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MONETARY POLICY AND THE STATE OF THE ECONOMY, PART II

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BEFORE THE

COMMITTEE ON FINANCIAL SERVICES
U.S. HOUSE OF REPRESENTATIVES

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CONTENTS

	Page
Hearing held on:	
February 16, 2007	1
Appendix:	
February 16, 2007	51

WITNESSES

FRIDAY, FEBRUARY 16, 2007

Bernstein, Jared, Senior Economist, Economic Policy Institute, Washington, D.C.	6
Blackwell, Ron, Chief Economist, American Federation of Labor and Congress of Industrial Organizations (AFL–CIO)	8
Blank, Rebecca M., Gerald R. Ford School of Public Policy, University of Michigan	11
Grant, James, Editor, GRANT'S Interest Rate Observer	14

APPENDIX

Prepared statements:	
Bernstein, Jared	52
Blackwell, Ron	68
Blank, Rebecca M.	74
Grant, James	00

ADDITIONAL MATERIAL SUBMITTED FOR THE RECORD

Hon. Barney Frank:	
New York Times article by Bob Herbert, dated 1/22/07, "Your MasterCard or Your Life"	95

MONETARY POLICY AND THE STATE OF THE ECONOMY, PART II

Friday, February 16, 2007

U.S. HOUSE OF REPRESENTATIVES,
COMMITTEE ON FINANCIAL SERVICES,
Washington, D.C.

The committee met, pursuant to notice, at 10:03 a.m., in room 2175, Rayburn House Office Building, Hon. Barney Frank [chairman of the committee] presiding.

Present: Representatives Frank, Maloney, Watt, Moore of Kansas, McCarthy, Lynch, Scott, Green, Cleaver, Sires, Hodes, Ellison, Klein, Wilson; Bachus, Lucas, Paul, Gillmor, Jones, Capito, Neugebauer, Putnam, Blackburn, and Roskam.

The CHAIRMAN. Today's hearing of the Committee on Financial Services will come to order. Would members of the staff please close the doors? This is a continuation of a hearing on Monetary Policy and the State of the Economy, and today we have a panel of four economists. Three were selected by the majority, one by the minority, and we think they represent a good panel of people to express their views on the subjects that are covered in the Monetary Report that are covered in the Humphrey-Hawkins bill that are before us today.

The key issue, I believe, before the country economically is how to continue and perhaps improve on economic growth in a manner that more fairly distributes the proceeds of that growth. No serious individual is trying to do away with inequality. Inequality is a driver of the capitalist economy, and it serves us well. But too much inequality can become socially problematic, it can become economically problematic, and it can become politically problematic. And the task I believe, for us, is not to do away with inequality, as I said, but to try to have public policies that contain it so that there is enough inequality to provide the incentives that the system needs to be productive, but not so much as to become socially, economically, and politically counterproductive.

Now politically, it is clearly counterproductive now. Whether or not it is socially, and whether or not it will become so economically, remains to seen. I would note that the Federal Reserve Chairman and others have cited the great strength of consumer spending as we go forward in the economy, but a number of people, including, I believe, the gentleman from Connecticut, Mr. Shays, yesterday raised a kind of paradox, which is that consumers are being told two things: One, to consume; and two, to save. And you cannot consume and save the same dollar, at least not legally. So the issue then becomes do the consumers have enough to do both? And that's

the economic problem. You can reach a point where there is simply not enough money going to the great bulk of citizens for them to do both. And it does appear right now that consumption is being maintained, but to some extent at the expense of savings. I've had friends in the financial community who are concerned about the low savings rate in America, the negative savings rate in some cases, saying to me, "Don't you think we need to do things to help the average citizen save more?" My answer is yes, begin by letting him or her have more money. For people who have run out of money by the end of the month, there is no incentive in the world that is going to get them to save. They cannot save what they do not have, and I think that is the problem.

And, of course, it is also the case that Henry Ford, when he decided to pay the workers $5 a day and was chided by some of his fellow industrialists for profligacy, made the very sensible statement that if he didn't pay them, they couldn't buy the cars. You can't have a mass production economy without mass consumption. And he, although he was a raving anti-semitic lunatic in other contexts, he was a pretty good economist as well as obviously a great industrialist, showing that intelligence does not necessarily jump from area to area.

But that's the dilemma we have, and I do think it is clear that certainly politically we have reached a point where excessive inequality has become a cause of political gridlock, not just in America, but elsewhere. You see it in Latin America with the increasing success of some politicians winning elections who many in America disagree with. And I must say I think it is far healthier to have elected officials like Lula and Kirshner than Morales and Chavez, but we are, I think, undercutting the responsible democratic left.

In America, it is clear to me that as trade promotion expansion, trade promotion authority expires, it will not be renewed in the current context. A Doha Round is unlikely probably because of resistance from many of my colleagues in the areas that represent agriculture, agriculture apparently being an exception in the minds of many of my conservative friends to all the doctrines of free enterprise and little government that they otherwise support.

But apparently Von Mises has a footnote that says that none of this applies to agriculture. It's apparently written in German, so I couldn't understand it, but my colleagues from the agricultural area apparently all seem to understand it.

But if they got a Doha Round, I don't think it would pass the House. We are bringing out a bill from this committee on foreign investment, direct foreign investment, which is clearly in the interest of the United States and of our workers. It is more controversial than it ought to be, because there is this fear on the part of the average American that foreign economic activity somehow will undercut them. I think it is wrong in this case, but it is not wrong in general. So that is the subject that I hope we will be able to address. I think all of us want to see growth go forward.

And I will just close by saying I was troubled by what seemed to me some bias that had crept in—well, not crept in, that is present in the Federal Reserve's approach, where in the Federal Reserve Monetary Report they say three things. One, production in America is now below capacity, will remain below capacity for sev-

eral quarters, and is expected to reach capacity, not to go above it. Two, inflation appears to be diminishing. Three, therefore, our major concern is inflation.

That does not compute. That bespeaks a bias, and while I do not believe—I think we've gotten proof that growth alone is not a sufficient basis for the kind of economy we want, it certainly is a necessary one. So as bad as things are when growth is not fairly shared, they would be worse if growth is diminished. And that is the set of problems we have today.

And I believe now I will turn to the gentleman from Texas, the ranking member of the subcommittee, for his time.

Dr. PAUL. Thank you, Mr. Chairman. I want to thank you for holding these hearings, and I am very pleased that you do have an interest in monetary policy, because over the years, I have emphasized monetary policy as being very important. I think it's frequently neglected.

There was a time that the Humphrey-Hawkins type of hearings that we've had semi-annually emphasized the issue of money growth and how this affected the economy. That is no longer the case; as a matter of fact, it's been de-emphasized. The Federal Reserve no longer even reports M3, as if total money supply has no importance, and yet there are some who think it still is important, even though most of us recognize that measuring money in this age of global financing has become more difficult.

Most of the time when we, in the Congress, and other economists talk about the Federal Reserve, they talk about the fixing of interest rates on the overnight rate and its influence. Generally speaking, they're dealing with central economic planning rather than dealing with the currency itself. I like to think more that the role of the Federal Reserve ought to be to guarantee that we have a stable value of the dollar rather than concentrating on prices. Because if we have a dollar that falls in value, and prices go up and you concentrate on the prices, then the policies are directed toward rising prices and not to the cause of the inflation, which happens to be the inflation of the dollars themselves.

The other thing that has always concerned me over the years has been the neglect in emphasizing that there are other things that occur when a central bank increases the supply of money. Not only might it lead to higher prices—the one thing is, you don't know exactly which prices will go up. Sometimes they're in the financial markets and sometimes they're in the asset markets.

But there also tends to be a neglect of some other consequences of what the Federal Reserve does. For instance, even if prices happen to be relatively stable because of increased productivity, generally, everybody is reassured. Well, there's no inflation. And they fail to recognize that there are other consequences of Federal Reserve monetary policy such as the misdirected investment, the malinvestment, the accumulation of debt, and the formation of bubbles. And if we look at our history, we know something about bubbles. We know about NASDAQ bubbles. We know about housing bubbles and the various different portions of the economy that will get out of control.

So, I am very pleased that we are having these hearings with this emphasis on Federal Reserve and monetary policy, and also

the important issue that we have been dealing with more recently, that of transparency of the Federal Reserve. And though there have been some new items introduced, like the release of the minutes, and we know a little bit more a little faster about the Federal Reserve, what's going on, we still don't know the details of international transactions, the international conversations and what type of agreements there might be with central banks, which I think are very important.

These are the kinds of things that I hope we can move forward and for which Congress will assume more responsibility. It is the Congress that is responsible, and I think we have been derelict in many ways of delivering so much of this responsibility to the Federal Reserve, and in many ways, the Congress, as it has in other areas in recent years, has not had adequate oversight, so I like the idea that we will have more oversight.

I have had concerns about the President's working group on financial markets, and not too many people talk about it or know about it, and quite frankly, even as a member of the Banking Committee, I wish I knew more about it. I haven't been getting information, and to me, that is rather significant if there is a group. We know the group exists, we know they meet, but we don't know what they do, and I'm hoping I get cooperation on the committee so we can find out more about how they do and what their plans are and what their intents are. That to me, is very important.

So, with that in mind, more transparency and more concentration on the value of our money and how it affects the distribution of wealth in this country, there is a saying that goes when you inflate a currency, there is a redistribution of wealth and it leaves the poor and the middle class and goes to the wealthy, and there are some statistics that point this out. And that's one of the reasons the working class can't keep up, because they suffer more from the inflation.

And with that, I yield back to the chairman.

The CHAIRMAN. The Chair apologizes. The gentleman has concluded. The gentleman from North Carolina, then we'll go to the gentleman from Illinois.

Mr. WATT. Thank you, Mr. Chairman. I'll be brief, although I wouldn't bet you that it would be the 1 minute that I told you it would be. I'm not betting, but I'm going to try to stay within that minute.

The CHAIRMAN. 10 seconds gone.

Mr. WATT. I walked into the discussion when the Chair was talking about Chairman Bernanke's statement that we wanted to both increase savings and increase consumption at the same time and how that may be difficult to do or impossible to do. I'm wondering whether, in the course of this discussion today, somebody can address the concern I have that there probably is actually a negative savings going on that's feeding this consumption in the sense that my sense is that most of the consumption that's taking place with a number of my constituents is taking place with borrowed money. It's not coming at the expense of savings, it's coming at the expense of negative savings, because people are borrowing money to consume. And it would be helpful in this discussion today to see how

this massive increase in personal debt that we are observing plays into this whole equation that we're discussing for the last 2 days.

And with that, I'll yield back.

The CHAIRMAN. I thank the gentleman. Since he did leave us some time, I would ask him to yield for the purposes just of saying, and he reminded me to do something. Bob Herbert of the New York Times did a very good column a while ago about the extent to which credit card debt and bankruptcies based on credit card debt have in some cases resulted from the need to pay medical bills by people who had no other alternative. And I would ask that the article which references a broader study be made a part of the record, because that's exactly the problem the gentleman was talking about, and it clearly is directly relevant here.

Mr. WATT. Just to reclaim my time for a second. That's part of it, but that's at least a mandatory expenditure when you're talking about medical expenditures. A lot of what I'm talking about is discretionary expenditures, which is not in an emergency medical situation of that kind. I just think people are putting more and more and more debt onto credit cards at the expense of savings of any kind, really getting further and further into a negative savings situation.

The CHAIRMAN. The gentleman is correct. The gentleman from Illinois.

Mr. ROSKAM. Thank you, Mr. Chairman. I just want to thank you for holding these hearings and really setting the tone in terms of a macro level. I think you made a very interesting point about sort of the orthodoxy of the free market. I ran into that in the Illinois legislature where we would all sort of worship at the altar of local control until our ox was being gored, and then suddenly we would all sort of manipulate things around.

But I think yesterday we heard some very interesting news, and I think encouraging news from Chairman Bernanke, and that is that the economy is strong, and I just want to point out a couple of those elements and then speak directly to what I think are some of the challenges that we face.

3.4 percent growth in 2006 with 7.5 million new jobs created since 2003, no small task. Unemployment is low comparatively, 4.6 percent in 2006. Inflation is under control. It fell from 3.4 percent in 2005 to 2.5 percent in 2006. And our productivity is up by 2.2 percent, and of course we've all been reading about how the stock market is exceedingly strong.

But there are still some challenges that are out there. We heard them yesterday a little bit, and that was a discussion or allusions at least to long-term entitlement costs and devising new ways to train dislocated workers and workers who are coming into the workforce.

I think it's important as we begin these conversations to realize that all of us on this committee, and I think all of us in Congress, agree that it's essential to help those in the lower wage portions of the economy to improve their earning power, but I don't think some of the rhetoric that has bubbled over characterizing all of these positions as merely Wal-Mart jobs or low skill jobs is accurate. In fact, Chairman Bernanke said yesterday, "There certainly

has been job creation at the high level as well as throughout the distribution of wages."

And at that, higher wage jobs, the problem is often that there's not enough skilled workers to fill that demand. And I agree with him. I have run into this problem in terms of interacting with manufacturers in my district, which is the west and northwest suburbs of Chicago, who are having a very difficult time filling competitive slots based on training levels.

So it's my hope that this will turn into a frank and positive discussion and that we avoid can some of the pitfalls that sometimes come up in economic conversations. We need to find ways to create and promote economic growth, but in my view, protectionism doesn't work, can't work, and will ultimately hurt our economy. As I've interacted with manufacturers, particularly in my district, they've said, "Look, we don't need help from that point of view. We just need help being more competitive here and at home." And we've all heard and seen egregious examples of CEO compensation that's been reported in the news media, but I think we risk killing the goose that lays the golden eggs if we overly regulate in that area. I think we need to create greater transparency. Again, my experience in Illinois has run its economy down considerably, now ranking 46th out of 50 in job creation due to a high regulatory environment.

Mr. Chairman, our success has always been tied to an ever expanding wave of social and economic opportunity for citizens, and that's why I believe that our best solution involves finding new ways to empower our citizens. I look forward to hearing these witnesses and their testimony, and I yield back the balance of my time. Thank you.

The CHAIRMAN. I thank the gentleman, and we will now get to our panel of witnesses who are being called upon in alphabetical order so that no one reads significance into it. And the first witness is Dr. Jared Bernstein, who is director of the Living Standards Program, the Economic Policy Institute and has been a very, in my judgment, welcome contributor to the policy debates we've been having in recent years about this very set of topics.

Dr. Bernstein.

STATEMENT OF JARED BERNSTEIN, SENIOR ECONOMIST, ECONOMIC POLICY INSTITUTE, WASHINGTON, D.C.

Mr. BERNSTEIN. I thank Chairman Frank, Ranking Member Bachus, and the members of the committee for our opportunity to testify on the critical issue of the importance of full employment in today's economy.

In recent months, top policy officials and economic commentators have wondered why there seems to be more economic anxiety among working Americans than might be expected, given the low unemployment rate and solid macro economy.

While some officials remain puzzled by this apparent disconnect between macro performance and perceptions of economic wellbeing, a quick look at some relevant data suggests it should not be such a head scratcher. After rising at rates close to that of productivity over the latter 1990's, the real wage of the typical worker, the median wage, flattened in real terms, as did the average real wage

of high school and even college graduates. After rising along with productivity growth over the latter 1990's, the real median income of working age families fell 5 percent or $3,000 since 2000.

In fact, the latter 1990's were anomalous. For most of the past 3 decades, real middle wage and income growth has occurred at a pace far below that of productivity growth. The economist's mantra, rising productivity growth boosts living standards, now begs the question: Just whose living standards are being lifted?

Two of the main reasons for the evolution of this productivity income gap are the absence of full employment and the loss of worker bargaining power. My key points today are truly tight labor markets are critically important for middle income working families. In a labor market that lacks the institutions and the norms to provide workers with some bargaining power in a global economy where those whose access to power and assets gives them a huge upper hand in the distribution of wealth, the predictable outcome is precisely the surge in inequality we've seen over the past few decades. In this context, full employment is one of the few reliable sources of bargaining power available to the American worker today.

Now one reason for this imbalance has been the allegiance to a "natural rate" theory of unemployment. Despite little evidence to support its contemporary use, this theory has led policymakers to give greater weight to inflation relative to unemployment concerns, and this has been partly responsible for years of unnecessary slack in the labor market. Economic elites have been operating from a playbook with an inherent bias against broadly shared prosperity.

Now the views of many economists and the policymakers who still heed their advice are driven by the belief that there is this so-called "natural rate" of unemployment, the rate below which inflation would not merely rise, it would continually accelerate until unemployment went back up to the so-called "natural rate." The Congressional Budget Office currently sets this rate to be 5 percent.

Like many other economists today, I consider this concept to be a poor guidepost for policymakers. Events have overtaken the original model, and the evidence I present below suggests that subscribing to the model risks persistent and unnecessary slack in the economy, wasting billions of dollars, and consigning millions of potential workers to fewer job opportunities and lower wages than should be the case.

We're not denying that a relationship between unemployment and inflation exists. We do, however, deny that policymakers can effectively identify the so-called "natural rate" and that unemployment below that rate leads to spiraling inflation. To the contrary, I provide evidence that when unemployment has fallen below the natural rate, middle-income families have prospered and vice versa. Tight labor markets are a critically important ingredient to a balanced economy where the benefits of growth are broadly shared.

Let me take a few moments to clarify these claims. First, the unemployment rate has been below 5 percent for over a year. Are we not currently at or at least close to full employment? And second, given that we're below this alleged natural rate that I claim looms large in economists' thinking, why has the Federal Reserve not raised interest rates since last June?

On the first point, while the current job market is relatively tight and a lot tighter than it was for the first few years of this recovery, our workforce has not enjoyed a sustained period of full employment in this business cycle, and the result has been the absence of broadly shared economic gains.

Second, while concerns about tight job markets generating wage push inflation are of course evident in their statements and speeches, the actions of neither the later years of the Greenspan Fed nor the Bernanke Fed appeared to be dominated by concerns about the natural rate. And to their credit, both men have consistently practiced a more nuanced version of monetary policy than would be the case if they were bound by the belief that unemployment below 5 percent would automatically lead to spiraling wage growth.

Allow me to demonstrate the points I'm trying to make here with a table that I handed out to all the members on the committee. They contrast two periods with very different outcomes for the median family. They are also two periods where the goals of macroeconomic policy were quite different.

Using historical estimates of this natural rate, we can determine when the actual unemployment rate was above or below the supposed floor in the job market. In truly full employment periods, the unemployment rate will be below the natural rate and vice versa. Between 1949 and 1973, as the table that I handed out shows, the unemployment rate was often below the natural rate, cumulatively 19 percentage points. This happens to be about the same number of points that unemployment was above the natural rate in the latter period. Not only was middle income growth much higher in the period when we were often below the natural rate, but inflation was lower as well.

Clearly, from the perspective of middle class incomes, and especially for minority families, for whom full employment has consistently made a huge and positive difference, tight labor markets, even below the supposed natural rate were associated with much better income growth.

Thank you.

[The prepared statement of Mr. Bernstein can be found on page 52 of the appendix.]

The CHAIRMAN. Thank you. Next, sticking with my alphabetical order, which the gentleman from Alabama is helping me master, we will hear from Mr. Ron Blackwell, who is the chief economist for the AFL–CIO.

Mr. Blackwell.

STATEMENT OF RON BLACKWELL, CHIEF ECONOMIST, AMERICAN FEDERATION OF LABOR AND CONGRESS OF INDUSTRIAL ORGANIZATIONS (AFL–CIO)

Mr. BLACKWELL. Thank you, Chairman Frank, Ranking Member Bachus, and other members of the committee for the opportunity to be here and to testify on behalf of the 10 million members of the AFL–CIO and its affiliated unions on the economy and the conduct of monetary policy.

I should begin by acknowledging that I happen to sit on the board of the Baltimore branch of the Richmond Federal Reserve Bank, but I'm appearing here today exclusively as a representative

of the AFL–CIO, and nothing I say is intended to express the thinking of either the Richmond Bank or the Board of Governors.

The CHAIRMAN. Unfortunately.

Mr. BLACKWELL. Our view of monetary policy, like our view of economic policy in general, proceeds from a single important central fact of our times, which is that in the richest country in the history of the planet, it's increasingly difficult for people to make a living by working.

We have a $13 trillion a year economy, and it's growing at over 3 percent a year, while real family incomes have stagnated. The rupture between productivity and wages that Dr. Bernstein mentioned is one of the signal facts of our time. I think I understand the diagram that you're looking at.

If you look at the early period of the post-war period, the period when the middle class was built, we had very rapid economic growth, over 5 percent a year. Rapid productivity growth and real wage growth tracked productivity step for step. That was the most rapid increase of living standards not only in the United States' history but in world history.

But the period after that is very different. Today, we believe that 3 percent is a very rapid pace of economic growth. Productivity growth is growing today very strongly, at least since 1995, but wages have been stagnant. The increase in productivity since 1973 is something like 67 percent, contrasted with 100 percent increase in the earlier period. But real wages have increased by 8 percent, 8 percent compared to 67 percent.

The only reason—and family incomes have gone up by something like 15 percent. But the only reason they've gone up is because each worker is working more hours per job. Each worker is working more jobs on average. And most importantly, each family is sending more of its members to work, placing enormous strains on the working family.

And of course, there's the borrowing of money against rising housing prices, first and foremost, but in general, rising indebtedness of households as they try to maintain living standards in a stagnating environment.

