawkins bill take more account than earlier versions of the threat that inflation poses to our economic health, they still do not ackowledge adequately the crucial need to reduce inflation, both as an integrated element in the process of achieving full employment and as a necessary condition for effective public and private planning. There is a real risk that the Humphrey-Hawkins bill, if enacted with the present lopsided emphasis, will accord by law a back seat to the need for more effective control over inflation. It seems paradoxical that this might take place at precisely the time when inflationary pressures are coming to represent the major threat to the stability of our economic process.

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