The Uneasy Case for Janet Yellen

John Feldmann

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Until the past couple weeks Janet Yellen has been widely considered the top contender to succeed Ben Bernanke as the Chairman of the Federal Reserve. Her credentials as an economist, successful career both in the Fed and academia, and personal qualities would seem to make her a shoe-in to become the first female Chair of the Federal Reserve. Yet questions are being raised whether she is the right person for the job. Among economic conservatives both in the Senate and outside she is described as too dovish. But even among liberal Democrats there seems to been uneasiness and there does not seem to be widespread enthusiasm for her candidacy.

I would suggest that this uneasiness might have less to do with Janet Yellen herself and more to do with a growing uneasiness, even among its initial supporters, with the unprecedented accommodative policies of the Bernanke Fed. There is a growing concern that the consequences of recent Fed policy – market distortions, dramatically expanded Fed balance sheet, etc. – are no longer worth the diminishing benefits of continued unprecedented accommodation. And appointing as Fed chair a person like Yellen who is likely to continue, maybe even prolong, these policies thus seems a bad idea.

The questions about Yellen seemingly began to be raised as she emerged as the leading candidate for Fed Chair and her dovish inclinations found the spotlight. This was exemplified in a February 2013 speech that Yellen gave to a conference co-sponsored by the AFL-CIO. The theme of that speech was "the Federal Reserve's efforts to pursue a goal that it shares with the labor movement: maximum employment."

Declaring a shared mission with organized labor was considered by those who watch such things closely to be an extraordinarily "dovish" statement for a Fed Vice Chair – and a potential Fed Chair – to make, and this was noted and widely criticized.

Maximum Employment in the Federal Reserve Reform Act of 1977

However, I would focus on certain other statements in Yellen's AFL-CIO speech, having to do with her interpretation of the Federal Reserve Reform Act of 1977. These statements reflect a viewpoint she shares with Bernanke, and lies at the heart of the uneasiness with her candidacy. Yellen asserts "that the Federal Reserve is the only agency in the U.S. government assigned the job of pursuing maximum employment" and she then goes on to cite the Federal Reserve Act of 1977 as the law that "spells out that responsibility." These particular claims did not gather much attention. With Bernanke's persistent reference to the dual mandate and his elevation of maximum employment as a standard by way of justification for his unprecedented policies, we have become immune to such claims. But I would suggest that the growing concerns that Bernanke has taken things too far, which is now morphing into doubts about Yellen, are actually rooted in their unwarranted expansion of the 1977 Act.

There is a lurking issue with Yellen's (and Bernanke's) view that the 1977 Act "spells out a responsibility" for maximum employment. If one looks more carefully at the text and context of the 1977 Act (and its predecessors) and traces how the Congress has developed the language for the Fed role in unemployment, it is hard to characterize it as a "spelled out Fed responsibility" for maximum employment. Below we lay out the argument that the legislative history of the dual mandate questions of whether the Congress ever intended the maximum employment standard to be given the weight it is now being given or for the Fed to play the role it now plays in employment policy. And in fact there is no "spelled out responsibility" for an expansive Fed role in unemployment in the 1977 Act. This is the reason that many have questions about Bernanke and are now questioning whether Yellen, who would be likely to continue or expand the emphasis on employment, should be his successor.

Legislative History and the 1977 Act

Before beginning, it is worth pointing out that well before Bernanke began to claim the 1977 Act as an explicit employment mandate, Yellen herself admitted in 1995 that the 1977 Act language was "vague," seemingly at odds with her reference in the AFL-CIO speech that the Fed responsibility was "spelled out."

Consider a statement that Yellen made in the January 1995 FOMC meeting regarding her position of the role of Fed monetary policy.

> GOVERNOR YELLEN.
>
> *"Then I ask myself, what is it that the Fed can accomplish? …. I conclude that the actions of this Committee affect not just the level and variability of inflation but also at a minimum the variablity of output and employment."*
>
> *"The moral I draw is simply that the Fed should pursue multiple goals. … I understand that the mandate of the Federal Reserve Act [of 1977] to pursue multiple goals is pretty vague."*

Yellen here appears to concede that the language of the 1977 Act enabling the Fed is "pretty vague," rather than clearly "spelled out." However, the question is not what seems vague or spelled out in the view of a particular central banker. The questions that must be answered are what was the Congress thinking when it chose this language and what did it intend to do in the 1977 Act. In order to properly undertake such an analysis properly one must also look at predecessors to the 1977 Act.