Moreover, economic insecurity is on the increase, as the chances of a working family losing 20 percent of its income in any 2-year period have doubled since 1980. And with 46 million people with no health insurance in this country, despite the fact that we spend more per capita on healthcare than any country in history, and with the shift by employers from defined benefit to defined contribution plans, which it's estimated by Ed Wolfe at NYU, has basically left older Americans aged 55 to 60 with lower net worth than their parents had, despite all the increases in wealth over the past generation.

So we basically have a situation where workers are struggling to make a living in the midst of the most prosperous country in the history of the world. And this is what—the stagnation of wages and the rupture between productivity and wages, which used to be the standard of fairness in our country, is one of the things that's driving inequality. Today the United States has the most unequal distribution of income and wealth in the developed world, and we're

more unequally developed today in terms of income and wealth than we have been since the 1920's, and we're headed backwards.

There are many causes for this stagnation of wages and the growing inequality, but I think we have to rethink our country's economic policy if we're going to be able to respond to this and allow our country to grow together again instead of growing apart economically, politically and socially.

The core issue, and Dr. Bernstein mentioned this, but I want to stress it, these various policies have shifted the balance of bargaining power from working people, whether they're in a union or not, to their employers. And the employers are using this increased relative bargaining power to reduce wages, keep productivity gains for themselves in the form of higher profits, shareholder pay, CEO pay, but also to walk away from their responsibilities for healthcare provision for their employees and for the retirement security of their employees.

And the solution to this, I mean, the guiding thread of economic policy from our point of view is that we have to enact economic policies that rebalance power between working people and the people for whom they work. And in doing so, it's not against these employers. We need great American companies led by far-sighted business leaders, and we understand the increased competitive pressure they're under from globalization and other forces. But we do have to find a way in this new global economy to balance this power between working people and their employers.

We proceed on economic policy and monetary policy from the point of view of the values of American working people, and four of those, in particular, are very important to mention.

The first one is that anybody in this country who wants to work should have a job. It's a terrible thing when people are left, as a matter of government policy, unemployed, as we currently do millions of people, unemployed, looking for a job, and unable to find one because of our policy of controlling inflation.

Second, if anybody does work in this country, their family shouldn't be living in poverty. And their family members, especially their children, should have access to healthcare, and they should have some reasonable hope that at some point in their working life they could stop working and live a dignified retirement.

Third, if they want to associate with their brothers and sisters at work and form a union, they should be able to.

And fourth, in conclusion, we know we live in a global economy, but American workers want to have a strong American economy, one that pulls its weight in the world and that is internationally competitive. The fact that we're borrowing 6 percent of our GDP to consume things that we no longer produce is a problem from the point of view of the sustainability of our country's competitiveness, and it's a problem for American working families.

But in this context, the very foundation of economic policy is the first value. If someone wants to work in this country and improve their living standards and that of their family through their own efforts, the government should assure that they have a job to occupy. This was recognized in 1946 in the Employment Act, and in 1978 in the Humphrey-Hawkins Act. But the conduct of monetary policy since that time has narrowed the dual mandate of the Fed-

eral Reserve to maximize employment on the one hand, maintain price stability on the other. That is has been effectively narrowed because of this NAIRU concept, on to inflation fighting. Hence, the irony that you were noting, Mr. Chairman, about the fact that inflation is still our biggest concern even though there's no sign of it anywhere.

I want to recommend shortly, briefly in closing that instead of narrowing the mandate of the Federal Reserve, we need to broaden and bring up to date that mandate. We currently have an economy, as mentioned by Mr. Bernanke as a strong economy. The current recovery is the weakest in terms of job creation of any recovery since the Second World War. And wages and productivity are still dividing. It's higher now than it was when the recession began. Our employment population is lower. We need to broaden it to include a genuine full employment and establish full employment as the foundation of our economic policy.

Thank you very much.

[The prepared statement of Mr. Blackwell can be found on page 68 of the appendix.]

The CHAIRMAN. Thank you. Next is Dr. Rebecca Blank, who is the Joan and Sanford Weill Dean of the Gerald R. Ford School of Public Policy at the University of Michigan, and I assume by the time you go back, they will have found someone to name the State of Michigan after so that they can maximize the deference that we pay.

Dr. Blank.

STATEMENT OF REBECCA M. BLANK, GERALD R. FORD SCHOOL OF PUBLIC POLICY, UNIVERSITY OF MICHIGAN

Ms. BLANK. Thank you, Chairman Frank, Ranking Member Bachus, and the distinguished members of the committee. I'm delighted to be here this morning. I want to give you just a few facts about life for low-skilled workers in America. I want to say something about the implications of rising inequality and then close with a very, very brief discussion of the policy implications.

It has always been clear that the most important policy to assist less-skilled workers is a healthy macroeconomy with strong job growth. There has historically been a strong positive correlation between unemployment rates and poverty rates. When unemployment rises, so does poverty. It is worth noting that inflation actually has little correlation with poverty among non-elderly adults. At the bottom of the income distribution, keeping employment high is significantly more important than keeping inflation low.

A primary reason why unemployment and poverty are strongly correlated is that unemployment tends to be concentrated among less-skilled and lower-wage workers. If you look at the trends in unemployment by skill over the past 25 years, three points become very quickly apparent. One, unemployment rates are substantially higher among less-skilled workers than more-skilled workers. Two, unemployment is much more cyclical among less-skilled workers. When jobs become scarce, those who lose their jobs first are those who are lower wage. Three, while overall unemployment rates do remain quite low at present, the unemployment rates among less-

skilled workers still are relatively high, higher than they were, for instance, at this point in time in the expansion of the 1990's.

Unemployment rates of course are only an imperfect indicator of what's going on in the labor market, and many people also look at labor force participation rates. Trends in labor force participation rates show a very interesting divergence by gender. Labor force participation rates among less-skilled men have been falling steadily, even through the rapid economic expansion of the 1990's, while they've been rising among less-skilled women. I might note those falls in labor force participation among less-skilled men are particularly strong among African American men in communities of color.

It's important to understand why labor force participation among less-skilled women is going up, while it's going down among men. Part of the answer is microeconomic policy, which, I realize, is not the jurisdiction of this committee. There have been changes in terms of welfare reform, in terms of expansion in the earned income tax credit, in child care subsidies, and in Medicaid that have made work more attractive, particularly for less-skilled women.

But policy changes at the micro level are only one part of the story. Macroeconomic shifts in demand are also very important. And the changes in relative wages that both of the previous speakers have referred to are a major reason for declining labor force participation among less-skilled men. Calculations of inflation-adjusted median weekly wages indicate that women who are high school dropouts have seen their weekly wages rise by 14 percent over the last 15 years. Men who are high school dropouts have basically seen no change whatsoever in their wages.

In short, as wages have changed in this economy, both less-skilled men and women have fallen further behind their more-skilled brothers and sisters. The job market has simply gotten tougher for less-skilled workers. But other changes among women, growing work experience, changes in policy, and greater returns to experience have offset these problems and led to somewhat greater wage increases and hence greater workforce participation.

And as others also have noted, this rising inequality of wages also reflects itself in rising inequality in household incomes. Some of that has been offset by the fact that more people are working, and working harder, so rises in household inequality are not quite as great as rises in wage inequality.

So why should we care about rising inequality? I think there are at least three reasons. First, there's a sense of economic deprivation among lower-income families as they watch others move further ahead. Tuition for higher education is increasing faster than inflation. Housing and rents in many areas are going up faster than inflation. Healthcare is almost impossible to purchase if you don't get it through your employer. Lower-wage workers in today's economy are finding it harder to achieve those things that are part of the American Dream: a house; a job with pension and health benefits; and the opportunity to send their children to college.

Second, economic inequality is linked with other types of social inequality. Health disparities between more- and less-skilled workers have risen. Differences in educational achievement between the best and the worst students have risen. These social inequalities

only reinforce economic inequality, and most troublesome, they limit opportunities for the children of today's lower-wage workers. Quite a bit of evidence now suggests that economic mobility is greater in many European countries than it is in the United States.

Third, economic inequality and a sense of relative deprivation have negative effects on the civic and the political realm. The economic experiences of the past 2 decades are simply different for those with a college education as opposed to those with a high school education. Fear of technological change and growing economic internationalization is fueling a backlash that will lead to bad policies that limit future economic growth. Public discussions of Social Security reform or health insurance are simply hard to hold when the bottom third of the population is going to retire only on Social Security and Medicare, while the top third has extensive market investments and long-term supplemental health insurance through their employer.

In short, economic inequality makes it harder to solve our common problems, and harder to evoke a sense of common purpose and experience. This is not only inconvenient for politicians, it threatens the civic nature of public debate in a democracy.

What should we be thinking about on the policy front? Chairman Bernanke, in a recent speech, called for investments in education and training to moderate inequality, and he's absolutely right. In the long run, more Americans need more and better education. But by itself, that's not a complete strategy. Three additional policy emphases need to be considered.

First, we need a strong labor market with growing demand for workers at all skill levels. This means macroeconomic policies that promote stable economic growth and low unemployment among all.

Two, we need to maintain and expand our policies that subsidize work for the least skilled and that encourage adults to take and keep jobs. This committee, I know, is focused primarily on macroeconomic issues, but the answers to these questions will also include some more specific focused microeconomic policies, such as expansions in the earned income tax credit, a moderate minimum wage level at levels similar to where it's historically been set, and assurances that low-income families have healthcare available to them.

Third, and finally, it is important to think creatively about ways to make sure that all Americans benefit from the economic growth that is resulting from our recent economic changes. There are two ways to redistribute the benefits of these changes more broadly. First, we do redistribute some of it through the tax and transfer system through such things as the earned income tax credit or better healthcare. But secondly, we can assist those workers who are displaced by new technologies or by shifts in where goods and services are produced. Policies such as wage insurance, aimed at cushioning income losses for displaced workers, can help America's workers adjust to a changing economy.

Work is a good thing in the lives of adults. It produces income, a sense of self-value, and demonstrates that an individual has skills to contribute to the society. We should do all we can to encourage men and women to acquire the skills and work behavior that allows them to support themselves and their children, but we

should also do all we can to guarantee there are jobs available to those who work, and to ensure that those who demonstrate their ability and their willingness to work are able to support themselves and their families.

Thank you.

[The prepared statement of Ms. Blank can be found on page 74 of the appendix.]

The CHAIRMAN. And to introduce our final witness, the Chair recognizes the gentleman from Texas.

Dr. PAUL. Thank you, Mr. Chairman. I would like to welcome Mr. James Grant, who is a financial journalist and the editor and founder of the GRANT'S Interest Rate Observer. He's also written several books on finances as well as even been involved in writing history books. So I welcome Mr. Grant today.

Thank you.

STATEMENT OF JAMES GRANT, EDITOR, GRANT'S INTEREST RATE OBSERVER

Mr. GRANT. Thank you, Chairman Frank, Ranking Member Bachus, and distinguished members of the committee. The currency that the Federal Reserve sponsors is the greatest achievement in the history of money. It is a miracle. It is uncollateralized, and has been since 1971. Nothing tangible stands behind it. It is purely faith-based, and yet this piece of paper of no intrinsic value passes from hand to hand, and they're nice to have as well. And so 30 years have passed since Humphrey-Hawkins enjoined the Fed to promote full employment and to promote a sound dollar. Those 30 years have by and large passed the Federal Reserve by, it seems to me. The Federal Reserve is a financial institution of moderate size. Morgan Stanley's balance sheet is bigger than the Fed's. The Fed holds $850 billion or so of government securities. The foreign central banks together hold an admitted $1.6 trillion, and the Federal Reserve has one policy tool at its disposal, and that is to manipulate a single interest rate.

Now when Pope Julius II said to Michelangelo, "Go paint the Sistine Chapel," he did not say, "Here is your roller." And yet this blunt tool is what the Fed has. A roller, however, has never destroyed an industry nor stymied an economy, but the black art of price control is just that dangerous. The Fed essentially is in the business of price control. It is not so different than the late and unlamented Interstate Commerce Commission, nor the unreformed Texas Railroad Commission. It is in the business of picking a rate out of the air and imposing that rate on a market.

Now people acting in markets are not infallible, nor are people in bureaucracies always in error. But I think we have come to believe, all of us in economics and finance, that by and large, prices discovered are better than prices imposed. And yet the Fed imposes a price. The Fed is well-intentioned and smart, too—so many college-educated economists—but the rate that the Fed imposes is not always the rate we ought to have.

Consider, for example, the 1 percent rate the Fed gave us from mid-2003 through mid-2004. You'll recall at the time that the specter of deflation loomed over the American economy. So far as I could tell, that was a specter of every day low and lower prices.

However, Chairman Bernanke, and then-Chairman Greenspan, who had previously sung the praises of globalization and high productivity growth, now decided that those things, in fact, posed a distinct menace.

And to save us from a price level too low, an inflation too low, they went out and ordered the printing of more money. Chairman Bernanke was especially vivid in that mission, reminding us that the Fed could, if it wished, drop dollar bills from aircraft, which I gather the Fed has done in Baghdad. But this was in the United States. So 1 percent was the rate for a full 12 months.

Not since the second Eisenhower Administration had anything like that been seen. The result was a great rush of prosperity into residential mortgage finance and into housing. Housing for the next several years generated fully 40 percent of private sector employment growth. Everybody and his brother—you didn't have to apply for a loan any more. They came to you. And this was fine. It was good for the working man, it was good for the families. Home ownership, a great, an inherently great good, one hears, went up and up.

And now we no longer have a 1 percent interest rate. The Fed has decided that the market needs a 5.25 percent interest rate. In consequence, there is a small but significant and growing and financially worrisome problem with mortgage finance. The so-called "subprime" area of our mortgage market is in disarray.

Interest rates are the traffic signals of a market economy, and when they are all switched to green, there is bound to be confusion at the intersections and a certain number of pileups. We have talked about growth and opportunity. Everyone wants the same thing. The question is, can the Fed deliver those things through the manipulation of one rate? In 1978, the United States was the net creditor to the world. Today we're a massive net debtor. In 1978, most interest rates were manipulated by the Fed under a regulatory regime that went out the window in 1980. The world is so very different from 1978 that we ought to think about what the Fed can do and what it can't do and not ask too much of this body of mere mortal men and women.

Thank you.

[The prepared statement of Mr. Grant can be found on page 90 of the appendix.]

The CHAIRMAN. Thank you, Mr. Grant. I'm going to go, in the interest of reaching people who didn't get reached, right to the gentlewoman from New York. Does the gentlewoman have questions, or do you want to defer?

Mrs. MALONEY. Well, I was going to pull a report out of my BlackBerry. Maybe I should defer till I get this report out.

The CHAIRMAN. All right.

Mrs. MALONEY. But I'll just say what it is generally. It is a report from the United Nations that rates countries in the Western industrialized world, and we are rated very, very low, I think 37th, or 47th. Let me look it up.

The CHAIRMAN. All right.

Mrs. MALONEY. But I'll ask one question now. You mentioned about the dollar and how important that is. Well, could any of the economists comment on the dollar and the fact that the last time

I looked it was 16 silver dollars to the dollar. The euro was much, much higher. The value of the dollar is falling in terms of the global market, and what does that mean for us?

I do want to comment to Mr. Blackwell that I'm very, very pleased that you were appointed to the Federal Reserve. Your voice is refreshing on the need to make sure that our economy expands and grows for all of our citizens, and I thank you for that really heartfelt testimony that you gave.

But could the panelists comment on the dropping value of the dollar and what that means for our economy and for our people? And also, America doesn't make anything any more. We've lost 22 million manufacturing jobs. And when I look around my district, it used to be a manufacturing district, now it's a service district. Can our economy continue providing just services and without really making anything? Thank you all for your testimony, and I thank the chairman for holding this very important hearing.

Mr. BERNSTEIN. If I may make a response to your question about the dollar, earlier in our discussion, one of the members of the committee mentioned that manufacturers in their district said they, "need help being more competitive." I've heard that myself. I think dollar policy actually plays a role therein. If some of the other countries with whom we compete manipulate their currency so that the U.S. dollar stays high relative to the value of their currency, it is much more difficult for our exporters to compete. And this has been occurring with, I think, quite alarming results. We've lost 3 million manufacturing jobs since 2000, and the story you told, Representative, is not at all uncommon, particularly in States in the so-called rust belt.

Manufacturing is an integral part of our economy. The productivity provided by manufacturing—innovation, not to mention the quality jobs, are integral to a powerful, strong, innovative economy. So I think as part of the mandate of this discussion, this committee needs to look at dollar policy with that in mind.

Now it sounds bad to think about a weak dollar. Weakness sounds like something we don't want. And if the dollar is to fall too quickly, that could be inflationary, as others have mentioned. But an orderly decline in the dollar and a strong stance against those who manipulate their currency to boost their exports and hurt ours should be well within our mandate.

Ms. BLANK. I'd like to just say something about the loss of manufacturing jobs as well. I'm from Michigan, so I'm very well aware of some of the concerns here. It's not that we actually make a lot less. We make an amazing amount in this country of real goods, not just services, but we use a lot less labor in it because of the rise of productivity. And the result of that has been huge displacement of, particularly, middle-aged men who thought they were set for life in terms of a reasonably well-paying job, and have now lost those jobs.

We have done very little to cushion those sorts of economic changes, and the loss of income and the loss of employment that's happened inside families that have been affected by these manufacturing shifts. It has really been very devastating in some areas of the country. It's time to think seriously about some polices that don't permanently cushion these things, but that provide at least

some safety net that allows people to make transitions in their lives when they get faced with these types of major economic changes going on around them.

Mr. BLACKWELL. I also wanted to point out that we consume just as many things as a people that we've ever consumed, but we produce only about 70 percent of what we consume. The other part is purchased from offshore, and oftentimes and increasingly it's purchased offshore from American companies operating offshore.

Part of the reduction of employment in manufacturing is not due just to productivity growth, it's due to the outsourcing and the offshoring of manufacturing activities in U.S.-based companies. And an increasing, a large portion of that is in China, which is the country that is manipulating its exchange rates and is tying the exchange rates of all Asian competitors above what they would be if the market were operating.

I think this is a special area of concern of the Federal Reserve, and they need to be asked serious questions about the strong dollar policy that they have supported since 1995. This strong dollar policy is making it more and more difficult to have meaningful, productive activity here in the United States.

When I mentioned before that we have an unsustainable borrowing and unsustainable $3 billion a day to pay for the things that we consume that we don't produce, nobody believes this is sustainable. We've got to find a way to produce a competitive U.S. economy that will require a lower dollar.

Mr. GRANT. Since the late 1990's, the price of gold in terms of dollars has gone up a great deal. Gold is a more or less stable source of purchasing power. Time was when $295 or so bought an ounce. Now it's $670. I don't think the dollar policy we have is strong, but I think we are hugely vulnerable with regard to the dollar.

This is a world of paper currencies, and there is something very fragile about it. These currencies owe their legitimacy to governments and their quoted value to speculators. Think about it. The U.S. dollar is the global brand name par excellence—nothing like it. Which, however, puts us at enormous risk for the portfolio preferences of the world at large. You know, we issue six—I don't know, 800 billion or so greenbacks a year into the world payment stream. These dollars are absorbed not by private investors who want the dollars because they trust them. They are absorbed at the margin, and importantly, by foreign central banks.

And how does a foreign central bank buy a greenback? It creates the local currency with which to buy it. So what you have been seeing is the huge creation of currencies by all countries. We send them paper, they send us stuff. The way they absorb the paper is by printing RMB, yen, Singapore dollars, and Korean yuan, so there is a huge outpouring of what on Wall Street is called liquidity.

Now liquidity is a word for bank credit. It's a word for elixir. You know it's—these currencies are flooding the world, and the United States position is much different than it was in 1978 when Humphrey-Hawkins was enacted. Then we might have been able to manipulate interest rates in order to increase employment. Now we

are at the mercy, to a great deal, of our holders of dollars abroad. We no longer have the freedom of action that we did.

The CHAIRMAN. The gentleman from Alabama. I'm sorry. The gentleman from Texas first? I apologize.

Dr. PAUL. Thank you, Mr. Chairman. I have a question relating to a chart on page 4 of Dr. Bernstein's written statement. I don't know if you have that chart, but it's a chart that shows a tracking with productivity and real compensation, and these two lines tracked together up between 1947 and 1971, then all of a sudden they started to diverge.

The productivity curve goes up where the real compensation flattens out, and I think that demonstrates much of what many of us have already talked about, that there is something unfair going on here. And yet I don't think we've gotten to the bottom of it to find out what was wrong, why it happened, and what we're going to do about it, and that is I think very important.

Not only has it happened in wages, but we see a difference in the income on Wall Street. You know, back in 1971 a certain event occurred, and I think it was significant. But at that time, wages, the CEO pay was 30 times the wage, but today if you add up all the benefits of Wall Street, it's 500 times the wage. And yet there is one firm in Wall Street that passed out bonuses of $16.5 billion, so there's a certain inequity going on.

In this period of time from 1971 up till now, in 1971 in today's dollar, the minimum wage was $9.50. Today it's $5.15. So we can't deny there's an inequity. But the event that occurred in 1971 was the breakdown of the Bretton Woods system. And if you put a chart on here with monetary supply increases, it would probably be growing much faster than productivity.

My question is, how willing are you on the panel to identify this and relate this to a depreciation of the money and it being a monetary problem rather than some other condition that we could correct by legislation? Dr. Bernstein?

Mr. BERNSTEIN. Thank you for that very interesting question. And in framing the question, I think you raised most of the answers that I personally would sign onto. And by the way, myself and Lawrence Mishel have written a mind-numbing paper that decomposes the gap between those two lines over that period, and I will submit it to your office.

