Testimony of Ron Blackwell
Chief Economist
American Federation of Labor and Congress of Industrial Organizations
(AFL-CIO)

Before the
House Committee on Financial Services
February 16, 2007

The State of the Economy, the State of the Labor Market And the Conduct of Monetary Policy

Thank you, Chairman Frank, and other members of the Committee. I welcome the opportunity to be here today to testify on behalf of the 10 million members of the AFL-CIO and share our views on the state of the economy and labor market and the conduct of monetary policy.

I should begin by mentioning that I was recently appointed by the Board of Governors of the Federal Reserve to the board of Baltimore Branch of the Richmond Bank. I want to make it clear that I am speaking here today exclusively as a representative of the AFL-CIO and the views I express do not reflect in any way those of the Richmond Federal Reserve or the Board of Governors.

From the perspective of the American labor movement, any reflection on the state of the American economy and labor market must address one simple, but central, question: "Why is it so difficult for so many families to make a living by working in the richest country in history?"

The U.S. economy is now producing over $13 trillion a year and, despite a recent slowdown, has been growing at a respectable rate. American workers are the most productive workers in the world, and they are more productive today than ever before. Americans work hard and today work more hours, on average, than workers in any other developed country.

Nevertheless, the vast majority of American working families are struggling to maintain their living standards in the face of stagnating wages, rising economic insecurity, eroding health care and retirement benefits and mounting debt. At the richest moment in our nation's history, the American Dream is fading for a majority of American workers.

We can, and must, do better. But doing so requires us to fundamentally rethink our country's economic policies. No area of policy is more important than our country's macroeconomic policy, in general, and monetary policy, in particular. We congratulate the Committee for holding these hearings and hope that this is the beginning of an on-going review of our country's monetary policy.

The Fading American Dream

American workers are suffering a now generation-long stagnation of family income and rising economic insecurity.

Since 1980, labor productivity has increased over 67 percent, but the real median wage has increased less than nine percent over a quarter century. Real median family income has increased a modest 15 percent over this period, but mostly because each job requires more hours, each worker is working more jobs and each family is sending more family members to work.

Moreover, the volatility of family income -- and with it the economic anxiety so many feel -- has increased sharply over the same period. Jacob Hacker the Yale political scientist estimates that the chances of a family suffering a 20 percent or greater decline in income over a two-year period have doubled since 1980.

Rising health care costs and dwindling retirement assets aggravate the economic anxiety working families feel. Only half of American families have an employer-provided retirement plan of any sort, and only 20 percent of workers today participate in employer guaranteed "defined benefit" pension plans, down from 40 percent in 1980. In substituting "defined-contribution" for defined benefit plans, employers are shifting the risk of retirement onto workers who, for the most part, are ill prepared to carry this risk.

And, as health care costs continue to rise, employers shift more and more of the cost of health care onto the shoulders of their employees. Again, working families with stagnating earnings are in no position to shoulder these costs and the ranks of the uninsured continue to rise. Today over 46 million Americans have no health insurance at all, despite the fact that as a nation we spend more on health care than any country in history.

The Ruptured Social Contract

The stagnation of wages has ruptured the crucial relation between wages and productivity that was the heart of the "social contract" that American business and labor struck in the early post-World War II period and that provided the foundation for building the American middle class.

When both productivity and wages doubled from 1946-73 – the fastest increase in living standards in our history -- the incomes of every quintile of Americans rose, and the bottom quintile rose faster that the top. Since 1973, however, as productivity continued to grow but real wages actually began to fall, family incomes stagnated and inequality began to grow. In the earlier period, we grew together as a nation. For the past 30 years, however, we have been growing apart -- economically, socially and politically.

Over half of all the gains from increased productivity since 1980 have accrued to the top 10 percent of American families, most of it to the top one- percent. Indeed, the incomes of top .01 percent of American families – those earning over six million dollars a year – increased 497 percent over this period.

As a result of this rupture between wages and productivity, an enormous redistribution of income – perhaps the largest in our history – has occurred from poor and working Americans to the top twenty percent of our families. Today, America has the most unequal distribution of income and wealth of any developed country in the world. And income and wealth are more unequally distributed in America today than at any time since the 1920s.