The history of Congressional activity involving the role of the Fed indicates that there have been a number of efforts to make "full employment" or "maximum employment" a responsibility of the Federal Reserve. Several of these efforts resulted in successful legislation – in 1946, 1977, and 1978, and in House Concurrent Resolution 133 in 1975. However, a careful review of the progress of these bills indicates that the effort to make employment creation a responsibility of the Fed was, in each case, strongly opposed and neutralized in the Congressional deliberations before final passage. The bottom line is that Yellen's interpretation of the 1977 Act may be more an indication of the hopes of the bill sponsors in each of these instances than the Congressional intent and content of the final version of the 1977 Act.

This initial effort to make the government and by implication the Fed responsible for employment was introduced in 1945, as the "Full Employment Act of 1945." The bill purported to place the responsibility full employment directly on the federal government. The 1945 bill largely followed the principles and policies of the Beveridge Plan, the blueprint followed by Labor Party in England that had just taken control of the government at the close of WWII. The original wording of the proposed 1945 bill was "the federal government shall provide such volume of federal investment and expenditure as may be needed to assure continuing full employment."

The legislative record and historical accounts indicate that this was a very controversial piece of legislation and that there was fierce opposition to creating such a job-creating role for government in the economy. Opponents viewed the bill as radically socialistic and antithetical to fundamental American values. As a result, it was thoroughly eviscerated in the process of reaching the Senate floor for a vote. The significance of the changes between the introduced bill and final legislation makes clear the extent of the opponents' victory. The obvious indication is the change in the title of the bill, from the Full Employment Act of 1945 to simply the Employment Act of 1946. As a concession, the provisions requiring "full employment" for everyone were reduced to a statement encouraging the federal government simply "to promote maximum employment." Here we get the term maximum employment that later appears in the 1977 Act, not from the initial driving urge that motivated the legislation but from a compromise to get a watered down bill passed. In addition, two other goals besides employment were added that had not been contained in the original bill, clearly designed to constrain the emphasis on employment. The Federal government was also to promote "[maximum] production and purchasing power." The emphasis of the legislation was no longer on employment.

How was the Fed's mandate under the Employment Act of 1946 interpreted at the time? As Vice Chair Yellen indicates in her February 2013 AFL-CIO speech, the 1946 Act was directed at the Presidency and the executive branch more generally and was not explicitly directed at the Federal Reserve. However, at that time the Federal Reserve was still under de facto control of the Treasury, an arrangement that had carried over from the close collaboration on policy during the Depression and wartime. Consequently, for roughly the next 30 years, the 1946 Act was seen as having a guiding effect on Federal Reserve policy making. However, following the interpretation of the reduced emphasis on employment of the final legislation, the focus of the Fed during that time period was on a growing economy with price stability with attention paid to employment. Employment creation was not the focus of the Fed's responsibility – it was the economy and price stability.

Chairman Martin's View of the Employment Act of 1946: No Emphasis on Maximum Employment

This can be illustrated with an example of the interpretation given the Act during the Chairmanship of William McChesney Martin who served as Fed Chair from 1951 to 1970.

> "The major objectives guiding monetary policy are no different from those that guide fiscal policy. They are summed up in the Employment Act of 1946, as currently interpreted: to encourage a steadily-growing, actively and productively employed economy with reasonable price stability."

Chairman Martin's interpretation of the guiding language of the 1946 Act seems to point to a more modest role for the Fed with respect to employment, namely "to encourage a steadily growing and productively employed economy." The object of the Fed's actions was to be the economy and price stability. Martin never spoke of maximum employment but rather productively employed. There was no emphasis on a Fed responsibility for maximum employment.

This interpretation of the 1946 Act language of "maximum employment" by Fed Chairman Martin is very important because it remained the touchstone for interpreting Fed's responsibilities for employment until Congressional changes in Fed responsibilities in the mid 1970's.

Maximum Employment Not the Emphasis of Concurrent Resolution 133

The first change to the 1946 mandate came in 1975 with the House Concurrent Resolution 133, which was associated with a companion Senate Concurrent Resolution 18. Examining HCR 133 closely is important because it explicitly became the language for the Federal Reserve Act of 1977 that Yellen now cites.