I think that there are a whole set of factors, and as I said, you ticked them off. But let me make a point that you didn't quite speak to as much before I talk to your Bretton Woods point. The fact is that productivity slowed post-1973. This is well known. And family income growth slowed as well. But right after that chart in my testimony comes a table which showed that as productivity slowed by a percentage point between the postwar boom and the latter—the period of the gap, where productivity growth slowed by one point, real median family income growth slowed by over two points per year. The problem was not just one of slower growth, but it was also diminished bargaining power, lower minimum wages, and a trading system that, I think, began to tilt against American workers in a way that Ron Blackwell has articulated and Dr. Blank as well.

This is also the period wherein monetary policy became, I would argue, much less concerned with Humphrey-Hawkins type goals of full employment and much more concerned with slaying an inflationary threat that has more often than not been a phantom menace in terms of the actual pressures on prices.

In terms of Bretton Woods itself, I do think that the time has come upon us once again to have that kind of arrangement where countries get together and agree on how exchange rates ought to flow instead of allowing the kinds of mechanisms that are currently, I think, distorting such flows.

Ms. BLANK. Can I just add one thing to that? One of the striking aspects of both that chart and other similar charts about what's happening in the United States is that you don't see these same patterns to anything like the same extent in other parts of the industrialized world. The European nations have not seen the sort of executive pay rise. Yes, it's gone up, but nothing like the extent it's gone up in the United States. So there's nothing that's inevitable about this. It is a function of how our economy and our policies organize themselves, and we could organize ourselves in ways that would turn some of these trends around.

Mr. BLACKWELL. I would just say, obviously, our members work and live in the real economy for the most part. We are concerned about the financial economy and its relationship to the real economy, and the Fed is in the center of that mix.

Clearly, there were very important changes, both in the real and the financial economy in the mid-1970's, all through the 1970's, including the breakdown of the Bretton Woods system.

I would suggest to you as something you should follow-up on is a discussion of whether or not in a global economy, we can conduct monetary policy as if we have a closed economy.

In the mid-1980's, when currencies got out of line, then-President Reagan was able to convene an accord which brought these exchange rates back into line and helped coordinate the macro-economic policies of the leading countries of the world, to produce more rapid growth and more equitably shared growth around the world.

We have no kind of leadership presently at the international level on that basis, and only the United States can provide it.

Mr. GRANT. When people talk about inflation, they define it, I think, arbitrarily and narrowly. Inflation proverbially is too much money chasing too few goods.

I think that, in fact, the thing that money chases varies from cycle to cycle and from era to era. In the 1970's, it was merchandise; more recently, it was financial assets.

For Chairman Bernanke to come before the committee and say the inflation rate is 2.1 percent; that is the measured rate of inflation. Excess of dollars have been chasing something else: stock certificates, bonds, commercial real estate, residential mortgages, and residential houses until recently.

It seems to me that we are the prisoner of the definition of "inflation" that does not always serve us well.

The CHAIRMAN. The gentleman from North Carolina.

Mr. WATT. Thank you, Mr. Chairman. I thank the chairman for a fascinating panel. I have so many questions in so many different

directions, that I am not sure which one I want to ask, and that is dangerous. Let me wander here a little bit before I ask anything.

The interplay between Dr. Bernstein's testimony and Mr. Blackwell's testimony about full employment most profoundly had this impact on me. I had this deja vu moment about the first Humphrey-Hawkins' hearing that I attended in this committee, and Chairman Greenspan was testifying.

I had come out of the private sector, not paying any attention to this interplay between interest rates and full employment and inflation, and the whole range of things he was talking about.

Unemployment was 6- to 7 percent at that time. Here was a man who was saying to us that we were very close to full employment. I would have to say I was stunned to have the person who was controlling our whole monetary and economic policy in this country tell me that at a time when I observed 15, 16, 18, and 20 percent unemployment in my Congressional district, particularly among African Americans, that we were at full employment.

A stunning revelation. It is the first time I focused on this concept of full employment. Had I not gotten side tracked yesterday on questions about regulatory stuff, the question I wanted to ask Mr. Bernanke was how do you define what "full employment" is?

This hearing is actually very helpful in that respect because you all are talking about a different kind of full employment than I have heard anybody at the Fed talk about. You are saying that the Fed's definition of "full employment" is 5 percent unemployment.

Mr. Blackwell is saying our definition of "full employment" should be every single person who wants a job should have a job. I take it that is what you are saying, Mr. Blackwell?

Mr. BLACKWELL. That does not translate into zero unemployment rate for reasons I will explain, but it should be much below 5 percent a year, certainly.

Mr. WATT. I am going to ask two questions and then I will stop. I will ask the first one to Mr. Blackwell and Dr. Bernstein.

How would you want to define "full employment" in the ideal world? And to Mr. Grant—I am sorry, Dr. Blank, I am not ignoring you—you talked about this blunt edge tool, the roller, in the paint scenario that the Fed has, just dealing with interest rates. It was not clear to me whether you are advocating giving the Fed more tools other than interest rate variations to have impacts, or whether you were advocating that we just pay less attention to the tool that they have and just disregard what they are saying more.

Let's deal with those two questions, and then I will shut up.

Mr. BERNSTEIN. Let me read you a quote from today's Wall Street Journal: "There is no specific level of employment or unemployment that is a trigger for inflation."

That is a quote from Fed Chairman Ben Bernanke. He is clearly saying he does not know what the full employment/unemployment rate is, in terms of rate. The 5 percent is the Congressional Budget Office's estimate of the NAIRU and one that I am quite critical of in my paper.

Second, to my knowledge—he said a lot about unemployment. Former Fed Chairman Greenspan never said what he thought the natural rate of unemployment was either.

Third, if you look at a graph in my paper, it shows that the best estimates of today's crack macro-economists are that the NAIRU is coincident with the average unemployment rate. This, as I describe in my paper, is a very poor guidepost.

I am just corroborating your view. For myself, especially given the conversation I just had with Representative Paul about the split between productivity and wage growth, I would believe that we are at full employment when we see the wages of most workers rise not in lock step with productivity, but in a range around that of productivity growth.

We achieved those conditions in the 1990's, between 1995 and 2000, and Dr. Blank's work has been very helpful in this regard as well.

We saw the wages of workers not at the 90th, 95th, 99th, at the 20th percentile, low wage workers, 80 percent, rise in step with productivity growth for the first time in 30 years.

Did skills all of a sudden fall from Heaven and turn these workers into highly skilled, more productive workers? No. The job market finally tightened up and the benefits of our very impressive productivity growth were broadly shared for the first time in decades. That is when I will sign off, when we are there.

Mr. BLACKWELL. I think answering this question of what "full employment" is in general and today is a very important thing for this committee to clarify and to understand the thinking of the Federal Reserve. In my service there, this term very seldom comes up.

I said in my testimony that it is an important value for the American labor movement and, I believe, for the bulk of American workers, that if somebody wants to work, they should have a job and it is the responsibility of the Federal Government to make that possible.

At any one point in time, Mr. Watt, people are between jobs, when you ask them—frictional unemployment; it is about 1 percent or so. At any given time, workers do not have jobs, or do not have the skills for the jobs that do exist—structural unemployment; another 1 point or so.

If you have a stated unemployment rate or full employment rate of 5 percent, what is that extra 3 percent of workers out there looking for a job every day, and in minority communities, it is double or triple that, and they are being told that the government is working to keep them from having a job in the name of fighting inflation.

We used to call this tragic situation and these people in this tragic situation "front line inflation fighters." Maybe that is a contribution to the national welfare, but it is cruel economic policy and a very inefficient way of enforcing price stability.

The main point in my testimony was to say that today, Humphrey-Hawkins was a long time ago, but today, I believe the unemployment rate cannot just be as it is in Humphrey-Hawkins, a single unemployment rate number, like 4 percent.

We have 4.9 percent. In the press, it says we have full employment. We are operating at 1 percentage point lower in terms of the employment population ratio than we were at the peak of the last recovery.

There are a lot of people who are out of the labor force. Professor Blank mentioned this in her testimony.

The third element is this connection, this rupture, between productivity and wages. A relevant concept of full employment would include both, all three of those elements.

The CHAIRMAN. Mr. Grant?

Mr. GRANT. Mr. Watt, you asked about the Fed's empty toolbox. The Fed can and does manipulate the interest rate. It has a second tool which is a soap box on which it is often to be seen.

Proverbially, a regulatory body can fix the price or it can fix the supply. If the U.S. Department of Agriculture wanted to put corn prices at $1 a bushel instead of much higher where they are in the market, it would not get much corn. It can pick its poison, supply or price, and since about 1982, the Fed has picked price.

Today, the Fed's price is on outlier. It is the highest price for interest rates on the so-called Treasury yield curve. The Fed is gambling that its judgment is better than the collective judgment of the marketplace. It might be.

You ask whether I want more armaments. No. I think the Fed has enough with one or two.

I think we ought to ask if the Fed really can fix this price any better than New York City rent stabilization apparatus could fix the residential rental structure for New York City.

The CHAIRMAN. I thank you. These are important questions, but please try to stick to one point. We will not be able to get everything in.

I was speculating on the limits of metaphor. I am sometimes moved to speculate on the limits of metaphor, and I just wonder whether the market could have painted the Sistine Chapel; I think things are being metaphorically carried too far.

The gentleman from Oklahoma.

Mr. LUCAS. Thank you, Mr. Chairman. I could not help but note that as we start to write a farm bill this year in the U.S. House, the observations about that, and agricultural economics is a fascinating part of the science.

Since 1933, we have done an amazing job of priming both sides of the engine by providing resources to encourage overinvestment on the production side, to keep food costs down, while at the same time providing food stamps to enhance consumption of that cheaper food on the other side.

It is an amazingly successful consumer bill.

That said, let's address for a moment the limitations, of course, of the Fed's ability to effect policy. A number of my colleagues, both today and on a number of occasions, have discussed the inequities that seem to be increasing in our society in salaries, bonuses, and those kinds of things.

Let me ask this question. Would the Fed's toolbox limited in its nature, and some of you might say that is a good thing, one of the traditional ways to address these issues, for the last 100 years, has been a progressive income tax code and our progressive estate tax code.

Let me ask the panel your perspective on that. Do you support going back to a more aggressive progressive tax code and estate tax

code, and expand on that for just a moment, if you would, why that matters, from your perspective.

Mr. BERNSTEIN. First of all, I apologize to Chairman Frank. We have been chomping at the bit to talk about these issues for about 10 years. We will try to do our best to keep our answers shorter.

Here is how I would answer that question. First of all, I do support a more progressive tax code. Interestingly, in my last comment, I talked about the truly impressive benefits of the full employment period, including accelerated productivity goals.

Remember, we had a productivity regime of 1.5 percent for about 25 years, a jump up to 2.5 percent in 1995 to 2000, and even a little faster in the more recent period.

This occurred in a period where the Federal income tax was more progressive than it is now. I very much reject the notion that changes to make the tax let's say, more regressive, has somehow boosted growth and gotten us closer to full employment.

To the contrary, the last time I observed full employment was when the tax code was more progressive than it is today. I tend to believe those two are not nearly as related as they are in the economic debate.

Secondly, a more progressive tax code, especially at a time like this, with high incomes rising so quickly, would give us more revenue to implement some of the programs Dr. Blank talked about, that I also think are very helpful in this context.

Ms. BLANK. I am a very strong supporter of progressive taxes, as well as some forms of estate tax. I will give you a slightly more theoretical response, which goes back to some of my comments on why we care about rising inequality.

The question is what do we mean by "equal opportunity" in this country, and I think equal opportunity has to mean giving people the base in order for them to achieve to their fullest capacity in terms of their own sets of skills and talents. That has to mean good public schools, it has to mean effective healthcare, and a whole range of things that require the government to be involved at least in part, in the provision of those services, even if the government does not do all of it.

That requires a stable tax base. This is needed to provide some re-distribution from those who happen to be advantaged in the particular economy to those who happen to be disadvantaged to create opportunity for the next generation.

I would make that same argument about estate taxes as well.

Mr. BLACKWELL. The AFL–CIO and American Labor Movement are very strong proponents of progressive taxes. We very much regret the direction taxes have been pursuing most recently.

The recent cuts in 2001 and 2003 were very disproportionately directed towards capital and away from people who work, and toward richer families as opposed to poorer families. We would like to see this remedied.

I also want to say that in terms of inequality, at least 80 percent of the growth of inequality is pre-tax income. It is growing inequality by virtue of the imbalance of power in the labor market. It is just adding insult to injury when the government weighs in with taxes that increasingly are disproportionately burdening poor and working class people.

It is worth mentioning here, as Mr. Grant has pointed out, that the Fed cannot generate full employment by itself. It is going to have to require the action of fiscal policy by the U.S. Treasury as well, including their decisions on taxes and spending.

These decisions have to be made in ways that respect the incentives in our economy to keep economic growth going, but you also have to be mindful of leaning against the wind and producing full employment.

Mr. GRANT. Mr. Lucas, I would favor something like the repeal of the 16th Amendment, but in any case—

Mr. LUCAS. To the point, Mr. Grant. Thank you. I yield back, Mr. Chairman.

The CHAIRMAN. I think you might get some screaming around here about a package deal if it would include some kind of alteration to the 17th Amendment that the United States Senate put in.

Let me recognize myself. One of the things that concerned me yesterday raised with the Chairman that has been alluded to was what seems to me to be a bias—"bias" is a negative word—a strong focus in the Federal Reserve on inflation to the exclusion of employment.

As I said, it is clear, at least to me, that growth alone does not resolve the problem, but the absence of growth would make just about everything worse.

Again, there was this sort of disconnect in my mind. The Fed had three statements in a row in the monetary report, not just testimony.

One, we are now producing below capacity and we will be doing so for some time and we will probably hit capacity after a while. No prediction of going above capacity. Two, inflation is moderating and the reasons that cause inflation are declining. And, three, a major concern is an outbreak of inflation.

What it suggests to me is that you could have a situation where, if we reached capacity without any significant increase in inflation, there would be an anticipatory increase in interest rates and a drop downward. There is at least a dual mandate in the Humphrey-Hawkins Act for employment and price stability.

I am concerned that there are people in the Fed who do not really accept that or who argue, and I would ask you to address this, who argue yes, they are going to serve employment but the best way to serve employment is to deal with price stability, that full employment, maximum achievable employment, will be an automatic or at least a semi-automatic result of price stability.

Let me begin with Dr. Bernstein to comment on that set of concerns.

Mr. BERNSTEIN. I can be quite brief. I would refer the chairman and the committee to the table I produced, which just quite clearly shows that over a period of 20-plus years, we were 19 percentage points below the NAIRU. That is, if the NAIRU is 5 percent and we are at 4 percent, that gets counted as a negative one.

We were 19 percentage points below the NAIRU compared to a period when we were 19 percentage points above this natural rate, and in the former period, inflation grew more slowly, and in the later period, inflation grew more quickly.

The CHAIRMAN. I think you said that there are people who say that the non-accelerating inflation rate of unemployment, the NAIRU, is roughly the unemployment rate.

My recollection from the 1990's was that it was a lagging indicator of the unemployment rate, that the people who believed in it started out by saying it was 6 percent and then unemployment was 5.5 percent, when unemployment dropped to 5 percent, they said it was 5.5 percent. As the unemployment rate actually dropped, this rate stayed above it.

Mr. BERNSTEIN. Half a point. What the economists who have defended this view have done is invent something called the "TV NAIRU," which is not the NAIRU you see on television. It is the Time Varying NAIRU. This led Jamie Galbraith to say not only is it invisible, but it moves.

In the policy agenda that I did not speak to in my testimony, in my spoken testimony, I argued that there is, of course, a role for the Federal Reserve, as we have been discussing, i.e., re-balancing the inflation and unemployment tradeoff.

This committee may choose to take another look at the Humphrey-Hawkins Act with an eye toward elevating the goal of full employment, the Fed's share, and his or her Humphrey-Hawkins' testimony to this body might be required to explain whether the labor market is at full employment and if not, what steps will be taken to get there.

The CHAIRMAN. Thank you. Dr. Blank?

Ms. BLANK. We all know a variety of historical cases where accelerating inflation has been a disaster. It is clearly appropriate for the Federal Reserve to worry about keeping us out of those sort of situations.

The question is, "Where are we right now?" One does not need zero price change to have a stable economy. Small and stable levels of inflation, particularly in the current financial markets with the way we are able to adjust to those with ARM's and various forms of price adjustment mechanisms seem just fine.

The only reason that I could think of to worry about inflation as a major problem right now is if one believes there is something lurking out there that could explode, where we do not know enough about what is going to happen.

The obvious example is energy prices. We saw an explosion in energy prices in the last several years. They have not come down to where they were before. If one believed those prices were going to go up again dramatically in the next year or so, then I think it would be appropriate to worry about inflation.

The CHAIRMAN. Even there, with a very significant increase, it did not trigger any kind of rapid inflation.

Ms. BLANK. That is absolutely correct.

Mr. BERNSTEIN. Especially in the core rate.

The CHAIRMAN. I would also say that I was struck with Mr. Bernanke. When I asked him why inflation was explicitly the major concern, and I thought this was rather odd, he said, "Well, they think we are going to not get above trend, above capacity, and they think there is an inflation problem, but they think they might not be right in what they think."

You cannot logically say I think, "A", but then I also think, "B", which includes "anti-A." Then you do not think "A." You cannot be given credit for thinking something and simultaneously thinking that you do not really think that. He is too smart a man for that logic, so I think it is just an institutional bias.

Mr. Blackwell?

Mr. BLACKWELL. I think there is an important lesson in this regard to be learned from Mr. Greenspan. I remember in the mid-1990's when economists were telling him that the NAIRU was 6- to 6.5 percent, and that if unemployment fell below that level, that there would be ever escalating inflation, accelerating inflation.

Because he was a practical man who studied the material in detail and was not given to obeying rules, NAIRU or otherwise, he allowed the economy to grow faster than that, and unemployment came down to 3.9 percent with no increase in inflation, and produced millions of jobs.

The CHAIRMAN. And increases in real wages.

Mr. BLACKWELL. That is right.

The CHAIRMAN. Thank you. One of the members of the Fed Board who was the greatest opponent of Mr. Greenspan on that, and who felt there was some kind of automatic trigger, wage inflation, and unemployment went down, is also the one who expressed some consternation about the conclusions of Mr. Grant and this panel. I suppose it is appropriate to ask Mr. Grant to comment.

Mr. GRANT. I think there is a big semantic problem that is concealing a bigger conceptual problem, namely that there is no such thing as wage inflation. Full employment does not cause inflation. People getting work at good wages does not cause inflation.

Money causes inflation. The Federal Reserve, when it falls into error, causes inflation.

They say we are producing below capacity. So we are, but we are consuming above capacity. What this trade deficit means is that we produce much less than we consume. The risk we face is not so much that oil prices will rise or certainly not that wages will rise.

The risk is that this Nirvana in which we find ourselves, in which we produce so much less than we consume, and we finance the difference with dollar bills we print, that ends because they lose confidence in the currency. That is the risk.

The CHAIRMAN. Thank you. Mr. Bernanke, to his credit, did address those who tend to blame wages. I appreciate Mr. Grant's answer. He acknowledged that, in fact, if wages rise to productivity at a point when price mark up's are much higher than they have historically been with regard to productivity-based labor costs, then it is not wages that is driving this up, and in fact, it would be a conscious decision, through the use of some maybe excessive market power to raise prices even higher. I do credit him for that.

Mr. Roskam?

Mr. ROSKAM. Thank you, Mr. Chairman. I thank you, witnesses, for your testimony today.

I am still in the "trying to size you up and figure you out" mode. What I am trying to do is figure out—I have always appreciated over the years when advocates come in and say, "Look, here is the good side, here is the bad side, and we are advocating this because

of this." I have not really heard that holistic approach from you. Maybe it is the time demands that are upon us, and I get that.

It does seem to me that there are some really good things that are happening in our economy today and your testimony, at least in terms of what I have heard, has not reflected that.

Let me challenge you with a quote. Then I will be quiet and I will listen and you can use the rest of my 5 minutes. You can either answer the question or duck it.

In the September 4th issue of The American Prospect, a guy named Stephen Rose wrote an article, "What's Not the Matter With Middle Class." A couple of sentences: "What progressive's generally say about the economy is unrelentingly pessimistic, stagnant wages, rising costs, overwhelming burdens of debt. It is a message that does not resonate with the middle class, not only because it is overly negative, but because it simply is flat out wrong.

"Absolute living standards for the middle class have only improved, even if relative increases in income do not match the gains at the top," which is basically the argument that you have been making today.

"It is true that the middle class is shrinking but that is because more families are better off. The share of prime age adults in households with real incomes above $100,000 rose by 13.1 percentage points from 1979 to 2004."

My dad always used to tell me growing up, he would say, "Peter, we live better than kings did 500 years ago", and I do not think there is any question of that.

In light of that challenge, can you reflect on what you think are the good things that are happening? If the premise is that it is all pain, death, murder, and sorrow, I do not share the premise.

If the premise is that there are challenges that are out there, great. I get that. I think it is always good to reflect on the success that we have had, and the success that we have, Mr. Blackwell, that have benefitted your organization and your membership, and the particular perspectives that you each bring to the table.

Mr. BERNSTEIN. Thank you. That is an important dimension to bring to the discussion. I did start my spoken testimony by citing how low the unemployment rate is in historical terms and how solid the macro-economy is.