Our wealthiest families prosper as never before, but the majority of working families are increasingly left behind. Working families are struggling to make ends meet on stagnating earnings. They are terrified of what a serious accident or sickness might mean for their families' economic security. They are anxious about their ability to retire and increasingly angry about the sheer injustice of our country's growing inequality. Most of all, they are worried about the future of their children.

There are many contributing causes to the stagnation of wages and the rupture of the productivity-wage relationship over the past thirty years. Central to them all, I suggest, is a steadily growing imbalance of bargaining power between workers and their employers. The implicit "social contract" that allowed Americans to grow together, and build the American middle class, in the early post-World War II decades rested on a rough balance of power between workers and their unions on one side and employers on the other. Today, this balance of power has eroded and the social contract with American workers is unraveling.

If we are to rebuild the relationship between productivity and wages and allow workers to share equitably in the value they help create, we must restore the balance of bargaining power between workers and their employers. This will require a change in our country's economic policies, including our monetary policy.

The Eclipse of Full Employment and the Role of Monetary Policy

In the early post-World War II period, when Americans were growing together economically, the central goal of macro-economic policy was full-employment. With the Employment Act of 1946, the federal government for the first time assumed responsibility for assuring that everyone seeking employment would find a job. The Humphrey-Hawkins Act of 1978 reaffirmed that commitment and mandated the Federal Reserve to pursue the dual objectives of full employment and price stability. The Humphrey-Hawkins Act even stipulated a quantitative goal for full-employment -- four percent unemployment, three percent for adult workers.

Under these Acts, the federal government actively coordinated fiscal and monetary policy to moderate the business cycle, spur economic growth and achieve full employment while maintaining reasonable price stability. The resulting tight labor markets bolstered the bargaining power of workers and allowed workers to share equitably in productivity gains. As long as real wages did not rise faster than productivity, there was no pressure on prices to increase.

All this changed, however, when the Federal Reserve, under the leadership of Paul Volcker and in response to the "stagflation" of the 1970s, moved aggressively to raise interest rates and slow the economy. The Fed's action did lower inflation dramatically, but at the cost of the most serious recession since the Great Depression in 1980-81 with enormous losses of employment and output.

Of more lasting consequence, however, the Fed shifted dramatically to emphasize price stability over full employment in guiding monetary policy. Indeed, a new consensus among monetary policy makers emerged bolstered by changing intellectual fashions among academic economists. This new concensus holds that the non-accelerating rate of unemployment (NAIRU) is determined exclusively by supply-side factors and, in the long run, cannot be influenced by the effects of interest rates on demand. According to the new consensus, monetary policy can only influence inflation.

While this consensus now dominates thinking among Federal Reserve policy makers, it is nevertheless subject to serious questions. The economic theory on which the consensus rests involves a number of arbitrary and unrealistic assumptions and the empirical estimates of NAIRU generated by the theory have varied widely and unpredictably. Given the very serious implications for monetary policy and the ability of the Federal Reserve to contribute to realizing the goal of full employment, the Congress must assess for itself whether there remains scope for monetary policy to affect employment and output as well as inflation.

Although the Fed's Congressionally mandated dual objectives have not changed, the actual course of monetary policy over the past 30 years has come to focus almost exclusively on price stability, at great cost to employment and growth as well the growing divide between productivity and wages. The resulting slower growth and slack labor markets have contributed to the stagnation of wages and growing income inequality.

Unfortunately, there is now a growing sentiment among monetary policy makers that the Fed should aim to achieve a quantitative target for inflation in the range of 2.0 percent per annum. This raises the important question of whether monetary policy should be "rule based" or "discretionary" and whether an inflation target, implicit or explicit, is consistent with the congressionally mandated target of 4.0 percent unemployment.

Chairman Greenspan was quite skeptical of inflation targets, or quantitative rules for monetary policy in general. Though he strongly agreed with the focus of monetary policy on inflation, Chairman Greenspan practiced a "discretionary" policy guided by individual judgements concerning changes in underlying economic conditions.