The Senate resolution 18 is summarized as follows by the Congressional Research Service: "The Board of Governors of the Federal Reserve, and the Federal Open Market Committee is directed to: (1) take action in the first half of 1975 to increase the money supply in order to promote economic recovery; and (2) maintain growth of the money supply commensurate with production, in order to maximize employment and stabilize prices. Requires the Federal Reserve to consult with Congress at semiannual hearings before the Committees on Banking concerning its money supply growth targets and other monetary policy actions required in the upcoming six months." The main emphasis was on money supply and growth of the money supply.

The summary of HCR 133, indicates even more clearly that the major focus of the legislation was on the management of monetary aggregates and on long term interest rates and the growth of the economy. The summary does not mention any maximum employment focus.

HCR 133 expresses the sense of Congress that the Board of Governors of the Federal Reserve System and the Federal Open Market Committee: (1) pursue policies in the first half of 1975 so as to encourage lower long term interest rates and expansion in monetary and credit aggregates; and (2) maintain long run growth of monetary and credit aggregates.

The testimony provided to the Congressional committees in support of these concurrent resolutions also focused on the money supply elements. That was the major emphasis of the legislation at that time.

As indicated, an understanding of HCR 133 is important to the analysis because the language of HCR 133 ultimately became the centerpiece of the 1977 Federal Reserve Act, which Yellen refers to as "spelling out" the Fed's role on jobs.

The 1977 Federal Reserve Reform Act

The bulk of the 1977 Act dealt with operational and organizational matters of the Fed, not with unemployment issues. The intent of the act was not to increase the Fed role in creating employment, as Yellen seems to suggest in the AFL-CIO speech. Rather, as enacted, the 1977 Act was merely a reaffirmation of HCR 133 that had been passed just two years before, which had been interpreted by the Congressional Research Service and those providing testimony as emphasizing interest rates and money aggregates. There is no "spelling out of Fed duties" with regard to a special role on unemployment, as Yellen suggests in her AFL-CIO speech.

The legislative history reveals the Congress' continuing uneasiness with creating a Fed responsibility for employment. As originally introduced, the 1977 Federal Reserve Reform Act bill went back to the language similar the "Full Employment Act of 1945" and listed the objectives of Fed monetary policy as follows:

"(a) The formulation and implementation of monetary policy under this Act shall be governed by the national policy to promote maximum employment, production, and price stability."

Again we see the charge to the Fed to "promote maximum employment," the formulation that had been defeated in 1946. If this bill as originally worded had passed and monetary policy was to be "governed by a national policy to promote maximum employment", then this surely would have been a new direction for Fed policy. And if the original language had been allowed to stand, it might give support to the Yellen interpretation of the 1977 Act as "spelling out a Fed responsibility for maximum employment." However, the language was changed and the charge on unemployment was again watered down as had happened in 1946. The specific reasons for that language change are helpful not only to our assessment of Yellen's assertion that duties were "spelled out" but also in understanding the Congress' intent in 1977 with respect to the Fed responsibilities for employment.

No Maximum Employment Emphasis in the 1977 Act

The introduced bill's wording of "promoting maximum employment" was objected to by many in the Congress because it would indeed have meant a major change in monetary policy and would have been a significant departure from House Concurrent Resolution 133, which as indicated had been settled only two years before. These objections gave rise to a proposal to amend the original wording of the 1977 Act by Congressman John Rousselot (R-CA) to simply conform the language in the Bill to the 'Senate passed version of House Concurrent Resolution 133', which put the emphasis on monetary aggregates.

Under the change proposed by Rousselot, Fed monetary policy would continue to focus on "maintaining the long-run growth of monetary and credit aggregates commensurate with the economy's long-run potential to increase production so as to promote effectively the goals of maximum employment, stable prices, and moderate long-term interest rates."

It is important to note that this re-adoption of HCR 133 was a significant modification of the introduced language of the 1977 Act, demonstrating a clear intent of Congress to reject the idea in the introduced bill of making the Fed and monetary policy responsible for "promoting employment." With the language proposed by Rousselot, no longer was the 1977 Act to stand for "a monetary policy governed by a policy to promote maximum employment." The focus would remain on the economy and monetary aggregates, just as it had been under Chairman Martin and the 1946 Act as well as under HCR 133.Again, there is no indication of a Congressional intent in 1977 of any "spelling out" of a new jobs responsibility for the Fed as Yellen suggests in citing the 1977 Act.