I think those are facts that we absolutely should take a lot of credit for and appreciate.

I think the two sides of the good/bad scenario are probably both seen in the second graph in my testimony, where I show productivity growth, not just growing, but accelerating. Productivity growth accelerated about a point between 1995 and 2000. Sounds like one little percentage point, but it is tremendously important. Then another point or so, although that seems to have trailed off, post-2000. Economists assume that the increase in productivity growth automatically translates into a better living standard.

I think what we are trying to say and what we are showing with this graph is that does not occur, when income inequality creates a wedge between the very impressive macro-economic system that we all celebrate, low unemployment rate, and the actual living standards of middle income families—you mentioned the work Stephen Rose cited.

In David Brooks' column the other day in the New York Times, he cited that same work saying middle income families of a certain age have an income of $60,000, something like that.

It turns out, I went to the data, and found those families have lost 4 percent, about $3,000, in their real income, between 2000 and 2005, when productivity growth was 20 percent.

That just does not seem right. It does not seem just. It does not seem fair. It does not seem like the kind of economy that is really linking the good side with the less good side.

If we have overemphasized the latter, I am sorry. That linkage is missing and it is critically important, and full employment is part of it.

Ms. BLANK. Economists are notoriously cautious and pessimistic. When asked to come and testify about what the problems are in the U.S. economy, here is what you get.

I absolutely agree with Dr. Bernstein that there are a lot of good things about the current aggregate economy. We have high productivity, low inflation, low aggregate unemployment, strong consumer spending, and strong business investment; it is a good outlook.

The issue here really is one of who is sharing in those gains. If you are a college-educated worker, the last 10 years, the last 25 years, have been some of the best years in history for more skilled workers in the United States. Things could not have been much better.

The issue is the very large group in the economy that just are not experiencing that same degree of growth. It is not trickling down, to use a phrase from President Reagan, and I think that is something that we have to be very concerned about.

Mr. BLACKWELL. I do not want to dodge the question. I started my testimony by acknowledging that we have the richest country in the history of the planet.

We have workers who are the most productive workers in the world, and they are more productive now than they have ever been. American workers work more hours today than workers in any other developed country.

Our key strength economically, as many imbalances we have, is our capacity to innovate in this country. In the increasingly global world, we are going to have to find a way to tap that and tap it together to stay on the leading edge of innovation.

That is not going to come out of labs and classrooms alone. That is going to come out of the American workplace. We have to be on the same page and working for the same cause if that is to happen.

The problems that we have identified are distributional problems, but that is one of the things that is dividing us, where we do not see a common purpose, as Rebecca Blank said.

We are dividing between the very wealthy and the very poor in this country. Under that kind of circumstance, we are not going to be able to tap the enormous resources we have and meet the challenges of an increasingly global world that we live in.

Mr. GRANT. The world is a cornucopia, thanks to the augmentation of the world's supply force, labor force, by all these people who were previously shut out. The world supply curve has moved downward and to the right. It is truly the age of abundance.

It seems to me at a time like this, you are supposed to ask questions. You are supposed to be worried when things are great. On Wall Street, things are perfect, and yet apparently improving. Never so many lent so much at so little margin of safety as they do on Wall Street today.

We should save the cheerleading for the bottom. Be bullish at the bottom, and bearish at the top.

The CHAIRMAN. The gentlelady from New York.

Mrs. MCCARTHY. Thank you. Thank you for your testimony. I find it fascinating.

One of the things that was not brought up was the alternative minimum tax and how that is affecting the middle income families.

I have always had the curiosity when we see so many lost jobs and even though unemployment is low, those that have lost jobs in the past, what kind of jobs are they exactly in today? Are they the same kind of pay? Are they lower pay?

We just read in the paper the other day that Chrysler is going to be letting go 13,000 people, 16 percent of their workforce.

I also sit on the Education Committee. We have been looking at, for a number of years now, how do we take these workers who are basically earning a decent salary and re-train them?

A number of issues that came forward and were put into law were that they would get a certain amount of money to go back to school. Yet, when I saw that amount of money, I am saying how are they supposed to go to school, how are they supposed to pay their mortgages, how are they supposed to pay their car payments and keep going, and that would be it. That would be used instead of a substitute of unemployment.

I do not see good programs that are forecast out there. It is one thing to re-train someone, and then they lose their job 2 or 3 years down the road. I do not think there is a good program out there.

What are we looking for in the future and how are we going to re-train these workforce jobs for those that might be manufacturing jobs, but obviously, we are in that trend of—we are not preparing our people. I think that is one of the big problems.

I will open it up to the panel.

The CHAIRMAN. Let's start with Mr. Grant.

Mr. GRANT. The answer I was formulating is, it is not my subject, so I will pass. I am sorry.

The CHAIRMAN. Mr. Blackwell?

Mr. BLACKWELL. I think it is a very, very important point. We are in a global economy. The economy is changing. Our competitive advantages as a country, as opposed to the companies involved, are our people and the skills they have, and the machinery for giving them those skills is simply not there, and neither are the resources.

I would suggest to you that if we are going to really make this an innovation-based economy, we have to make training available to all workers, incumbent as well as displaced workers. We simply cannot afford not to train people for the highest productive and most creative job they are willing and able to take.

We will not otherwise be able to pull our weight in the world economy. We are completely supportive of that kind of idea. We regret that the discussion in Congress is so much how do we deal with the people who are the losers, and how do we get them into

a Wal-Mart greeter job as quick as possible, and not spend any money on them, either on unemployment insurance or training.

I suggest that we should be taking the position that whether they are an incumbent worker or whether they have been displaced, displaced by trade or anything else, they should have an opportunity to train themselves for the most productive job they are willing and able to take.

Ms. BLANK. I wish I could be optimistic about re-training, but I have to say the evidence that I know suggests that most people over the age of 40, and as I look around this room, that is most of us, do not re-learn new skills very easily, and are not very optimistic about going and taking on entirely new jobs and new careers. We absolutely need to provide support for re-training, for mobility, for workers who have been displaced, but we have not been very successful at that in the past.

We need some demonstration projects, some additional funding that would let us test whether there are some better ways to do this. I cannot be very optimistic about that. I think you have to go back and say what we need to do is to ensure that nobody drops out of high school; that those who graduate from high school can read, and they can do basic math; and that those who get through high school go on and get some additional higher education of some sort, whether it is an associate's degree or a 4-year college degree. Workers need to be ready for a flexible career that means they are able to shift between industries and between jobs over their lifetime, because that is the prospect for most of today's younger workers.

Mr. BERNSTEIN. My take on re-training is a bit more optimistic. We do actually know some things that work. The tough news is that they are pricey. You cannot do effective re-training on the cheap.

My concern when I look at where our fiscal priorities are heading is that we are squeezing that very part of the budget, domestic discretionary spending, where our training dollars are going to have to come out of, so I think we are going in the wrong direction.

The only other comment I will make is that full employment itself is associated with more incumbent training by employers of their workers and occupational upgrading. That is, when you are in a condition of full employment, labor markets are tight, and there is not a long line outside of the factory or the firm door.

Employers are more likely to undertake training themselves because they have to. Workers' wages are being bid up, and they need to pay for those higher labor costs with increased efficiency.

We call it a full employment productivity multiplier. I think it is real and another important dimension of the benefits of full employment.

The CHAIRMAN. Mr. Neugebauer?

Mr. NEUGEBAUER. Thank you, Mr. Chairman.

I want to go in a little bit of a different direction, because some of the things that have been said today, I may not necessarily agree with, but one of the things I think this country was founded on were principles of liberty, freedom, and opportunity.

And that government, and I have not seen it in the Constitution, was not charged with creating jobs, nor do I think it is a very good

job creator, but I think government can cause jobs not to be created.

I think Mr. Blackwell said, and I agreed with him totally, we have moved into a global economy. What we ought to be doing from a policy standpoint is trying to figure out ways that we can make America more competitive because to me, that creates more opportunity, and in the more opportunity is opportunities for people to have better jobs, higher paying jobs.

Two points that I want you to address. One, I question today whether monetary policy has any significance in that process.

Two, I think more today if we want to talk about how we make more opportunity and create more jobs is we talk about the fact that there is kind of a three legged stool that keeps America, I think, today not being competitive in a lot of ways.

One of those is our tax structure. We had the second highest corporate income tax rate in the world. Secondly, we have a regulatory environment that really strangles those people who are trying to create jobs in our country today, and all you have to do is look at the fact that we have not built a new refinery in this country in over 30 or 40 years.

The third piece of that is this litigation web out there that if a company is doing well, and they make a little mistake, somebody is going to entitle themselves by dipping into that corporate treasury and redistributing that money.

I think the question to each one of you is, does this monetary discussion about employment, does it have a relevance in a global economy?

Mr. Bernstein?

Mr. BERNSTEIN. The financial markets certainly respond to the slightest blink of an eye of Federal Reserve bankers. Monetary policy means a lot to them.

It is also the case, I think we heard earlier, that the Federal Reserve does not set the unemployment rate. I think those comments are accurate in that regard. I think Mr. Grant would agree.

The Federal Reserve does not set the unemployment rate with some really acute degree of accuracy. They absolutely can, in my view, by ratcheting interest rates up higher than they ought to be keep that unemployment rate from falling to a level that I think is truly beneficial, and when they do that, they squander billions of dollars about putting it into potential jobs and wellbeing, as we have all discussed.

I would certainly agree, especially regarding money supply in a global economy, that the actions of the Federal Reserve are much less powerful than they would be if we had anarchy. On the other hand, they do make a difference.

Ms. BLANK. The economy is not a well-defined system of equations; if you push this button, you know what you are going to get out of the other end. Would that it were, we would all be better off in that we could predict better.

What does monetary policy do? Monetary policy creates stability in the financial markets, in particular. It does other things as well. It creates trust that the U.S. economy is on an even keel, and what is happening in financial markets leads to business investment and consumer behavior in all sorts of important ways.

Therefore, monetary policy affects long-term economic stability and aggregate economic growth. That is very highly important not just for what happens in business America, but it is highly important for what happens to the families out there as well.

I think you cannot look at that and say that they are not important to these sets of issues. Certainly the choices that the Federal Reserve makes with regard to inflation versus unemployment, in particular, can affect the number of jobs that are out there.

Mr. BLACKWELL. I think it is a very important question. We clearly exist in a global economy. No one has any doubt about that, and no one expects the Federal Government to create jobs. The vast majority of our jobs are private sector jobs.

The question is, does the Federal Government have any responsibility for shaping policies that affect the jobs that are created? In that category, I would say emphatically, yes.

The question is, given the global and changing nature of the economy, what is the nature of the changes in those policies that we ought to address?

By our arguing that full employment needs to be re-established, we are suggesting a very powerful way that we think policy could affect the material standards of living that we have been talking about here.

Monetary policy, as Mr. Grant has pointed out, only operates with one instrument. We could talk about other instruments that it needs to be operating with, in financial markets and internationally.

That institution has more significance in terms of the Federal impact on the economy and the level of job creation and the important relationship between productivity and wages than any other public institution in the country, and it is accountable to the public through the Congress.

Mr. GRANT. Everyone says the world is a global economy, but I say it is very global. Let me give you an example of how "very" it is.

In the day, you were a customer of your own nation Central Bank. Today, the national markets are basically without boundaries, and people can, and massively do, lend and borrow in currencies not their own.

There is an immense trade today in borrowing currencies with low interest rates and investing the proceeds in assets with much higher yields. The yen is the world's favorite currency for borrowing.

The Federal Reserve does not set monetary policy for the Japanese Central Bank. Nonetheless, people outside Japan can, and massively do, use the yen as a borrowing source.

The world is positively awash in this elixir called liquidity. The Fed is only one central bank. It is not the institution it was in 1978. It is diminished by the idea of globalism.

Where is employment doing well? Wall Street. Why might that be? Because people are gaming this system of worldwide currencies. Wall Street has never done better. Job growth is nearly at an all time high, and it is because of the institution of Central Banks, but not for the reason we think, because people can game the system of managed currencies.

The CHAIRMAN. The gentleman from Massachusetts.

Mr. LYNCH. Thank you, Mr. Chairman. First of all, I want to thank the chairman and the ranking member for holding this hearing. One matter of disclosure is that I actually am a member of Mr. Blackwell's union; I pay regular dues.

Mr. Chairman, my voice is gone. I am going to have to come back later and ask my questions.

The CHAIRMAN. All right. We thought you were doing your Jimmy Durante imitation.

Mr. LYNCH. No. I sound more like one of the Soprano's, I think.

The CHAIRMAN. The gentleman will now be temporarily wounded/departed. Mr. Scott.

Mr. SCOTT. This is a fascinating hearing. Monetary policy and the state of the economy, while the economy looks good on the surface, there are subtle as well as very obvious problems arising, which I certainly believe need to be addressed.

I want to talk about a couple of those and have you respond to them. The first one is this gap in wealth. I would like to hear each of your thoughts on the current state of our CEO's of these major corporations who are receiving these outlandish pensions, and exorbitant amounts of salary. They are all fine people. We live in a free capitalistic system where the forces of supply and demand and a free marketplace determine these things.

The problem is while all this is happening, we have lower- and middle-class workers who are just barely struggling to make ends meet. The ratio has gone from something like in the range of a differential from 10 to 1 to almost like 200 to 300 times what the workers make. This has just been extraordinary.

I think we have to take a closer look at what we, as Americans, value in terms of our workers. Those at the top are enjoying the perks of this great wealth, and we can agree that the income gap between the wealthiest of Americans and the poorest of Americans is continuing to widen.

When we put that together with the other phenomena that is happening in our economy as a result of the baby boomers, the entitlement programs, the Medicare, the Medicaid, Social Security, and demands on our health system, all are increasing because people are going to be living much longer, 80/90 years old, and so much of this is a burden on the wage earner. That class is shrinking.

I think our only real opportunity to increase that is with an elephant in the room dealing with labor and economy that we have not mentioned, and that is immigration, and how you take these—I see the immigration issue as giving us kind of a windfall to help us to be able to increase this wage earner group as we go forward. There is no other group that we can really look to.

There are 14 million people here, many of them not buying into the system. We are not cataloging them, but yet they are benefitting from it. That is the area that, I think, we can increase our wage group, but I think there has to be some imbalance there.

I want to talk about that for a moment. Healthcare, I think Mr. Blackwell talked about—it is almost shameful and insulting, that in a country as advanced as ours, we have people without health insurance.

I give a health fair in my district every year. In Georgia and in that Belt, so many people are without healthcare. We can do so much better than that. I think that is part of the problem there.

The other area is one glaring statistic that I want to present to you, because it very much concerns me. It is a statistic focusing on African American men. Clearly, almost 30 percent of African American men at some point are going to be in jail or in prison. There is such a waste there. It is a disturbing number that states that only 66 percent of African American men are reporting themselves at work or looking for work.

Those are three areas I want you to just tag for a moment if you can. I think it provokes some thought. The status of African American men and the peculiar situations they are facing in the marketplace, it also dovetails in with this imbalance in our labor force and with CEO's making so much, and then our challenges for healthcare.

Mr. BERNSTEIN. Let me try to be brief. I am going to defer the African American men question to Dr. Blank because some recent work of hers speaks directly to that. In the interest of time, I am going to speak about the CEO pay, immigration, and just a word on healthcare.

In the context of my testimony, I stress the issue of bargaining power. I think what we have going on right now, as we expressed earlier, very positive aspects of our economy regarding productivity growth, the efficiency with which we are changing our economic inputs into outputs is really quite stellar, and a huge gain.

Given the fact that so many workers lack the bargaining power they need to claim their fair share of that growth, it is as if the pie is getting larger, the bakers are doing a great job, but they are getting smaller slices.

How do you change that? That is what I would like to focus on in talking to a body like this one.

There is a discussion now about something called the Employees' Free Choice Act. This is an act that would level the playing field for union organizing, clearly a bargaining power tool.

We have talked about a higher minimum wage. That is another way to re-claim some of that fair share of productivity growth, redistributing, without, as has been mentioned, killing the golden goose. Full employment as well.

In the interest of time, I will stop there.

Ms. BLANK. Let me say a word about your concerns regarding African American men. You are absolutely right. This is the most disadvantaged group in the labor market, whether you look at skills, wage levels, or labor force participation. This is obviously a really big and complex question and it gets into a whole lot of history as to how we got here.

Clearly, one of the biggest issues here are the urban schools where an awful lot of African American children, boys and girls, are coming to some of the worst schools in our country and coming out simply not prepared for the labor market in which they are finding themselves.

You put on top of that some of the changes in our jail and incarceration policies, which as you point out, have removed large num-

bers of African American young men, put them into prison, and then put them back into society with no support.

One of my biggest concerns is that after spending 15 years talking about welfare-to-work programs, we really need to spend the next 15 years talking about jail-to-work programs, about ways to move men from incarceration back into the community.

Mr. SCOTT. Thank you.

Mr. BLACKWELL. Just briefly on CEO pay, it was a 20 times differential between CEO's on average and workers in 1980. It is now 431 times. The average CEO makes more in the first day of work than the average worker does all year, and he makes more before lunch on the first day of work than a minimum wage worker makes all year.

This is a signal point. CEO's are now claiming over 10 percent of all corporate revenue, a point of enormous concern to American workers, not only in equality, but even President Bush mentioned the lack of relationship of this compensation to performance of these companies. He was met by silence on the trading floor in New York when he raised this point.

This is a matter of corporate governance and corporate reform for which there is much, much need here, and which needs some attention on Capitol Hill in the form of hearings.

Why is this happening and what can and should be done about it without killing the golden goose.

A quick point on the entitlement question. We spend, as I said before—

Mr. GRANT. As to CEO's, I am a CEO of a minor corporation and what I aspire to is to become the CEO of a major corporation. I think this is a matter of taste and of the marketplace. There are some things for which the government really cannot provide the solution, and I think this is one of them.

Mr. SCOTT. Madam Chairwoman, may I just ask if Dr. Blank, in her report—I did not know she had a report on this very perplexing problem facing African American men and the employment labor force, could we ask that she get a copy to us?

Ms. BLANK. I do not have a specific report, but I can get some resources to you.

Mr. SCOTT. Thank you.

Mrs. MALONEY. [presiding] Mrs. Blackburn.

Mrs. BLACKBURN. Thank you, Madam Chairwoman. Thank you to our witnesses for being here.

Mr. Grant, three quick questions for you, and I enjoyed your comments last night on the economy. We talked a little bit about long-term liabilities for the Federal Government, and of course, GAO is saying that with the entitlement programs that were put in place 40 years ago, the growth of those, that we are looking at that in the near future consuming as much as 30 percent of the GDP.

If you will very quickly speak to the effect that is going to have on the economy and then relate that to how it would affect our low income workers and the poor.

Mr. GRANT. Mrs. Blackburn, a great question, which I certainly cannot answer.

As a truism, we are prosperity; we do not pay. The tendency is for prosperity not to pay. Somehow, society gets richer. Somehow, these overwhelming and menacing liabilities get dealt with. I do not know how we will deal with them. I have confidence that we will, but I cannot say exactly how. The numbers at the moment look horrific. Beyond those observations, I am afraid I really cannot comment.

Mrs. BLACKBURN. Let's talk for just a moment about the tax structure. You may have already covered this. We know that so many countries are going to a flat tax structure. There is quite a bit of conversation around that now.

Mr. Neugebauer talked with you a little bit about competitiveness and taxes and regulations and the effect that would have on our economic growth.

I would like your input as to what your thought is on what we should do on a tax structure, if we should follow the other countries and move to a flat tax structure, move to a different type structure that is capped?

Mr. GRANT. In principle, I believe that you tax the thing you want less of and tax more lightly the thing you want more of. If we want more enterprise, it would seem to me that you tax that less.

For that principle and for the general principle of liberty and for keeping what one earns, I am favor of flatter and lower taxes.

Mrs. BLACKBURN. Let's talk for just a second about intellectual property rights. We have discussed the global economy. I found it quite fascinating that protection of the intellectual property rights has not come up in any of the discussions and you have not equated the impact of that onto the economy.

Personally, I feel like when we look at a global economy, protection of those rights, fighting against piracy, counterfeiting, is very important to having those domestic jobs, and Dr. Blank was talking about jobs and re-training, capturing those jobs that are semi-skilled and higher skilled jobs, keeping them here.

Do any of you have a comment that you would offer on intellectual property rights and how you see that affecting our jobs' growth and retention, economic growth?

Ms. BLANK. Other than simply to affirm what you said, this is a very important issue for American business, for us to keep business competitive, to protect patents and to protect intellectual property.

Mrs. BLACKBURN. Any additional thoughts? Dr. Grant?

Mr. GRANT. I am in the business of producing written matter, which is easily duplicated. It is one of the abiding problems of this line of business.

We aggressively defend our copyright, and I can only begin to imagine what it is like to have a global franchise with the global risks of piracy and infringement. I cannot imagine a more pressing issue in a time when more and more of what we do is of a service nature and less and less of the product end.

Mrs. BLACKBURN. Mr. Blackwell?

Mr. BLACKWELL. We really strongly support intellectual property rights protection. We think we need to take piracy out of international commerce.

We feel just as strongly that we ought to take the oppression of workers out of competition among countries, and therefore, that is the basis on which we argue for the inclusion of worker rights, fundamental worker rights, in those agreements.

We wish those rights were protected as well as they are in intellectual property rights.