An important lesson on the importance of a flexible approach to monetary policy can be drawn from the experience of the late 1990s. Economists were then estimating a NAIRU in the range of 6.0-6.5 percent and warning that unemployment could not be lowered without causing a dangerous acceleration of inflation. Chairman Greenspan, noting important changes in economic conditions, allowed the unemployment rate to fall to a low of 3.9 percent in 2000 with no acceleration of inflation at all. This was the last time the economy approached full employment as well as the last time real wages rose along with productivity. This was also the last time we saw a measurable increase in real incomes for the vast majority of working families, especially our poorest families.

How many millions of workers would not have found jobs if Chairman Greenspan had adhered to the consensus view of the monetary policy in the 1990s? How many billions of dollars of output and income would never been realized? And, had real wages not increased in the late 1990s, they would be lower today than they were in 1973 and inequality would be even higher than it is today.

The brief period of near full employment came to an end with the 2001 recession. Though the recession was short and shallow by historical standards, the labor market recovery has been the weakest of any recovery since World War II. Only in 2005 did employment recover its pre-recession levels and only last year did real wages begin to increase. The unemployment rate has fallen to 4.6 percent, but the important employment/population ratio is still a full percentage point below its pre-recession peak.

Despite the slow recovery, productivity growth actually accelerated from its already healthy pace in the previous five years. Nevertheless, in the context of a very weak labor market, the growth of real wages slowed sharply and median family incomes declined by 2.9 percent, compared to an 11.3 increase in the previous five years. Poverty and inequality grew while the proportions of Americans covered by health insurance and pension coverage both fell.

The experience of the late 1990s speaks clearly for the importance of a flexible monetary policy for achieving full employment, helping restore the balance between productivity and wages and allowing workers to benefit from the increased value they help create.

Rather than narrowing the scope of monetary policy concern to price stability, the Federal Reserve should broaden the scope of its concern to include not only full employment, but also helping maintain the crucial relation between productivity and wages.

Full employment requires close coordinate of monetary policy of the of the Federal Reserve with the fiscal policy of the U.S. Treasury. And, because we live in an increasingly global economy, both the Federal Reserve and Treasury must manage the exchange rate to achieve full employment as well. Currency manipulation by the monetary authorities of our trading partners, particularly in Asia, is one of the most important factors behind the loss of 1.3 million good paying manufacturing jobs in the U.S. since 1998 and our unsustainable trade deficit.

Conclusion

We must restore full employment as the foundation of our country's economic policy – both monetary and fiscal – if we are to reconnect productivity and wages and assure broadly shared economic growth. We must also reconnect our country's economic policy with economic values that resonate powerfully with all Americans. Our policies should assure that:

First, anyone who wants to work in America should have a job. We need a renewed commitment to full employment as the foundation of our country's economic policy to assure rapid growth and broadly shared prosperity. The Congress must recommit itself to the Humphrey-Hawkins Act and insist on more balance in the Fed's monetary policy as between its goals of full employment and price stability.

Second, anyone who works every day (a) should not live in poverty, (b) should have access to quality health care for themselves and their family and (c) should be able to stop working at some point in their lives and enjoy a secure and dignified retirement. A meaningful floor under wages and working conditions is necessary if the lowest paid workers are to share in increased productivity. We must also restore economic security to working families by reforming our health care and retirement systems.

Third, American workers should enjoy the fundamental freedom to associate with their fellow workers and, if they wish, organize unions at their workplace. The Congress should take immediate action to pass the Employee Free Choice Act to allow workers the freedom to organize free of employer interference and the fear of job loss. This Act would represent an enormous step toward restoring balance between workers and their employers and helping repair the ruptured productivity-wage relationship.

The American economy is changing rapidly and posing very difficult challenges to the living standards of America's working families. But I am confidant that workable policies that meet these challenges and assure the economic basis for strong and broadly shared prosperity can emerge from a dialogue involving business, labor and the public at large. I commend the Committee for beginning this dialogue.

Thank you again for the opportunity to be with you today and share the views of the American labor movement.

##########