To the contrary, the legislative record of the 1977 Act provides evidence that the Congress had a specific and more limited concern in mind regarding the inclusion of maximum employment. There is testimony in the Hearings from the Bill's sponsor, Congressman Henry Reuss, then the Chairman of House Banking Committee, that his objective in including the "maximum employment" language was to prevent the Federal Reserve from following the policies of what Reuss referred to as the "new Metternichs." Metternich was a reference to the early 19th century Prime Minister of Austria, and was intended by

Reuss' as a criticism of what he considered the excessively hawkish European central bankers of the 1970's —who, as the legislative record indicates, Reuss believed were using overly strict monetary policy in such a way as to actually cause an increase in unemployment. In other words, from the perspective of Chairman Reuss, the sponsor of the bill, the intent behind the 1977 Act as it related to employment was not to create a Fed responsibility to use monetary policy to actively promote maximum employment. Rather, the intent was to discourage the use of overly restrictive monetary policy in such ways that would have the effect of increasing unemployment. This is a subtle but importantly different interpretation from that given the 1977 Act by Vice Chair Yellen who has asserted that the Act "spelled out" a responsibility for maximum employment, and who finds in that 1977 Act a Congressional intent to provide a shared role with organized labor and make the Fed the only agency in government responsible for maximum employment.

Explicit Recognition of Price Stability

In fact, the interpretation proposed in this analysis is supported by other historical accounts that indicate that the Congress was mainly focused on inflation and price stability in the 1977 Act. In a brief "History of the Federal Reserve" written by researchers at the San Francisco Federal Reserve Bank, the 1977 Act is cited as being noteworthy for setting forth the first explicit recognition of price stability as a national policy goal for the first time. "The Federal Reserve Reform Act of 1977 was enacted during a period of surging inflation. It explicitly set price stability as a national policy goal for the first time."

Surging inflation and price stability were considered the focus of the legislation. We submit that the historical background and language of the 1977 Act, when viewed in the proper light, then does not support a "spelled out" intent of Congress to make the Fed the agency of government responsible for creating jobs.

Conclusion

Based on this brief analysis of the historical and legislative backdrop of the 1977 Act, Yellen's assertions in the speech to the AFL/CIO (that the Fed has a similar responsibility to organized labor for maximum employment and is the only governmental agency with such responsibility) are of dubious warrant.

In our view, Yellen was closer to stating the case accurately in her statements in the January 1995 FOMC meeting, that the 1977 legislation itself is "pretty vague." The legislative history of that and preceding Congressional initiatives does not place the heavy emphasis on unemployment as a responsibility of the Fed, as Vice Chair Yellen indicated in her speech to the AFL-CIO. This, we would submit, is the reason for the unease with her candidacy.

In another 1995 FOMC meeting, Yellen articulated a seemingly different perspective on her monetary policy priorities:

> "Let me begin by saying that there is a great deal about this bill [the Economic Growth and Price Stability Act of 1995] that I can endorse. I think the focus on price stability as the single appropriate long-term goal of the FOMC is correct… I like the idea that we should be asked to define price stability and report to Congress on how we intend to achieve it. I like the bill's recognition of the fact that the attainment of price stability is not costless in terms of

> transitional losses in output and employment, and I like the fact that it explicitly directs us to take these losses into account in the transition period."

Yellen's description in 1995 of a Fed responsibility for taking "transitional employment losses into account" with "price stability as the single appropriate goal" seems quite different from the current Fed role she describes in her AFL-CIO speech of the Fed "pursuing a goal it shares with the labor movement: maximum employment." Perhaps Vice-Chairman Yellen could satisfy her critics and dispel the unease with a reconciliation of her views and a balancing clarification of her assertions before the AFL-CIO this past February.

Further reading:

* Full Employment Act of 1945, Hearings before the House Committee on Expenditures in Executive Departments, Sept.-Oct.- Nov.1945; catalog.hathitrust.org;

* Federal Reserve Reform Act of 1977, Hearings before the House Committee on Banking, Finance and Urban Affairs, CIS 1977-07-18; Y4.B22/1:F31/53; Also on fraser.stlouisfed.org

* FOMC transcripts for January 31, 1995/February 1, 1995 and September 26, 1995, available on the website of the Board of Governors of the Federal Reserve System

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