Mrs. BLACKBURN. Dr. Bernstein, I had one question for you, if I have a couple of minutes left. I have done some reading recently on child poverty and the reasons for child poverty, which is a heart breaker to all of us.

So much of what you see are low levels of parental work and numbers of single parent homes. Those are two indicators, no matter what you are reading and who it is from, that are always there.

When we talk about public benefits, I would love your input as we talk about jobs that are not those bottom rung jobs, as we talk about public benefits, and just a comment from you if they were restructured to reward work and to reward marriage, what your feeling is if that would help reduce those levels of child poverty.

Mr. BERNSTEIN. I am quite clear that the evidence is strong that precisely that type of program would go a long way in exactly the right direction. The reason I get there—it is great that we are talking about it in the context of a hearing about full employment.

If you look at the employment rates of single mothers during the 1990's, we had welfare reform certainly pushing them into the job market, but we also had the first full employment economy in 30 years pulling them in, we had an expansion of the earned income tax, it could mean $4,000 or more to a single mother with two or more children, as well as a whole set of work supports to help subsidize the gap between what that woman earned and what she needed to bring her family above poverty.

By the way, I think the poverty line is actually insufficient if we are talking about what these families really need for wellbeing. I think that the one two punch of work supports, a subsidized wage through the earned income tax credit, which I think is a program that has wide support in this body, and a full employment economy gets us a long way towards the goal.

You mentioned a marriage program. In the interest of time, I am going to stop there. Maybe Dr. Blank has also looked at that and wants to speak to that.

Mrs. MALONEY. I would like to hear from Dr. Blank as a recognized authority on this subject.

Ms. BLANK. On poverty rates among single mothers, it went down from 48 percent to 35 percent over the last 12 years. Much of that is precisely because of the incentives we put in place to make work pay, so to speak, through the earned income tax credit, through subsidies to child care, and through some pushes from welfare as well, to put people out into work.

The fact that only one-third of single mothers are poor is hardly a cause for a celebration, but things are moving in the right direction.

It is certainly true that all of the research evidence suggests that children are better off growing up with more adults in their life. If those adults are married, that is great. If the dad is not in the household but is involved with the kids, that is good. If the grand-

parents are involved with the kids, that is good. The more adults you can put in a kid's life, the better off you are in terms of helping them move forward.

I think we do not have very good policies—we do not know how to do marriage policies very well. We know a lot more about how to create jobs than we know about how to create marriages. That is one reason why I tend to focus a lot more on the job side because I think we have policy leverage there that is more effective.

Mrs. MALONEY. The gentlewoman's time is up. Congressman Lynch?

Mr. LYNCH. First of all, thank you, Madam Chairwoman. I want to thank the panelists for helping us out here.

As a matter of full disclosure, I am a former president of the Iron Workers Union in Boston. My monthly dues that I pay every month, part of it goes to Mr. Blackwell's union, the AFL–CIO.

The title of this hearing is, "Monetary Policy and the State of the Economy." I am tempted to ask which one, which economy?

I represent both the City of Boston, which is a major financial services market as well as healthcare, and I also represent the City of Brockton, which is an old shoe manufacturing city, both wonderful cities, and I represent about 19 towns, the workers in which are probably a blend of both economies.

One of the things that troubles me is when some economists, not the ones here today, but some economists talk about job loss and wage stagnation, like they were talking about the weather, like it is a natural phenomenon that we have nothing to do with or no control over, and that we are in this global economy, so why try?

From where I sit, and what I have seen over the past 5 years here in Congress, I think there is a real purposeful dimension and deliberate effort in some cases to undermine the bargaining power of workers in this country, both the skilled workers who are whipsawed by the threat of moving high tech jobs overseas, and also the bifurcation between union jobs versus non-union jobs in this country.

I look at the purposeful efforts by this Administration, the Bush Administration, and their policies. They have led efforts to cut overtime standards for 6 million workers under the Fair Labor Standards Act; the first action by the President after Hurricane Katrina was to cut the prevailing wage in Mississippi and Louisiana so workers could work for less. That is what he thought was the most important thing to do after Katrina, cut the wages of workers in Mississippi and Louisiana. Come on.

The trade policies and tax policies that we have adopted in this country to incentivize companies to move offshore or to ship their jobs overseas, as the kids say in my neighborhood, "You got to get real about this stuff."

I am a former worker of the General Motors plant in Framingham, Massachusetts. That plant closed down because of policies that incentivized the practice of General Motors closing down plants in Massachusetts, Michigan, Illinois, and shipping them over the border into Mexico. They did that.

That did not happen in a vacuum. That happened as a result of policies that successor Administrations have adopted and there is a whole framework here of labor policy within the United States

that is overseen by the Labor Department and the National Labor Relations Board.

People in my district are shocked when I tell them that the mission statement of the Labor Department is to strengthen free collective bargaining. They are dumbfounded. They are also shocked to learn that the National Labor Relations Act, which created the NLRB, the Act itself guarantees the employees the right to organize and to collectively bargain.

You would not know that if you simply watched what is going on at the NLRB, which together with the Labor Department, more so than the Labor Department, has really adopted an attitude and a position that is hostile to workers' rights.

While I do see the greater dynamic here of forces in the macro and micro economies, there is a definite effort here of this Administration and some of our departments to beat down the rights of workers and of these families to make a decent living in this country.

While I really appreciate the high level and the quality of your debate, I have to say there are some real things that we could be doing here, I think, to empower some of these workers.

Mrs. MALONEY. The gentleman's time has expired. I grant him another 20 seconds.

Mr. LYNCH. What do you think we could do in this country to strengthen that? You all mentioned at the beginning of your statements this imbalance in bargaining power.

Mrs. MALONEY. Mr. Blackwell, very briefly.

Mr. BLACKWELL. Put a meaningful floor underneath wages. The minimum wage should be one-half of the private sector wage for non-supervisory workers. Give workers the right to organize unions when they so choose.

Very centrally and first, I would suggest that at the center of this hearing's purpose, to re-establish full employment as the responsibility and the purpose of government, to maintain tight labor markets.

With tight labor markets, minimum labor standards and the right to organize will close this gap with productivity and wages.

Mrs. MALONEY. Thank you. Congressman Green?

Mr. GREEN. Thank you, Madam Chairwoman. I thank the witnesses. Perhaps I should not say "witnesses," the panelists, for being here today. You have really been most edifying.

It may look like a set-up for one labor person to follow another, but I, too, associate myself with labor, having been a dues check-off member; that means you are really involved in the process.

We talked a lot about full employment. I think it is a most important subject, full employment. Some people have some degree of consternation or look askance at the term "full employment" because some people can remember a time when folks had full employment but they did not receive the emolument that employment should accord.

An extreme example would be slavery. Every African in America, not African Americans, but every African in America had full employment, but they did not get the emolument that employment should accord the worker.

I have coined my own term, fruitful employment. Full employment is great, but I think fruitful employment is better. You can have full employment, work full time, and still live below the poverty line. People do it every day in this country. Say, someone is a full time employee, they get $10,000 plus a year, and they have one child. The poverty line is $13,000, so they are working full time, and still living below the poverty line.

You can have full employment and not be able to afford health insurance. You can have full employment and have no retirement benefits. Full employment is not as significant as fruitful employment, employment that allows one to have the emoluments that employment traditionally accords.

I agree that there are some things that can be done, and I think that you are on target when you talk about the restoration of the balance between industry and labor, and things are out of balance.

They are not out of balance because of the workers. The workers have tried to maintain the balance. Right now, the industry has the advantage, and policies have allowed the industry to acquire the advantage.

Either there has to be a reversal or we have to have some new policies. I think we have to index the minimum wage. Minimum wage ought to be indexed. CPI or possibly poverty. No one should work full time and live below the poverty line. Index the minimum wage to poverty. You do not live below the poverty line if you are working full time.

There has to be some thought of whether the paradigm that we currently utilize to deliver healthcare is the best paradigm, because right now, the paradigm is to do it through one's place of employment.

Well, we cannot compete in the global marketplace, it seems now, with other world class corporations who do not have to factor that in when they compete with American corporations.

Is this going to be the most efficacious way to deliver healthcare through a paradigm that puts corporate America at a disadvantage in this global economy.

I think we have to give much consideration to what has been said about the earned income tax credit and I would like Dr. Blank, if you would, to say a little bit more about the earned income tax credit.

I am concerned as to whether or not if we expand it, it will, of course, have an impact on the economy, but can we expand it and not have a negative impact on the economy. That is the argument that is always made when you talk about expanding these things.

Finally, I am concerned about living in the richest country in the world, where 1 out of every 110 persons is a millionaire. The richest country in the world where we can spend $269 million not per year, not per month, not per week, but per day on the war. $269 million up from $177 million, because of what we are appropriating. With that kind of money and these kinds of riches, I am concerned about—

Mrs. MALONEY. The time of the gentleman has expired. I grant him another 20 seconds.

Mr. GREEN. Thank you. I am just concerned about the hope index. How does it impact one level of society to see another level

of society not sharing the sacrifice. The war is being funded on the backs of the least, the last, and the lost. What about the hope index?

Thank you. Thank you for the additional time.

Mrs. MALONEY. Dr. Blank?

Ms. BLANK. The earned income tax credit, I think, is one of the best policies aimed at low-income families in the country today. The reasons that we could expand this without having very negative effects are twofold.

First of all, it is a very well-targeted policy. It is focused on workers who have low wages in low-income families. Unlike the minimum wage, which benefits even those workers, the vast majority of which actually are teenagers, in middle and upper income families, the earned income tax credit goes only to low-income families.

Secondly, it has relatively low displacement rates. One of the concerns about wage subsidies is often that companies pay less, because they basically take the Federal dollars and displace their wages with Federal wages.

The reason this doesn't happen as much with the earned income tax credit is it is paid through the tax system, not through companies in the way traditional wage subsidies are.

If I am an employer, I do not know if you are getting the earned income tax credit or if Jared here is getting it, and therefore, I cannot sort of play games with how much I am paying you. I just do not know who is receiving it and who is not, because I do not know anything about the rest of your family and your total income categories.

Expanding the earned income tax credit is often viewed as—it is viewed as a very efficient policy that has fewer of these sorts of displacement effects than many others.

Mrs. MALONEY. Thank you very much. Congressman Cleaver.

Mr. BERNSTEIN. Can I add two sentences to that response?

Mrs. MALONEY. Yes.

Mr. BERNSTEIN. There are two ideas to expand the earned income tax credit currently being discussed by policymakers.

One is to increase the benefits to childless workers and another is to increase what is called the third tier, to add an extra benefit for families with three or more workers; right now, it is two or more. Both of those have been shown to have considerable anti-poverty effectiveness.

Mrs. MALONEY. Thank you very much. Congressman Cleaver.

Mr. CLEAVER. Thank you, Madam Chairwoman.

I have two hopefully quick questions. First of all, I do not know if any of you are able to do so, but I would like to speak Chinese for a moment.

As many of you may know, under the current Administration, the U.S. debt to China quadrupled since 2000. In the year 2000, $62 billion in U.S. public debt was held by the People's Republic of China. China's holdings on foreign securities today in terms of the securities held by China in the United States exceeds $1 trillion.

China just tested some new missile as a demonstration that they have arrived militarily. We are having this big debate here on whether or not we should escalate the fighting in Iraq.

The truth of the matter is that even though the brave and honorable men and women who are fighting in Iraq are doing exactly what the country has told them, the truth of the matter is that their fighting is being financed by China and other foreign countries.

Do you think this is a matter of national security or is it something that we should just push aside because most Americans do not understand the debt even if you tell them that every single American, including the unemployed, has a portion of the debt—$28,000 today and rising.

The third leading expenditure in the budget that was just submitted by the President is the interest on the debt, and it rises $600,000 a minute.

I do not know if any of you can speak Chinese, but if you can, I would like your response, and I would like to ask one other quick question.

Mr. BLACKWELL. I think the issue of the imbalance between China and the United States, in particular, is an enormously important issue for the world economy. It is also perhaps a national security concern.

I just wanted to point out one thing that might not be on your screen. In order to keep its currency at the current levels, China is buying large quantities of mortgage-backed securities, which keeps housing prices higher than they otherwise would be. People are pulling equity out of those houses. That is part of what has been driving the economy.

The only thing that has been driving this economy in the past few years is expenditures by consumers, which is debt finance, and in part, by the borrowings of the Chinese Bank.

Mr. CLEAVER. What happens if China dumps its diet of dollars?

Mr. BLACKWELL. Obviously, that is a catastrophe. No one expects they will because they would be hurting themselves as well. There is this kind of dance.

Can they continue to buy an unlimited quantity of U.S. debt and manage the risk that represents to their own economy, and what happens to their economy and the U.S. economy if they decide to diversify.

Mr. GRANT. Mr. Cleaver, in the early going, one of the Congressmen said that you cannot consume and save the same dollar, but in fact, you can, and we do. We buy things from China. That same dollar comes back in the form of a purchase of a Treasury security or a mortgage-backed security.

We have what they call the exorbitant privilege of issuing this reserve currency, which has stood us in such great stead, but we are ever at risk of the world changing its mind. It will choose other assets, other reserve assets.

Yes, it is a clear and present danger to our prosperity. We are consuming much, much more than we produce.

Mr. CLEAVER. Final question, Madam Chairwoman. I think my colleague is gone, who raised this issue. If everything is so good in this country, why is it that for only the second time in the history of the Republic we have a negative savings rate?

In most Asian nations, the savings rate is 20 percent and above. I think the savings rate in the United States is like .9, close to a full percent.

We have never had a negative savings rate since the Depression, 1932 and 1933, and then we started having a negative savings rate in 2005 and 2006.

If everything is great, why is it that Americans—

Mrs. MALONEY. The gentleman's time has expired. I grant him another 20 seconds.

Mr. CLEAVER. Why are Americans spending all they make and then borrowing to make ends meet? Thank you, Madam Chairwoman.

Mr. BERNSTEIN. Quickly, I think one of the reasons for that dynamic is because interest rates, up until a while ago, were so low. Then-Chairman Greenspan used to make the point in this very room, when we talked about these very imbalances, he would say that servicing the debt burden does not seem to be any worse now than it was in prior years, it is around the average level.

The reason was that even though debt was high, interest rates were low. Now, interest rates have crept back up, and yesterday, Chairman Bernanke presented a chart on the finance obligation ratio, that is how much household income it is taking to pay debt, and that is at historically high ranges now.

I agree with you that this is a worrisome development.

Mr. GRANT. One thing to be aware of is that this country's current account is mainly trade deficit, almost all of it, but there is something called the balance on income; how much we earn on our assets abroad versus how much they earn on their assets here.

For three consecutive quarters, that number has been negative, the first time it has happened. We are now borrowing from the Chinese, as it were, to pay the Japanese. It is a very big change in our external financial position.

Ms. BLANK. I do want to say a word about savings. Partly, savings rates are low because we have expanded credit availability, particularly to lower income households. The ability to borrow, for instance, for housing mortgages, in the subprime market, has expanded homeownership by 10 points in this country.

That also increases foreclosure rates, because not everybody is successful in the long run at that, and you have to balance out what you are getting from this additional credit with the additional financial stresses you are creating on households.

For some people, the expanded ability to borrow has actually really given them a great deal of economic opportunity they did not have before.

Mrs. MALONEY. I thank the panel. I would now like to recognize the ranking member, and then I have one final question.

Mr. BACHUS. I would like the panel to comment on portable healthcare plans or portable retirement plans. Companies used to be loyal to their employees. Today, there is not that loyalty, and senority does not count for as much, unfortunately.

Mr. BERNSTEIN. I have been watching the system of employer provided health and pension unravel at a rate that is becoming a bit alarming. I think it is still a bedrock system, and I do not want to create a sense of hyperbole to my alarm.

The fact is that employers are shedding these obligations. We have seen a large sustained shift from defined benefit pensions to defined contribution pensions. Many folks are lucky if they even have that.

The end result is that more risk is placed on workers in terms of essentially shopping for those very necessary parts of a social insurance system on their own.

There are those who believe that kind of market competition will help, and I salute that up to a point.

The fact that the risks have shifted such that individuals are bearing more and more, I think, is a worrisome trend.

Mr. BACHUS. Can you also comment on whether or not you have proposals or know of proposals that might work. I know Wal-Mart recently proposed that we have a national healthcare insurance. Of course, people wondered if that was because they wanted someone else to pick up the tab. At least, they were bringing the issue forward and I commend them for that.

As you said, with less union jobs, and less bargaining power, some of these benefits are disappearing.

Mr. BLACKWELL. Portability is good. It is not because jobs are changing rapidly, but portability cannot be used as a mechanism for allowing employers to walk away from their obligations under the system, either for healthcare provisions or for retirement security.

We can imagine a system, and we were thinking about proposing one, where people who offer a healthcare plan or qualified healthcare plan or qualified retirement security plan can run their own plan the way they always have.

Employers who do not have such plans would be required to contribute a proportion of their payroll into a public system that would supplement a system that we already have and that would provide full portability.

What we are very concerned about is efforts like that of the chairman of Wal-Mart. He says that we need to solve the healthcare problem, but what he has in mind is off-loading his obligations onto some kind of individual mandate onto these very working families who do not have the money to pay for it, and they simply end up in the ranks of the uninsured.

Ms. BLANK. Just a quick comment. There are a variety of portability plan options that really are aimed at people who have health insurance who move across companies. That is important.

It is equally important to worry about the folks who are at employers who basically do not provide, and cannot provide, health insurance because they are small employers. For this group, we need to create some sort of risk pooling schemes at the State level that can both allow those employers to contribute and, at the same time, give portability to people who move across industries or who retire early or whatever. If we could do this, it would be a wonderful improvement over the present system.

Mr. BACHUS. Thank you. Dr. Blank, I think you may have been on television, responding to Chairman Bernanke. I had a question about the jobs being created. You all may be aware of his testimony.

His response was there is an enormous demand for high-skilled workers and high-paying jobs, and the constraint on highest paying jobs, for example, in manufacturing is not the demand but the supply. Firms cannot find workers of sufficient qualifications in many different areas. There certainly has been job creation at the high level as well as throughout the distribution of wages. Is there a problem with educating Americans for those jobs?

Ms. BLANK. There is a problem with education and skills in this country. We do not have the floor on skills that many other countries do. Students who get the worst education come out of our public school system with less literacy, less math skills, and less job preparation than the bottom end of the skill distribution in a number of our competitor countries.

In the long run, the only way we are really going to increase competitiveness and jobs for the entire population, and to ensure long term full employment, is going to be a strategy of education in the public school system.

Mr. BLACKWELL. There has been creation of high-skilled jobs, no question about it. The question is the proportion between the high skilled jobs, higher paying jobs and the lower paying jobs.

It is often reported, I think, particularly through the channels that the Fed hears, they hear from the business community that we cannot find workers who have the skills we need at the rates we are prepared to pay. That is the kind of shortage I think they are reporting. If there were high wages being offered out there, there would be workers who would respond to those wages.

Mr. BACHUS. One of my frustrations has been—I will just take my home State of Alabama. Our medical schools graduate about half of the doctors we need. There is a critical need for doctors in rural areas. It is not for want of applicants. I always hear people had a 4.0 on a 4.0 scale or 3.8. There are probably 2,000 qualified applicants each year, and they accept 125.

Dr. Blank, you are from the University of Michigan. Why are the universities not recruiting these people? Why aren't the State—there are qualified applicants. In many cases, the education is offered in maybe subjects where there are not jobs, in engineering and subjects where we are constantly told this is why people are coming overseas; we do not have skilled Americans. What can we do about that?

Ms. BLANK. I do not have a good answer. I do not know enough about the medical school market.

Mrs. MALONEY. We are going to have to wrap this up in a second. Go ahead.

Ms. BLANK. I do not have a good answer. I simply do not know enough about the specifics of what limits enrollments in medical schools.

Mr. BACHUS. Even in engineering or other fields?

Ms. BLANK. Right. I wish I had an answer for you but I do not.

Mrs. MALONEY. Congressman Ellison?

Mr. ELLISON. Thank you, Madam Chairwoman.

My questions revolve around this issue of bargaining power on behalf of workers. I have to be in and out, so I hope you have not already addressed this issue.

Could you talk a little bit about what accounts for the diminished bargaining power of working people vis-a-vis labor unions or even just on their own?

Mr. BLACKWELL. I think there are four major areas that I would identify. One is that we have a much more global labor market than we had, and this global competition has cost us jobs as firms have outsourced. Even the jobs that have not been outsourced; we see that across the bargaining table every day. If you do not pay more for your healthcare, we are going overseas. If you demand a wage increase, we are going overseas.

The other thing would be privatization of government services and de-regulation of particular industries.

The third thing would be, as Dr. Bernstein has mentioned, the fact that the labor market institutions, like the minimum wage, has been lowered to virtually subpoverty levels, and the lack of workers' rights to effectively organize.

One that is right in the center of the meaning of this hearing is the slack in labor markets. The demand for workers is growing more slowly in its recovery than it has in any other post-war recovery. That creates, as I think Dr. Bernstein again described, where you have a long line of people outside the door prepared to take your job if you make unofficial demands.

Alan Greenspan, I believe, mentioned this in his hearings during the late 1990's. Things have changed. There is a lot of fear among working people. That is the reason why they are not willing and able to make stronger demands for improvements in their lives.

Mr. ELLISON. Mr. Blackwell, you mentioned the right to organize. Do you think that if Congress strengthened the right to organize, for example, if there was employer neutrality, binding arbitration on the first contract, how would that impact labor? How would that impact workers' bargaining power?

Mr. BLACKWELL. There are 90 million workers in the United States today who would be eligible to join unions if they want. Over 53 percent of those people say they would join a union tomorrow if they could. The reason they do not is employer interference in their decisions, and hiring anti-union consulting firms and firing workers who try to form unions. 31,000 Americans were fired illegally from their jobs last year for attempting to form an union.

Mr. ELLISON. Did not the NLRB do something about that?

Mr. BLACKWELL. Those were the ones who were found to be illegally fired, but the penalties that are attached to those firings are so minimal that it is considered by business as just a cost of doing business.

All you get if you have a finding on your side is you get the difference between the wages you actually earned and the wages you would have earned if you had your job. The employer might have to post something in a lunchroom saying they will not do it again. That is not a meaningful bar from interference in workers' rights to organize.

Mr. ELLISON. What about this idea of the captive audience? This is a practice where employers might just call people into a room and say hey look, and make comments about the problems with unionization.

How does that practice impact employee bargaining?

Mr. BLACKWELL. Obviously, if you are living on property that is the property of your employer, the employer has the right to take you into a private room, and this is very routine, this is a core tactic of union avoidance, and they explain, find out the nature of your concerns, why you are interested in forming a union, and that is the occasion where they threaten you with the loss of employment or where they actually terminate you from employment if they decide you are incorrigible on this issue.

That is why we just basically have to take the employer out of the decision among workers about whether they are going to join a union or not. This is a question of freedom of association. This is not a question of the employer voting on whether they have a union or not.

Mr. ELLISON. You talked about a slack in the labor market. Could you help put some better definition to the term "unemployment?" I think most people think you are unemployed if you want a job and you do not have one.

I have heard other definitions like these are the people who are still applying for unemployment benefits, that is how we count them, and then maybe there are some other people who might still be looking, which I think would be a little bit harder to pin a definite number on because you would have to rely on a survey.

I know this is elementary for you. Just for the sake of this record, could you define what "unemployment" means so we can have a clearer understanding of what we are really talking about?

Mrs. MALONEY. If I could add, Mr. Ellison, your exchange with Mr. Blackwell earlier showed why we need to pass the Employment Free Choice Act that Senator Kennedy and others have put in.

Mr. ELLISON. Let me agree with the chairwoman on that point.

Mr. BLACKWELL. I was suggesting before that we have almost lost the term "full employment" from our dialogue. I think the importance of this hearing is we are re-visiting that concept. I think we need to revise the definition of it. It cannot just be the 4 percent unemployment rate that was stipulated in the Humphrey-Hawkins Act.

It has to look at the employment population ratio, which is still a full percentage point below what it was in the previous peak. A lot of people that are not even in the labor force, as Dr. Blank had mentioned.

Also, it has to look at precisely this question of the relationship, is there sufficient tightness in the labor market in order that productivity and wages are moving together, or at least in the same direction?

Mrs. MALONEY. Thank you. The time of the gentleman has expired.

The chairwoman recognizes herself briefly. Mr. Blackwell explained earlier that working families are keeping up their standard of living or trying to by working harder, longer, taking multiple jobs, and sending more of their family members to work.

I want to spend a little time talking about what this means. This is really having a serious impact on real people whose lives are simply becoming worse.

It is damaging families in America. The report that I mentioned earlier came out from UNICEF at the United Nations. This report

said that American children are worse off by multiple objective measures than children in 21 industrialized countries. We come in last.

The United States was last in health and safety, very low in education, and second to last in family and peer relationships and behavior and risk.

I would like the panel's comments starting with Dr. Blank, who is a recognized expert in this area. This reflects the strains, I would say, on working families caused by the gap between productivity and wages. I would say wages are a family value and this report certainly shows that.

I read reports all the time. I was absolutely shocked by this recent U.N. UNICEF report. I would like to hear briefly from the panel.

Ms. BLANK. I agree entirely with your concerns. I should note that if you look at upper income families, you do not see some of these same things, if you are looking at educational achievement, at health issues, all the things that the U.N. report looks at, those are not problems in upper income families.

The reason the United States ranks low on those statistics is because we have this wide distribution and a much lower bottom end in terms of income and skill levels and health disparities than other countries with whom we are being compared.

This whole issue of inequality is key to understanding why the United States is ranking so low. We simply do not have the same floor, providing the same protections for our lower skilled or low wage families as other countries do.

Mr. BERNSTEIN. Let me talk for a second about that from the perspective of middle income families. If you look at married couples with kids over the past 25 years or so, their hours of work, the time that family spends in the paid labor market, is up by about 500 hours over this time period.

That means typically, working wives are spending more than 3 months more in the labor market than they were before. That is not by any means an automatic bad. Part of that represents opportunities that were not available to women in the past.

The fact is this: If you take wives' earnings out of the equation, this family's income has hardly grown at all. Their income growth has been a function of working wives going to work and working more weeks per year, and more hours per week. That is a very positive development, but it is also a development that creates stress on middle income families, and a lack of work/family balance that I think shows up in those types of statistics.

Mr. BLACKWELL. I would only add the disproportionate stress as to the women, who as we know still absorb a disproportionate part of work at home while they enter the labor force to help support their family.

Mrs. MALONEY. I want to thank all of my colleagues and the panelists and the chairman for putting together an extremely interesting hearing.

The Chair notes that some members may have additional questions for this panel, which they may wish to submit in writing. Without objection, the hearing record will remain open for 30 days for members to submit written questions to these witnesses and to place the responses in the record.

This hearing is adjourned. I thank everyone for attending.

[Whereupon, at 12:44 p.m., the hearing was adjourned.]

A P P E N D I X

February 16, 2007

Monetary Policy and the State of the Economy

Testimony before the Committee on Financial Services
U.S. House of Representatives

February 16, 2007

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Introduction

I thank Chairman Frank and members of the committee for the opportunity to testify on the critical issue of the importance of full employment in today's economy.

In recent months, top policy officials and economic commentators have wondered why there seems to be more economic anxiety among working Americans than might be expected given the low unemployment rate and solid macroeconomy. Though the Iraq war was obviously prominent in voters' minds during the midterm elections, polls revealed that significant majorities were concerned about policy makers' handling of economic issues as well as their own economic circumstances.[1]

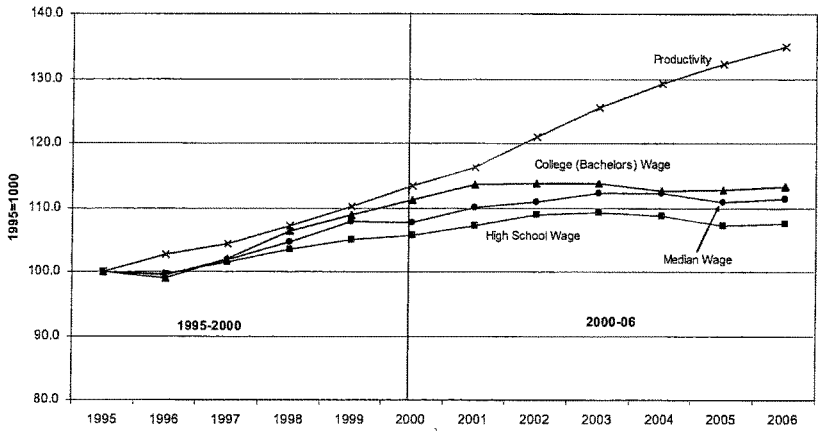
While some officials remain puzzled by this apparent disconnect between macroeconomic performance and perceptions of economic well-being, Figure 1 suggests it should not be such a "head-scratcher." After rising at rates close to that of productivity over the latter 1990s, the real median wage flattened in real terms, as did the average real wage of high school and even college-educated workers. Granted, the figure compares the second half of a recovery (1995-2000) with a period that includes a recession, but unemployment was below five percent by late 2005, and productivity growth has been even stronger in the 2000s than in the latter 1990s.

In other words, the productivity/wage gap towards the end of the figure is not wholly a cyclical phenomenon. Nor can it be explained away, as some have tried to do by citing the growth of employer-provided fringes. Over the five years of economic recovery—2001q4-2006q4, real compensation grew at an annual rate of 0.8% while productivity grew 2.8% per year.[2] In fact, as is extremely clear in Figure 2, which plots the long-term relationship between productivity and the compensation of non-managerial workers, this

[1] For example, according to the New York Times exit poll, two-thirds of voters reported that they are either just maintaining their living standards (51 percent) or falling behind (17 percent).
[2] Real compensation is from the Employment Cost Index, and productivity is nonfarm business.

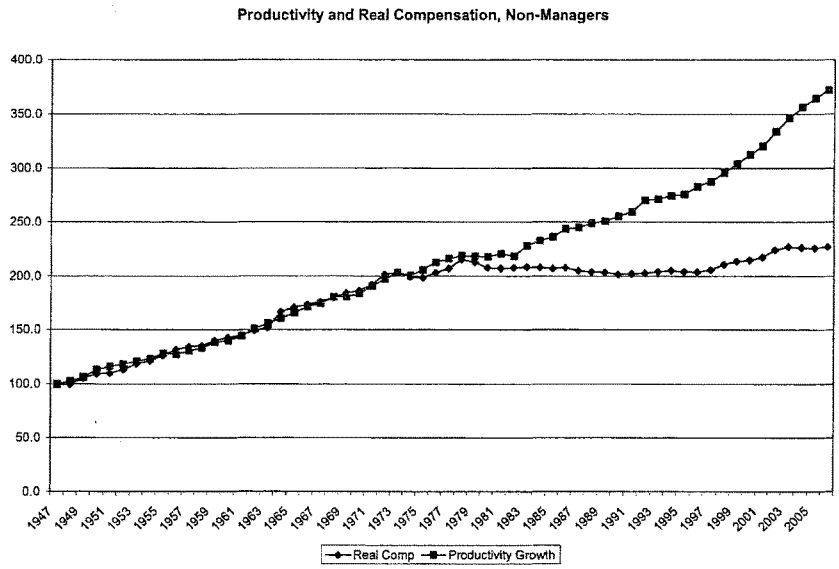
gap between growth and living standards of working families has been a prominent and unsettling feature of the economy over recent decades.[3]

The Productivity-Pay Gap:
Hourly productivity and real wage growth, 1995-2006



Source: Mishel et al, 2006, Fig. A.

[3] Wage data in Figure 2 are from the BLS series on average hourly wages of production, non-managerial workers (about 80% of the workforce). These values are scaled up to include fringes by multiplying them by the ratio of compensation to wages from the NIPA accounts.



There are many reasons why this gap has evolved but in this testimony I focus on two related determinants: the absence of full employment and the loss of worker bargaining power. The key points are as follows:

- The combination of slack labor markets and diminished distribution mechanisms such as unions, minimum wages, and more balanced trade, has led to a persistent gap between growth and living standards for many working families.
- One reason for this imbalance has been allegiance to a "natural rate" theory of unemployment. Despite little evidence to support its contemporary use, this theory has led policy makers to give greater weight to inflation relative to unemployment concerns, and has thus been partly responsible for years of unnecessary slack in the job market.

- The post-1973 growth slowdown does not explain the extent to which middle incomes have lagged growth. Other factors are in play, including slack job markets and diminished bargaining power.
- During periods of full employment, middle-family wage and income growth has been much stronger, and inflation has grown no faster than periods of slack job markets.
- Economic elites have been operating from a playbook with an inherent bias against broadly shared prosperity. There is, at this point in time, no legitimate macroeconomic rationale for this bias, and I urge policy makers to chart the course back to a policy set that restores full employment, worker bargaining power, and much more equitable outcomes.

The Evolution of Natural Rate Theory and Its Impact on Working Bargaining Clout

Any discussion of full employment must deal with the concept of the NAIRU, the non-accelerating inflationary rate of unemployment. For the purposes of this panel, the important point is that the NAIRU model generates the "natural rate of unemployment," the rate below which inflation would not merely rise, it would continuously accelerate until unemployment went back up to the so-called natural rate. The Congressional Budget Office currently estimates this rate to be five percent.

Its relevance to our discussion today is clear. If this concept is wrong in that it fails to accurately describe the relationships between these key variables, using the NAIRU to set monetary policy could lead to unnecessary slack in the job market, which is particularly devastating to the least fortunate and demonstrably harmful, as I show below, to the income growth of middle-income households as well. Similarly, if the concept is right but we cannot accurately estimate the correct value—the unemployment 'floor,' as it were—we also risk the danger of erring on one side or the other.

Like many economists today, I consider the NAIRU to be a poor guidepost for policy makers.[4] Events have overtaken the original model, and while some useful advances have been made (Ball and Moffitt, 2001), the evidence I present below suggests that subscribing to the model risks persistent and unnecessary slack in the economy, wasting billions of dollars and consigning millions of potential workers to fewer job opportunities and lower wages than should be the case.

In brief, and simplifying considerably, the original NAIRU story was based on the idea that the unemployment rate is usually at equilibrium, i.e., just where it should be in terms of supply, demand, and stable prices. Those unemployed at this "natural rate" can't find work at the wage they think they deserve, but that's because they have an upwardly skewed view of their worth (or marginal product). However, the monetary or fiscal policy authorities want to lower the unemployment rate, and get these folks a job, so they undertake stimulative actions (lower interest rates, tax cuts, etc.).

Wage offers do rise, and these formerly jobless workers leave the sidelines and join the job market. However, firms offset their now higher labor costs by raising prices. Soon, the new workers recognize that they've been tricked: their reservation wage, though finally met, is not going as far as they think it should. They then demand yet higher wages—and this is a key piece of the theory that I critique in a moment—and the wage/price spiral is underway. The only way to stop it is for unemployment to return to the natural rate, but by then, the inflationary damage is done.

When this model was developed in the 1960s, it had strong predictive power and seemed to accurately describe events, particularly in the latter 1970s. But evidence over the past decade, stemming both from research and real events, suggests that the model no longer holds and that policy maker's allegiance to it has done more harm than good—in my view, a lot more.

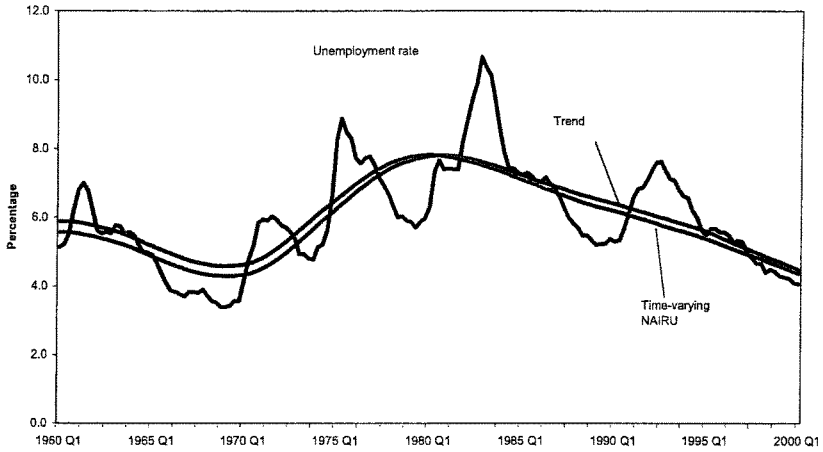
[4] International Economist, Benefits of Full Employment, Chapter 2.

Most recently, the NAIRU took a beating in the latter 1990s, a period of great relevance to my testimony regarding the benefits of full employment. At that time, economists believed that full employment was consistent with an unemployment rate of six percent, so when the jobless rate began to fall well below this alleged natural rate, the NAIRU-ites expected inflation to accelerate, especially given the increase in real wages. To the contrary, inflation decelerated.

Undaunted, NAIRU devotees made two adjustments. First, they allowed that because of changes in the economy and workforce, the value of the natural rate varied over time. This led to estimates like those in Figure 3, created by top macro-economists in a 2001 publication.[5] The figure shows that the TV (time-varying) NAIRU is just about the same as (is statistically indistinguishable from) the unemployment rate. If this is true, then we can't know the NAIRU in real time (since the trend will be changing in unknowable directions in real time) and the concept becomes a very weak guidepost. As Leone noted, "If the 'time-variant NAIRU' looks to all the world like a smoothed version of the actual unemployment rate...then policymaking based on the NAIRU comes perilously close to a formalized version of the simple rule of thumb: 'keep the unemployment rate near its average of recent quarters.'"[6]

[5] Staiger, Stock, and Watson (2001).
[6] Richard Leone, in foreword to Krueger and Solow, 2001.

Unemployment rate and NAIRU, 1960-2000



Source: Staiger, Stock, and Watson, 2001

Second, economists began to add productivity growth to the model, a variable that was not in the original formulation. This has turned out to be an important development indeed. Alan Greenspan, for example, appears to have recognized that with productivity accelerating in the latter 1990s, higher labor costs could be non-inflationary, as they were offset by steady unit labor costs. This makes sense: firms in the latter 1990s generally kept their profit margins intact, and paid higher wages out of more efficient production, obviating any pass-through to prices.

It makes sense, but it's not a NAIRU model, and this is part of my message. It is not at all clear that the Federal Reserve is operating from this model. The unemployment rate has been well below the CBO NAIRU, yet the Fed is into a sustained pause regarding interest rates and inflation appears to be decelerating. While concerns about tight job markets generating wage-push inflation are of course evident in their statements and speeches, the actions of neither the Greenspan (in the second half of the 1990s) nor the Bernanke Fed appear to be dominated by concerns about the natural rate.

I believe one reason for this is the diminished bargaining power of the American worker. Over the post-1979 period when inequality and wage stagnation were most pronounced, unionization rates fell by half, from about 25 to 13 percent. The real value of the minimum wage fell to its lowest level in 50 years. Trade penetration has climbed steadily (exports plus imports are up from about 19% to 28% of GDP since 1979) and our international indebtedness has grown to historically unprecedented levels, as globalization and offshoring increasingly put U.S. workers in competition with workers around the world.

With significantly diminished bargaining power, the NAIRU story falls apart. Unemployment is not voluntary, and workers can't push for ever higher wages. Econometricians can make these models fit by allowing them to move with trend unemployment or productivity growth, but these changes violate the basic premise of the model, which is based on workers' behavior and expectations, and these behaviors have changed in ways that render the model ineffective.

The structure of the economy has changed significantly over the past few decades, and these changes have had a major impact on the distribution of power, and thus the distribution of economic rewards. Simply put, in a labor market that lacks the institutions and norms that provide workers with some bargaining power, in an economy where those whose access to power and assets gives them a huge upper hand in the distribution of wealth, the predictable outcome is precisely the surge in inequality we have seen over the past few decades.

In this context, full employment partially takes the place of those institutions and norms that previously ensured a more equitable distribution of growth. It is one of the few reliable sources of bargaining power available to the American worker today.

Full Employment, the Natural Rate, Inflation, and Median Family Income Growth: A Long-Term Perspective

With the caveat that I'm reducing many big and complicated changes over many years into a few key variables, the following two tables make an important and compelling case for a new economic policy that gives great prominence to concerns regarding bargaining power, full employment, and inequality.

The first table shows the annual growth rates in the real income of the median family, productivity growth (the source of improved living standards), and average unemployment, a rough proxy for full employment/bargaining power. Obviously, big changes occurred in our economy over these long periods. Changes in family and labor force composition, family labor supply, immigration, technology, trading regimes, and much else are embedded in these trends.

In the first period, real median income and productivity grew at about the same rate, while average unemployment was 4.8%. In the second period, median income grew much more slowly, and the average unemployment rate was considerably higher: 6.3%. The lack of income growth over this second period is typically ascribed to the slowdown in overall growth—shown in the table as a point less per year of productivity growth (1.8% vs. 2.8%).

But these data show that it is not correct to stop with the insight that both the economy and income grew more slowly, post 1973. The deceleration in middle-class income growth, shown in the bottom line of the table, was much greater than the slowdown in productivity growth. Note also that this income slowdown occurred despite the large increase in women's labor supply; Mishel et al (2006, Table 1.24) show that among middle-income families with children, 1979-2000, working wives added over 500 hours, the equivalent of over three months of full-time work in the paid labor market.

In other words, along with the productivity slowdown, the list of bargaining-power-reduction factors noted above came into play, and what growth there was flowed less to the broad majority of working families. At the same time, unemployment was 1.5 points higher on average. The fact that there was less growth to go around is only part of the

story. Because of shifting bargaining power and the loss of full employment conditions, middle-income families worked harder but gained less.

Middle-class income, productivity, and unemployment: two regimes

	Annual Growth Rates		
	Real Median Family Income	Productivity Growth	Average Unemployment
1948-1973	3.0%	2.8%	4.8%
1973-2005	0.6%	1.8%	6.3%
Difference	-2.4%	-0.9%	1.5%

Sources: Census and BLS. Productivity is for nonfarm business sector.

Again, these outcomes have many determinants, but one is the shift away from a macroeconomics based on full employment to a microeconomics based on managing individual incentives and expectations. Moreover, despite statistics like those above, the consensus view among economists and policy elites is that the policy shift has been a smashing success. Paul Krugman, in a recent essay on Milton Friedman, a founder of the natural rate theory, made this same point: "...given the common assumption that the turn toward free-market policies did great things for the US economy and the living standards of ordinary Americans, it's striking how little support one can find for that proposition in the data."[7]

A final table, similar to the one above, adds a NAIRU analysis to the picture. Using CBO historical estimates of the NAIRU, we can determine when the actual unemployment rate was above or below the "natural rate." The first column of the table accumulates the annual percentage-point differences over the two time periods. Thus, if CBO's NAIRU

[7] See Krugman, http://www.nybooks.com/articles/19857.

was 5% and the actual jobless rate was 4.5%, this would show up as a -0.5 percentage point in our analysis.

Over the period when middle-incomes tracked productivity, the unemployment rate was often below the NAIRU, cumulatively 19 percentage points below over the years 1949-73. This happens to be about the same number of points that unemployment was above the NAIRU in the latter period. Not only was middle-income growth much higher in the period when we were often below the NAIRU, but inflation was lower as well (and note that the latter-year inflation comparison leaves out the years of very high inflation in the early 1980s to avoid an upward bias; nor do I adjust latter period income growth for families' additional hours of work).[8]

Clearly, from the perspective of middle-class incomes, tight labor markets, even below the supposed natural rate, were associated with much better income growth. As these numbers suggest, the concept of the natural rate has not been helpful to the median family.

NAIRU Divergence, Family Income, Unemployment, and Inflation, 1949-2006

	Cumulative Points Diverging From NAIRU	Real Median Family Income (annual growth)	Average Unemployment	Average Inflation*
1949-73	-19.4	3.2%	4.8%	2.4%
1973-2006	18.8	0.6%	6.2%	3.7%

* Post-73 comparison leaves out 1979-82 to avoid upward bias. Including these years gives an average of 4.3%.

[8] Core inflation follows a similar pattern, 2.9% in period one vs. 4% in period two, also omitting 79-82 from period two. BLS core inflation data begin in 1958, so period one goes from 1958-73 is this comparison.

Sources: CBO NAIRU estimates; Census Bureau, median family income (RS deflator); BLS, unemployment; BLS, CPI-RS deflator.

Conclusion[9]

The data in the table above cover many years and many regimes, leading some, no doubt, to discount their relevance. But consider that over the current business cycle, productivity growth has been stellar, growing once again at an annual rate of 3% (2000-06), while real median family income is down 0.5% per year (2000-05, most recent data). And look back at Figure 1 for a graphic depiction of a recovery that, at least from the perspective of middle-income workers, has been productivity rich but income poor.

I believe a reason for this productivity/income gap is that policy makers, led by neoclassical economics, have abandoned the two main goals of the economics of an earlier era: (1) ensuring that we as a society tap our collective potential and fully employ our economic resources, especially people, and (2) providing individuals with ample protections and publicly provided insurance against undesirable market outcomes—weak job creation, high unemployment, rising poverty rates, falling real incomes—and other challenges like aging out of the workforce or becoming disabled.

This policy regime has been replaced by one devoted to: (1) getting rid of the policy set associated with the old economics and (2) making sure that individuals are offered the optimal incentives, the ones that should lead them to behave in ways that, according to the models, bring about the most efficient results.

In other words, the target of economic policy has shifted away from maximizing *society's* potential through promoting full employment and insurance against market failures, and towards incentivizing the *individual's* interactions with the market.

[9] Some of the material in this section is from Bernstein, 2006, Chapter 2.

Today, we're seeing the results of this shift: greater inequality, a fiscally strapped federal government, the shifting of risk from the government and the firm to the individual, the drying up of large risk pools, and the loss of the systems and institutions—like pension coverage, minimum wages, overtime rules, and a durable safety net—that smoothed some of the rough edges of our market economy, without diminishing its growth potential.

Can we, however, realistically take lessons from the past given the myriad changes that have occurred over the last few decades? As Andy Stern recently pointed out, "We're as far from FDR as he was from Lincoln, and I doubt he was looking to Honest Abe for policy guidance."

My colleagues at the Economic Policy Institute and I believe we can construct a policy architecture that both respects the opportunities and constraints of the modern, global economy, while lastingly reconnecting the living standards of the median family to the growth of productivity. Our project, the Agenda for Shared Prosperity, is well underway, and we encourage committee members to learn more about the ideas that we, along with some of the most progressive and innovative thinkers in economics today, are developing.

Along with health and retirement security, fair trade, education and fiscal policy ideas, we are developing an agenda for rewarding work, and maintaining full employment is at its heart. This, unsurprisingly, includes a role for the Federal Reserve. This role may entail rebalancing the inflation/unemployment trade-off with less emphasis on fighting the phantom menace of wage-push inflation. This committee may choose to take another look at the Humphey-Hawkins Act with an eye towards elevating the goal of full employment. The Fed chair, in his or her HH testimony to this body, might be required to explain whether the labor market is at full employment, and if not, what steps would be taken to get there.

For groups that are chronically underemployed—those out of the reach of even tight job markets—we might want to consider direct job creation. In Savner and Bernstein (2004), we argued that "...when labor markets are slack, we create public-service jobs to keep people gainfully employed, drawing on the successful experience of transitional jobs programs that have sprung up around the country using public funds to create work for people struggling to get a foothold in the labor market. Such jobs could meet important community needs and let people use their newly minted skills. What's more, the message is clear and consistent with values we all agree with: Everyone who wants to work should have the chance to do so."[10]

Of course, given that diminished worker bargaining power is at the heart of productivity/wage gap, measures that rebalance these dynamics will also facilitate a more equitable distribution of growth. Measures to level the playing field for union organizing, like the Employee Free Choice Act, make sense, as does the recent legislation to raise the Federal minimum wage. EPI's policy project suggests a framework for pushing back against the downsides of globalization while preserving the gains, including more aggressive tactics to reverse growing international indebtedness, and getting Congress back in the business of writing more balanced trade agreements.[11]

Opponents and defenders of the status quo may well argue that such proactive efforts will distort the invisible hand, lead to spiraling inflation, embolden workers to push for wages beyond their "marginal product," spook financial markets, and so on. But the historical evidence undercuts these arguments, showing no discernable utility of the "natural rate" model in the current context. Moreover, the magnitude of the productivity/wage gap, the extent of poverty amid plenty, the staggering levels of wealth concentration, the abuse of executive pay-setting practices, and the depth of economic insecurity among the American middle class suggest that the status quo is unacceptable. I urge the committee to consider these and other ideas as you undertake to chart a path back to broadly shared prosperity.

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[10] http://www.prospect.org/web/printfriendly-view.ww?id=8357.
[11] See Faux 2007, http://www.sharedprosperity.org/bp179.html.

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Testimony of Ron Blackwell
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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.

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Employment, Job Opportunities, and Inequality Among Workers in the U.S. Economy

Testimony to the
Committee on Financial Services
United States House of Representatives

February 16, 2007

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Chairman Frank, Ranking Member Bachus, and distinguished members of the Committee, I appreciate the opportunity to appear before you to discuss the state of the economy and the state of the labor market. I am an economist by background, and have long been very interested in the interactions between the macroeconomy, economic policy, and labor market outcomes. I speak here on behalf of myself and not the organizations with which I am affiliated.

Participation in the labor market is key to economic success in the United States. At an individual level, jobs and earnings are the primary source of income for most families; at a macroeconomic level, greater employment raises overall output and increases economic growth. In this testimony, I plan to focus on the economic opportunities available to the least-skilled workers in the population, discussing the extent to which they have been able to find work and earn enough to support themselves in the U.S. labor market. I will also say a few words about the problem of rising economic inequality.

It has always been clear that the most important policy to assist less-skilled workers is a healthy macroeconomy with strong job growth. There has been historically a strong positive correlation between unemployment rates and poverty rates: When unemployment rises, so does poverty. In fact, when cash assistance became less available to single-parent families during the 1990s, the correlation between unemployment rates and poverty for these families became stronger.[1] It is worth noting

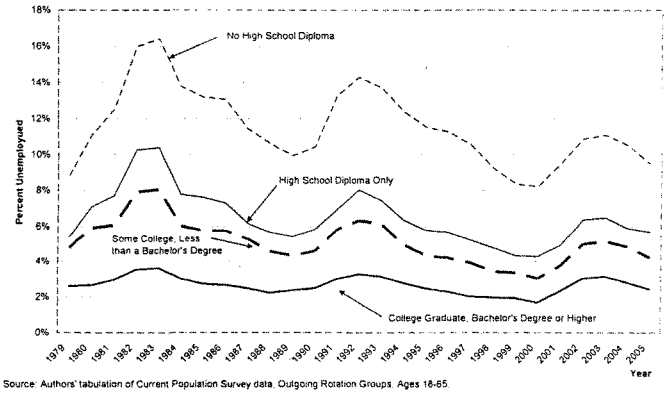
[1] Rebecca M. Blank, "Fighting Poverty: Lessons from Recent U.S. History," *Journal of Economic Perspectives*, Vol 14(2): 3-19, Spring 2000, or Robert Haveman and Jonathan Schwabish, "Has Macroeconomic Performance Regained its Antipoverty Bite?" *Contemporary Economic Policy,* Vol 19(4): 415-427, October 2000.

that inflation has little correlation with poverty.[2] For non-elderly adults and their children at the bottom of the income distribution, keeping employment high is significantly more important than keeping inflation low.

Trends in Unemployment and Labor Force Participation over the Past 25 Years

A primary reason why unemployment and poverty are strongly correlated is that unemployment tends to be concentrated among less-skilled and lower-wage workers. Figure 1 shows the trends over the last 25 years of unemployment rates by skill level, distinguishing between four groups of workers: those with less than a high school degree, those with only a high school degree, those with some post-high school training but not a four-year college degree, and those with a four-year college degree or more.

Figure 1
Unemployment Rates by Skill Level, 1979-2005



Source: Authors' tabulation of Current Population Survey data. Outgoing Rotation Groups. Ages 18-65.

Three immediate facts are clear from Figure 1:

[2] Op. cit.

- *Unemployment rates are substantially higher among less-skilled* rather than more-skilled workers. The brunt of unemployment at any point in time is borne by lower-wage workers. For instance, in January 2007, over 55% of those unemployed were low-skilled (with only a high school degree or less), although less than 40% of the labor force was in the low-skill category.
- *Unemployment among less-skilled workers is much more cyclical* than among more-skilled workers. When jobs become scarce, those who lose their jobs first tend to be the temporarily employed, the part-time employed, or those employed in less stable jobs and industries. This is disproportionately lower wage and less skilled workers. Hence, unemployment among the less skilled rises rapidly in economic slowdowns.[3]
- While overall unemployment rates remain quite low, *unemployment among less-skilled workers is still relatively high.* The ratio of unemployment among less-skilled (high school degree or less) to more-skilled (more than a high school degree) workers is higher now than in the late 1990s. The current economic expansion has not increased employment as much for less-skilled workers as did the amazingly strong economic expansion of the 1990s.

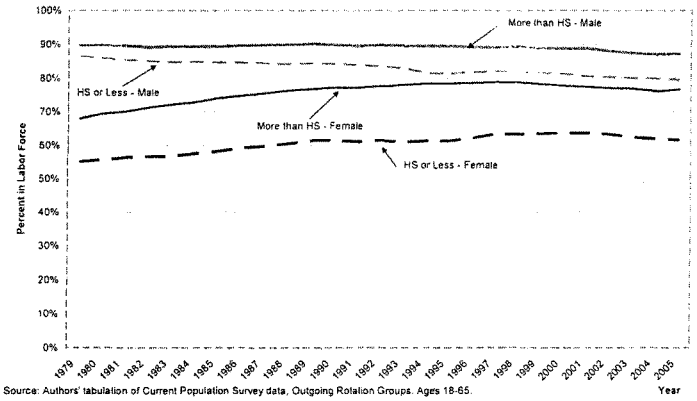
Of course, the unemployment rate is not a complete indicator of the job opportunities available (or not available) to workers. In times of higher unemployment, many workers, particularly women, tend to drop out of the labor market all together, which means they are not counted in the unemployment statistics. As a result, we often

[3] For more extensive information on the relatively greater responsiveness of less-skilled and more disadvantaged workers to the economic cycle, see Hillary W. Hoynes, "The Employment, Earnings, and Income of Less-Skilled Workers Over the Business Cycle," in *Finding Jobs: Work and Welfare Reform*, David Card and Rebecca M. Blank, editors, New York: Russell Sage Foundation, 2000.

look at overall labor force participation rates – the share of adults who are working or seeking work (that is, unemployed) – as a measure of the job opportunities available. More people are drawn into the labor market in a strong economy.

Figure 2 plots labor force participation rates over the past 25 years among more skilled and less-skilled men and women between the ages of 18 and 65, again distinguishing between those with a high school degree or less and those with more than a high school degree.

Figure 2
Labor Force Participation Rates by Gender and Skill Level



Source: Authors' tabulation of Current Population Survey data, Outgoing Rotation Groups. Ages 18-65.

Figure 2 shows two important trends:

- *Labor force involvement is falling among less-skilled men*, relative to more-skilled men. Surprisingly, this decline in work involvement continued even through the booming economy of the 1990s and has surely continued during the 2000s. This trend is particularly striking among African American men. Among less-skilled adult black men, only 66% report themselves at work or looking for work in 2005.

- In contrast to less skilled men, *labor force participation of less skilled women has been rising rapidly* over the past decade. This has been linked with welfare reform efforts and other policy changes (such as the expansion of the Earned Income Tax Credit) that pushed women off cash assistance and provided greater incentives for them to work.[4]

Why Has Work Fallen Among Less-Skilled Men While Rising Among Less-Skilled Women?

It is important to understand why it is that less-skilled women are working more while less-skilled men are working less, since this may give us a clue about how to reverse the decline in labor force participation among men. Part of the answer is policy-related. As access to cash welfare assistance has become more limited, less-skilled women (particularly single mothers) are working more. Between 1990 and 2004, the share of income from cash assistance fell from 23% to 5% among single mothers, while the share of income from earnings rose from 57% to 66%.[5] This helps explain why women might be working more, but it does not explain why male labor force participation is falling.

As welfare reform pushed women into the labor market, a number of other policies that were designed to subsidize work among lower-wage workers have disproportionately benefited less-skilled women and particularly single mothers. The large expansions in the Earned Income Tax Credit (EITC), which provides a substantial

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[4] Summaries of this research are provided in Rebecca M. Blank, "Evaluating Welfare Reform in the United States, *Journal of Economic Literature*, Vol 40(4): 1105-66, December 2002, and in Jeffrey Grogger and Lynn A. Karoly, *Welfare Reform: Effects of a Decade of Change*, Cambridge: Harvard University Press, 2005.

[5] Based on tabulations of Current Population Data.

subsidy through the tax system to low-wage workers in low-income families with children, have been very important in propelling more single mothers into work. Several researchers suggest the EITC was more important than welfare reform in increasing work and earnings. Along with welfare reform, both federal and state governments have significantly increased child care subsidies, making it cheaper for women with children to work. Finally, changes in public health insurance through Medicaid have also assured that children (but not their parents) in low-income families are covered by public health insurance.[6] This means that women who leave public assistance to work in low-wage jobs without health insurance coverage will no longer lose insurance for their children, and this may also have increased their willingness to work.

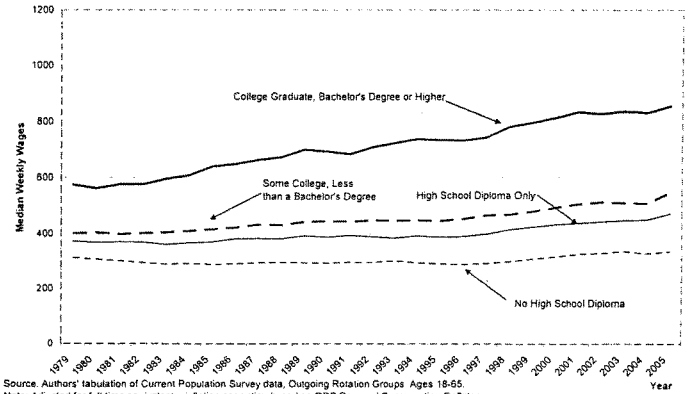
In short, *the United States implemented a set of policies that subsidized work and that particularly encouraged former welfare recipients to move into work.* The result was a significant increase in employment among this population. Furthermore, this increase in employment has lasted through the first decade of the 2000s, despite a somewhat more sluggish labor market. While labor force participation has fallen somewhat among less-skilled women in recent years, it remains above where it was in the early 1990s (see Figure 2).

But policy changes are not the only story for understanding differential male/female changes in employment. *Macroeconomic shifts in demand are also very important.* Declining demand for less skilled workers has pulled down wages of both less-skilled men and women. These declining real wages among men have been directly correlated with their declining labor force participation. Women's wages were less affected, however, as other offsetting forces have moderated these demand changes.

[6] The two publications referenced in footnote 4 also provide summaries of this research.

Figure 3 shows median weekly wage rates among women by skill level for the past 25 years. Wages among less-skilled women have increased over time, particularly since the mid-1990s. My own calculations of inflation-adjusted median weekly earnings indicate that women who are high school dropouts have seen their weekly wages rise by 14% between 1990 and 2005, while women with only a high school degree have seen increases of 21%.[7] These wage increases reflect increased labor market experience among women (which is correlated with higher wages), increases in the returns to experience (so that each year of experience results in greater wage growth), and sharp reductions in the extent to which women with children experience lower wages.[8]

Figure 3
Women's Median Weekly Wage Rates by Skill Level (2005 dollars)



Source: Authors' tabulation of Current Population Survey data, Outgoing Rotation Groups. Ages 18-65.
Note: Adjusted for full time equivalents; inflation correction based on GDP Personal Consumption Deflator.

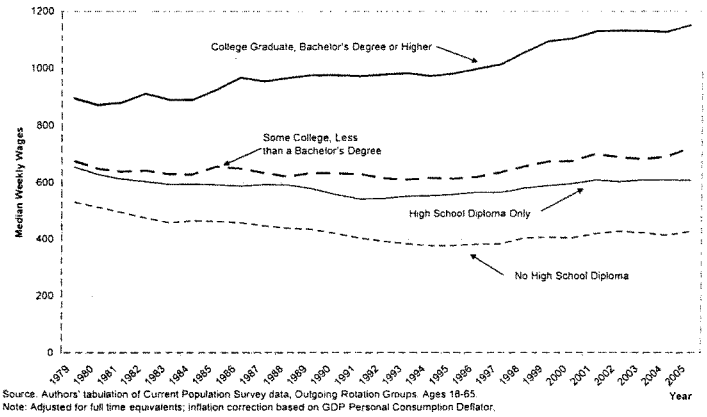
These wage changes among less-skilled women are in contrast to less-skilled men. Figure 4 shows the same wage trends among men by skill level over the past 25

[7] These calculations are based on the Outgoing Rotation Group data from the Current Population Survey for women ages 18-65. The data are adjusted for hours, to provide a measure of full-time equivalent wages. Inflation adjustments are based on the GDP Personal Consumption Deflator.

[8] See the article by Rebecca M. Blank and Heidi Shierholz, "Exploring Gender Differences in Employment and Wage Trends Among Less-Skilled Workers," in *Working and Poor: How Economic and Policy Changes are Affecting Low-Wage Workers*, edited by Rebecca M. Blank, Sheldon H. Danziger and Robert F. Schoeni, New York: Russell Sage Foundation, 2006.

years. In recent years, from 1990 to 2005, real median weekly earnings among men rose much less than among women. Among male high school dropouts, wages were virtually unchanged over this period, rising by 1%, while wages rose by 9% among those with only a high school degree.

Figure 4
Men's Median Weekly Wage Rates by Skill Level (2005 Dollars)



Source. Authors' tabulation of Current Population Survey data, Outgoing Rotation Groups. Ages 18-65.
Note: Adjusted for full time equivalents; inflation correction based on GDP Personal Consumption Deflator.

Less-skilled men and women have fallen progressively further behind their more skilled brothers and sisters; completing a high school degree no longer allows access to jobs that pay middle-income wages. In this sense, the job market has gotten tougher for both low-skilled men and low-skilled women. But other changes among women – growing work experience, greater returns to experience, and a reduced trade-off between children and wages – have offset these problems and led to somewhat greater wage increases among less-skilled women.

While the evidence suggests that less-skilled women are doing better than similar men, I do not want to paint a rosy picture of the low-wage labor market for women. Because women's wages are lower than men's, they often earn very low

incomes while struggling to meet the demands of their employers, caring for their children, and organizing child care during work. One group in particular appears to be struggling the most. A group of highly disadvantaged single mothers seems to be facing particularly low incomes. This group – often referred to as "disconnected" -- is neither working nor on welfare. Most disturbing, this group has been growing rapidly post-welfare reform. Currently, 20 to 25% of single mothers report themselves as neither working nor on welfare, double the number only 10 years ago.[9]

This group is very poor. Only half of these mothers live with another adult, and even those who do have low household incomes. Research suggests that this disconnected group is largely composed of women who have left welfare but who have multiple disadvantages or barriers to work, including low skills, health problems and especially problems with depression, responsibility for a child or adult with health problems, substance abuse problems, and current or past experience with domestic violence. The more such "barriers" a women faces in her life, the less likely that she is able to find and keep a stable job.[10]

Unfortunately, cash assistance through welfare has become increasingly unavailable to these women as well. This population is most likely to be either time-limited from welfare or sanctioned for non-compliance with welfare rules. I am deeply concerned about this quarter of single-mother families – and their children! – that have not succeeded in making a stable transition from welfare to work and who are able to work only sporadically or part-time. This is a group for whom we need to rethink our

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[9] Rebecca M. Blank, "Improving the Safety Net for Single Mothers Who Face Serous Barrier to Work," *Future of Children*, Vol 17(2), forthcoming Fall 2007.

[10] Op. cit. See also Lesley J. Turner, Sheldon Danziger and Kristin Seefeldt, "Failing the Transition from Welfare to Work: Women Chronically Disconnected from Employment and Cash Welfare." *Social Science Quarterly*, Vol 87(2): 227-249, June 2006.

policies, re-creating a safety net that can help provide economic stability to this group of women and children.

The Impact of Inequality

It is, of course, worth noting that Figures 3 and 4 indicate strong and continuous increases in wages among the college educated. The demand for more-educated workers has grown strongly over the past 25 years, while the demand for less-skilled workers has not. This rising inequality in wages is reflected in rises in household income inequality as well, although income inequality has not increased as much as wage inequality. This is because more adults in poor households are working today than in past decades, hence increases in hours of work are offsetting relative wage changes.[11]

Rising inequality has been correlated with a variety of economic shifts in the U.S. economy. Shifts in demand have privileged more-skilled workers, relative to their less-skilled brothers and sisters. These demand shifts are due to changes in technology and in the global competition for workers.[12] More-educated U.S. workers – and we have the best group of highly-educated workers in the world – have gained enormously from the expanding and increasingly interconnected international economy and from the new technologies in information and communication. Less-educated workers have gained much less from these changes.

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[11] Sheldon H. Danziger, "Fighting Poverty Revisited," FOCUS, Institute for Research on Poverty, University of Wisconsin-Madison, forthcoming.

[12] An extended literature discusses these wage trends. A very good recent contribution summarizes this literature, David H. Autor, Lawrence F. Katz, and Melissa S. Kearney. "Rising Wage Inequality: The Role of Composition and Prices." National Bureau of Economic Research Working Paper No. 11628, Cambridge, MA: NBER. September 2005.

Why should we care about rising inequality? There are at least three reasons. First, there is a *sense of economic deprivation* among lower income families, as they watch others move further ahead. Tuition for higher education is increasing faster than inflation; housing prices and rents in many areas of the country have increased much faster than overall prices. Health care is almost impossible to purchase on the open market, if not provided by one's employer. Lower-wage workers in today's economy find it hard to achieve those things that are part of the American dream…your own house, a job with pension and health benefits, or the opportunity to send your children to college.

Second, economic inequality is *deeply linked with other types of social inequality.* Health disparities between more and less-educated workers have widened over the past few decades. Differences in educational achievement are widening between the best and worst students. These social inequalities only reinforce economic inequality. More troublesome, they may limit opportunities for the children of today's lower wage workers. Economic mobility has always been an important promise in America. But widening inequality makes it harder for the children growing up in today's low-income families to dream about doing better. In fact, quite a bit of evidence now suggests that economic mobility is greater in many European countries than it is in the United States.[13]

Third, economic inequality and a sense of relative deprivation can have *negative effects on the civic and the political realm.* The economic experiences of the past two decades are very different for those with a college education than for those with only a high school education. This makes it hard to engage in a common conversation about economic problems and their solutions. Fear of technological change and of

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[13] Markus Jantti, et. al., "American Exceptionalism in a New Light: A Comparison of Intergenerational Mobility in Nordic Countries, the U.K. and the U.S.," IZA Discussion Paper No 1938, Bonn: IZA, 2006.

growing economic internationalization is fueling a backlash that can lead to bad policies that limit future economic growth. Public discussions of social security reform or health insurance reform are hard to hold when the bottom third of the population has only social security and Medicare to rely on in old age, while the top third has extensive market investments and long-term supplemental health coverage through their job. In short, economic inequality makes it harder to solve our common problems and harder to evoke a sense of common purpose and experience. This is not only inconvenient for politicians; it can threaten the civic nature of public debate in a democracy.

Inequality is an inherent and necessary part of any market economy, but the sharp rises in relative well-being between different groups in the current economy is very troublesome. High and rising levels of inequality are a social and economic problem that will limit economic and policy progress on many fronts.

Policy Implications

What do we need to be thinking about on the policy front to deal with these differences in employment and earnings opportunities? I strongly agree with Federal Reserve Chairman Ben Bernanke, who in a recent speech has called for investments in education and training to moderate inequality.[14] In the long run, more Americans need more and better education; and as Chairman Bernanke has noted, it might be as important to expand pre-kindergarten education as to reform high schools. There is increasing evidence regarding the value of publicly available pre-K programs, for instance.

[14] "The Level and Distribution of Economic Well-being", speech by Ben S. Bernanke on February 6, 2007. See http://www.federalreserve.gov/BoardDocs/Speeches/2007/20070206/default.htm

But, by itself, a strategy focusing on educational improvements is not enough to assure adequate work and income among less-skilled Americans and their families. At least three other broad policy components are necessary:

(1) We need a *strong labor market with growing demand for workers at all skill levels.* Interestingly, some recent research suggests that middle-income workers may be recently experiencing as many or more limitations in job growth as lower-wage workers.[15] Those of us from Michigan are especially aware of the need to keep our economic growth strong and our industries competitive. This means macroeconomic policies that provide stable economic growth and low unemployment for all workers.

(2) We need to *maintain and expand our policies that subsidize work for the least skilled and that encourage adults to take and keep jobs.* It is an unfortunate fact that employment may not lead to economic self-sufficiency among today's low-wage workers. As their wages have grown more slowly, rising energy prices and rising housing prices have left less-skilled workers struggling to pay the bills. For the least-skilled workers, full-time work at or near the minimum wage results in an earnings level that is well below poverty if they are trying to raise children and support a family.

While I know that this Committee tends to focus on more macroeconomic policies, a healthy macroeconomy requires attention to specific policies that subsidize and encourage less-skilled workers to stay in the labor market. We are far better off keeping less-skilled workers stably employed in mainstream jobs than risking the social problems that result from lack of jobs or inadequate incomes, including crime, underground economic activity, lack of residential stability, and a cycle of poverty and

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[15] David H. Autor, Lawrence F. Katz, and Melissa S. Kearney, "The Polarization of the U.S. Labor Market, *American Economic Review*, Vol 96(2): 189-194, May 2006.

low skills that gets passed from one generation to the next. This means maintaining the EITC and even extending its generosity among less-skilled workers who do not have younger children to support. It means a moderate minimum wage, set at levels similar to where it has historically been set. It means assuring that low income families have health care available to them, so that illness doesn't mean economic disaster from either loss of employment or unpayable medical bills. It means that Unemployment Insurance should be available to workers who lose their jobs, even if those jobs were part-time or low-wage.

(3) It is important *to think creatively about ways to make sure that all Americans benefit from the economic growth caused by recent economic shifts*. The economic changes of the past 25 years have not been good for less-skilled workers. Perhaps these problems were neither preventable nor foreseeable. As an economist, I believe in the value of global markets and world trade for U.S. economic growth, just as I believe in the value of inventing and applying new technologies to increase productivity. These changes have provided enormous advantages to college-educated American workers. But they have disadvantaged less-skilled workers.

There are two ways to distribute the benefits of these changes more broadly. First, we can redistribute some of the gains through the tax and transfer system. This is exactly what an expanded EITC or better health care coverage provides. Second, we can assist those workers who are displaced by new technologies or by shifts in where goods and services are produced. A policy such as wage insurance, aimed at cushioning income losses for displaced workers, can help America's workers adjust to a changing economy.

Work is a good thing in the lives of adults. It produces income, but it also provides a sense of self-value by demonstrating that an individual has skills to contribute that the economy values. We should do all we can to encourage men and women to acquire the skills and work behaviors that allow them to support themselves and their children. But we should also do all we can to guarantee that there are jobs available to those who want to work, and to ensure those who demonstrate their ability and willingness to work are able to support themselves and their families.

Thank you.

House Committee on Financial Services

Hearing on monetary policy

February 16, 2007

James Grant
written statement

The Federal Reserve figuratively prints the thing we all want more of. Why so little of this manna seems to find its way into deserving pockets is at the top of today's agenda.

Under the law, the Fed has a dual mandate. It must protect against inflation, as defined, and promote full employment. But Congress and the American people have come to expect much more from our central bank than even that tall order. We ask, in addition, that it make an inherently risky world safe. We expect the Fed to deliver us from the consequences of hedge-fund explosions, sovereign-debt defaults, bear stock markets, bank failures, deflations and other financial and economic vicissitudes.

It can't be done. Goldman Sachs itself would blanch at the task. It's not that low inflation and high levels of employment are incompatible. They are not, I believe. The experience of the past 50 years assigns a pretty heavy burden of proof to any exponent of the so-called Phillips curve in any of its many guises. A little more inflation may bring forth (for a while) a little more employment. Much more dependably, a little inflation will deliver a little more inflation, and then a little more, and so forth, followed by much less employment.

The trouble with the Fed's mandate boils down to two obstinate facts. The first concerns inflation itself. It is not easy to define, let alone to control. "Too much money chasing too few goods" is familiar but incomplete. "Too much money, period," is better, though admittedly vague. What the money chases varies from era to era. In the 1970s, it was goods and services. More recently, it was houses (and office buildings and highly leveraged corporations, among other investment assets). The fact that we called this levitation of house prices something besides inflation does not alter the fact that a monetary disturbance changed the way millions of Americans lived and worked. Once upon a time, former chairman Alan Greenspan defined inflation as a change in prices sufficient to cause people to adjust their behavior. The house price bubble exactly conforms to that definition. It was a kind of inflation.

Obstinate fact No. 2 lies in the way the Fed goes about its work. It fixes an interest rate. This one and only policy instrument is a very blunt tool. What Pope Julius II did not say to Michelangelo was, "Here's your roller. Now go paint the ceiling of the Sistine Chapel." It is worse than that with the Fed, however, because a paint roller never

destroyed an industry or led directly to shortages of New York City apartments or disintermediated the nation's thrift institutions. So great is the Federal Reserve's prestige that it is easy to gloss over the essentially disreputable method by which it goes about its job. The fact is that the Fed—like the unreformed Texas Railroad Commission, the New York City rent-stabilization apparatus and the late, unlamented Interstate Commerce Commission and Civil Aeronautics Board—is in the business of price control.

Now I want to give credit where credit is due. The currency that the Fed sponsors is passed from hand to hand the world over. It is not the first dominant global monetary brand—the pound sterling ruled the roost in the 19th century and for a few decades of the 20th. But the dollar is the first universally honored irredeemable paper currency. Not since 1971 has anything tangible stood behind it. It is uncollateralized—faith-based—yet the world accepts it. It is America's greatest export. The United States consumes much more than it produces and discharges its foreign debts in money that it alone is allowed to print. If there were ever a golden age of paper money, this is it.

Perhaps out of respect for these wonderful facts, the financial world has suspended its disbelief about the Fed's operating method. Ask a Wall Street economist if the Department of Agriculture should set soybean prices or the Federal Energy Regulatory Commission gasoline prices, or whether the Fed itself should get back into the business of fixing bank deposit rates (as it did from 1933 to 1980), and your answer would be a disdainful stare. Yet these same believers in the efficacy of price discovery accept that the Fed can determine the correct federal funds rate. They go further: Having dreamt up the right rate, the Fed should impose it on the market.

Of course, people in markets are not infallible. Neither are people in bureaucracies incapable. Markets are not divinely ordered. But market judgments, however imperfect, are generally less imperfect than the decisions decreed from on high. It's true that the Fed does not impose its will without reference to markets. But, having taken the markets' pulse, the Fed sometimes decides that it knows better than they do. It so judged in 2002-03, and it seems to believe it again today. This is very thin ice on which the Fed is skating—on which we are all skating, the American wage earner not least.

The Fed was at its most unilaterally willful four years ago. You may recall that the Federal Open Market Committee was agitated about what it chose to call deflation. The stock market bubble had burst, there was a short recession (March-November 2001), the CPI had lost its bounce and employment growth was disappointingly sluggish. Japan had not yet rubbed the sleep out of its eyes from a decade-long economic hibernation. The risk of falling prices preoccupied our central bank.

The Fed had begun to chop away at its interest rate before the recession officially began. It was hard at it all during 2001. By the time the anti-deflation campaign reached full rhetorical strength, the funds rate sat at 1¼ percent, the lowest in decades. But it was still too high, the FOMC broadly hinted. Messrs. Bernanke and Greenspan vowed to do everything in their power to hold the inflation rate to a decent minimum, say 1½ percent

to 2 percent a year. And to what lengths would they go? "[T]he U.S. government has a technology called a printing press (or, today, its electronic equivalent)," said Mr. Bernanke in November 2002, "that allows it to produce as many U.S. dollars as it wishes at essentially no cost." That left little enough to the imagination. Neither did the remarks of his then boss, Mr. Greenspan, who observed: "The Federal Reserve has authority to purchase Treasury securities of any maturity and indeed already purchases such securities as part of its procedures to keep the overnight rate at its desired level. This authority could be used to lower interest rates at longer maturities. Such actions have precedent: Between 1942 and 1951, the Federal Reserve put a ceiling on longer-term Treasury yields at 2½%."

To some of us, these urgent warnings seemed misplaced. They were inconsistent not only with earlier Fed pronouncements, but also with common sense. In the late 1990s, the Fed could hardly stop talking about free trade and high productivity growth. They were unqualified blessings, it said. Digital technology was a time-and-motion man's dream come true. The fall of communism and the rise of the Internet were opening previously shut-in labor markets in Asia and the former Soviet Union. The global supply curve was shifting downward and to the right.

The sum of these changes pointed strongly to everyday low, and lower, prices for tradable goods and services. Was this not a good thing? Not exactly, the Fed now decided. Once the inflation rate approached the zero mark, it might keep falling. And if prices actually fell, and kept falling, why would anyone go shopping today? They would wait for the sales tomorrow. And it must have weighed on Messrs. Greenspan and Bernanke that the U.S. economy was increasingly leveraged. Falling prices are good for consumers, bad for debtors. The United States itself had become a sizable debtor to the rest of the world.

Wall Street did not dwell overly long on the possible inconsistencies of the Fed's anti-deflation policy. It focused instead on moneymaking. If Mr. Greenspan, a lifetime apostle of free markets, was now threatening to muscle 10-year yields down to as low as 2½ percent, it was an open invitation to buy bonds. Market interest rates, including mortgage rates, duly plunged.

Interest rates are the traffic signals of a market economy. Green, red or amber, they direct the speed and destination of investment capital. The solid green signals of the early 2000s channeled capital and labor into residential real estate. The influx transformed the character of the mortgage market. No more, it seemed, did home buyers have to apply for a loan. More and more, the lenders came to them, whoever they were. Newfangled mortgages—"affordability products," as they were called—threw open the doors of home ownership to millions of formerly unqualified buyers.

The Fed's low interest rates and the lenders' ingenuity combined to bridge the gap between high house prices and not-always-high incomes. If a simple adjustable-rate mortgage could not close the deal, the bankers and brokers had other ideas. Option ARMs, deferred-interest loans and easily accessible junior liens meant that just about

nobody couldn't qualify. White lies, too, played their part in the drive toward universal home ownership. So-called low-documentation mortgages put the applicant on his or her honor. Income? Job title? Years of employment? Your word was your bond. Low-doc mortgages became especially popular among subprime buyers. In 1999, according to UBS mortgage research, just 21 percent of low-rated loans were closed with less than full documentation. In the past two years, fully 41 percent were. Wall Street gathered up these millions of new mortgages, packaged the collateral and modeled the cash flows to create asset-backed securities. The scale of this operation is one of the wonders of modern finance. Of all the residential mortgages outstanding in the United States, 80 percent were originated after 2002. Of all the subprime mortgages outstanding, 75 percent were originated after 2003.

Without this interest-rate-assisted mortgage boom (and credit-assisted consumption boom), job growth in the early 2000s might have been even more sluggish. As it was, according to Asha Bangalore, an economist at Northern Trust Co., housing-related employment generated 43 percent of all private-sector job creation from November 2001 to April 2005. As might be expected, this kind of work has been getting scarcer. Thus, from November 2001 to January 2007, and housing-related businesses have produced just 19 percent of all private-sector jobs. The famously adaptable U.S. economy is generating new opportunities.

Adaptability is a very handy quality these days, as the financial traffic lights are sometimes stuck on red or green, a source of con confusion and the occasional financial pileup. Now is one of those difficult times. The Fed's interest rate, 5¼ percent, is the highest on the Treasury yield curve. The market seems to want a lower structure of interest rates, whereas the FOMC is prepared to push higher. The market appears to be less worried about inflation than about the unintended consequences of the mortgage bubble—i.e., rising delinquencies and foreclosures, a nasty downturn in the prices of some of the mortgage-backed securities created last year and the risk of contagion in the wider economy. The Fed, for now, will have none of it. It is worried about inflation but sanguine on the economy and the housing situation alike.

Pharmaceutical companies must disclose the side effects of the pills and medications they advertise, and the purveyors of monetary remedies should be held to a similar standard of candor. Once, at least, the FOMC seemed to own up to some of the unwholesome consequences of its radical intervention of 2001-04. "Some participants," said the minutes of the Dec. 14, 2004, FOMC meeting, "believed that the prolonged period of policy accommodation has generated a significant degree of liquidity that might be contributing to signs of potentially excessive risk-taking in financial markets evidenced by quite narrow credit spreads, a pickup in initial public offerings, an upturn in mergers-and-acquisition activity and anecdotal reports that speculative demands were becoming apparent in the markets for single-family homes and condominiums."

These concerns were well-founded, and two years later the "signs of potentially excessive risk-taking" are even more glaring. The subprime mortgage market, about which we are suddenly hearing so much, has its counterpart in the business world.

Speculative-grade corporations are borrowing heavily at concessionary interest rates and with ever less documentation. They, like the subprime mortgage borrowers of 2005 and 2006, seem to expect low rates to persist or—at the very least—that the capital markets will afford them some future opportunity to refinance their debts on terms just as advantageous as the ones they have recently secured. On the other hand, millions of subprime borrowers are discovering that sometimes interest rates go up, and asset prices go down.

The Fed owes its public a forthright accounting of the risks it runs with the policy it pursues. I mean the risk that it picks the wrong interest rate, one that sets in motion a train of adverse events unimagined by the people who imposed the rate in the first place. In all things economic and financial, the Fed is a force for what it likes to call stability. But few things are so ultimately destabilizing as a belief that the world is in for a long spell of peace and quiet.

The Fed, like a good physician, should first do no harm. And, like a good drug company, it should not withhold its warnings on side effects. In interest rates as in painkillers, the secondary reactions can be debilitating.

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Your MasterCard or Your Life
By Bob Herbert
The New York Times

Monday 22 January 2007

Americans are increasingly living in a house of cards - credit cards.

A disturbing new report shows that with health care costs continuing their sharp rise, low- and middle-income patients are reaching for their credit cards with alarming frequency to cover treatment that they otherwise would be unable to afford.

This medical debt, to be paid off in many cases at sky-high interest rates, is being loaded onto consumer debt that is already at dangerously high levels. Many families have been crushed by the load, driven from their homes, forced into bankruptcy, and worse.

The report, released last week, was jointly compiled by Demos, a public policy group in New York, and the Access Project, which is affiliated with a health policy institute at Brandeis University and is trying to broaden the availability of health care in the U.S.

Imagine for a moment the seriously ill patient who needs to be hospitalized. In the cold new world of health care, the primary message to such patients is often "Show me the money!"

In many instances, of course, the patient does not have the money. What the report found is that even people with health insurance are being drained by health care costs to the point where the credit card seems the only option.

"As deductibles and co-payments increase," the report said, "hospitals are finding more patients unable to pay their medical bills. Some hospital management analysts are expecting an increase in self-pay patients and are bracing for higher levels of bad debt.

"In recognition of the evolving payment landscape and the risk of hospital bad debt, health care providers are more aggressively seeking upfront collection of co-pays and deductibles. A component of this strategy is to encourage patients to use third-party lenders such as credit cards to pay for medical expenses they cannot afford, which families frequently do to meet high medical bills."

It's one thing to reach for your Visa or MasterCard to pay for a Barbie doll or flat-screen TV. It's way different to pull out the plastic because you've just learned you have cancer or heart disease, and you don't have any other way to pay for treatment that would prevent a premature trip to the great beyond.

A society is seriously out of whack when legalized loan sharks are encouraged to close in on those who are broke and desperately ill.

This medical indebtedness is hardly surprising. Health care costs continue to rise much faster than family income and inflation, and Americans (who have stopped saving altogether) were already mired in staggering amounts of personal debt. Some families have been putting their groceries on credit cards. Many have taken the financially disastrous step of using home equity loans to bring down credit card balances.

A serious illness for people already in shaky economic circumstances can be the final push into bankruptcy.

According to the report, called "Borrowing to Stay Healthy," about 29 percent of low- and middle-income families with credit card debt reported using their credit cards to pay medical expenses - in most cases for major medical problems.

Over all, a full 20 percent of low- and middle-income families with credit card debt said they had used their cards to cover major medical expenses over the prior three years.

This indebtedness - subject to monthly late fees and penalties, and interest rates that can reach 30 percent - only adds to the trauma of serious illness.

It's believed that 29 million Americans are burdened with medical debt of one form or another. Individuals who are already saddled with medical bills that they can't pay are much more likely to avoid further medical treatment and to leave drug prescriptions unfilled. Such decisions often have life-threatening consequences.

There is an epidemic of personal bankruptcies in the U.S. and medical factors are believed to play a role in as many as half of them.

These are problems that cry out for reform - of the American health care system and the American way of debt, both of which seriously threaten the American way of life. At the very least, in the short term, we need to protect financially vulnerable patients from a credit card universe in which there are no legal limits on fees or interest, and where the abuse of customers is the norm.

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