NINTH DISTRICT NOTES

# La Crosse Town Hall

*Questions and answers from Wisconsin are a great example of the two-way communication essential to good policymaking*

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*On Sept. 4, 2013, I held a public town hall with citizens in La Crosse, Wis. This is the third such event I have held within the Ninth District, and I look forward to more in the future. These events have proven very useful for me, as a policymaker, to get a deeper understanding of the public's interest and concerns, and I hope they have proven just as useful for those in attendance.*

*As with the previous town halls, the one in La Crosse generated very good questions, both from the audience and from the moderator, Taggert Brooks, chair of the department of economics at the University of Wisconsin-La Crosse. What follows is an excerpt from that evening that captures some of the key questions on people's minds. The full conversation is available on our website, minneapolisfed.org.*

### Who holds the Federal Reserve Board accountable for its decisions?

This is a great question. And it's a great way to lead off the evening, because who holds the Federal Reserve Board accountable for its decisions is, of course, the American public. The Federal Reserve is a creation of Congress through the Federal Reserve Act, and it's only right that we be held accountable to the American public for our decisions.

Now, that happens in a variety of ways, which is true of a lot of governance situations, and things can get somewhat technical. Let me describe what I think is the primary method of accountability. Go back to January 2010, when Chairman Ben Bernanke was being considered for a second term as chairman of the Federal Reserve System. He had served a term from 2006 through 2010 and at that point was nominated for a second term. That nomination was up to the president of the United States to decide. He had to decide whether or not the vision, the strategy the Fed followed under Chairman Bernanke's leadership, was one that he felt comfortable with. If he had not felt comfortable with it, and he's elected by the people of the United States, he would've gone in a different direction.

Then there's a second check, a second form of accountability, which is that the nomination has to be confirmed by the Senate of the United States. There was a lot of discussion about whether the Senate felt comfortable with the performance of the economy under Chairman Bernanke's leadership and the vision with which Bernanke had led the Federal Open Market Committee. But after that discussion, Chairman Bernanke's appointment was confirmed by the Senate.

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So I think that's the main way you see accountability working. That chain through the chairman being appointed by the president and confirmed by the Senate, I think is the main form of accountability.

**Our next question concerns prices. It's what people pay attention to frequently. So they want to know what's causing food prices to go up.**

Right, so this is another very good question. Let me talk a little more broadly about prices in general. The Fed moves interest rates up and down to try to influence demand. That influences prices. It doesn't just influence food prices, though. We don't have anything that can influence one particular price. We're trying to influence prices of all goods and services all at once. If we raise interest rates, that reduces people's desire to spend and firms' desire to spend today, and that will tend to push down on prices and push down on inflation. But it pushes down on all prices at once. And our goal then is to keep this bundle of goods and services that people buy, including food and energy—we're trying to keep that price growing at around 2 percent per year.

Now, what this question asks is what is causing food prices to go up by so much, and a very short answer to this question would be that food prices really aren't going up by that much. And why do I say that? Well, if I look at how much food prices have gone up over the past year—and this is going through the Bureau of Labor Statistics measures of the consumer price index—they've gone up less than 2 percent, around 1.4 percent over the past year. To go back over a five-year period, food prices have gone up around 2.2 percent per year, pretty close to the Fed's 2 percent target.

But I think that short answer doesn't cover it because I get this question all the time. And I think the right way to think about this is that it's not really a question about prices; it's really a question about wages. I think the reason people feel prices are going up by so much is because prices are going up by so much relative to their wages. Compensation growth in the United States has been very slow over the past five years and has been even slower over the past year. So if your compensation's not growing very rapidly, even a normal price increase feels like it's very sharp and very fast.

The reason it's important to distinguish these two is that the treatment from our point of view as monetary policymakers may well be quite different. The fact that wages are growing so slowly and compensation is growing so slowly is really a sign of some of the problems in the labor market. The fact that employment is so low—so many people are looking for work—that puts downward pressures on compensation, and that makes goods like food seem very expensive even if prices are growing at close to the normal rate of inflation. So that means your target at that point, the policy treatment, is really more stimulus and not so much cutting back on stimulus, which is what would be the right treatment if prices were actually growing more rapidly than our target.

**I think the next question that naturally comes from that is, you mentioned earlier that inflation's below target, but the question this person asks is: How is low inflation even possible given that the Fed is buying so much in terms of long-term assets? How is it possible for inflation to be so low?**

These are all excellent questions because they really get at the heart of what we're trying to do. … The Fed's transactions, known as quantitative easing, are just changing the maturity composition of outstanding government liabilities from long to more short. The reason it has only a modest impact on the U.S. economy is because this is a very modest transaction. You're just changing the composition of the assets, the liabilities that are outstanding by the government.

There is a positive effect on the economy associated with this by pushing down on long-term yields, by buying up these long-term securities and pushing down on long-term yields. That's a positive for the economy by stimulating the economy. But the effect is much more modest than this big number; $85 billion will make you think because this is actually really small compared to the pool of all long-term assets in the world. You're trying to push the long-term yield of everything in the world through this lever, and you're having an effect, but it's pretty modest.

The next question gets to the second part of the dual mandate and starts to talk about unemployment. They're interested in whether or not the Fed considers the numbers of people leaving the job market. The full question asked about the people in the labor force participation rate falling as people possibly give up on job search. They're wondering to what degree the Fed considers that job-leaving, if you will.

So let's start with basics, the way the Bureau of Labor Statistics reports what's called the unemployment rate. The way it's measured is they go out and survey a large number of households every month. They ask people in those households, do you have a job? If you have a job, you're called employed. Or if you don't have a job, have you looked for a job in the past four weeks? They add those two groups together, and that's called the labor force. The fraction of the labor force that's in the second group that is the searchers, people who looked for a job in the past four weeks, those are called the unemployed. The unemployment rate is a fraction of people in the labor force who are, in fact, unemployed.

Now, of course, there's a large number of other people who have not looked for a job in the past four weeks and don't have a job. The question is, how do you treat those? So the Bureau of Labor Statistics reports broader measures of unemployment, what they call labor underutilization. They'll ask questions about, OK, you haven't looked for a job in the past four weeks, but have you looked in the past year? And if a job would come along, would you take it? These people are called marginally attached.

This will lead to a higher measure of unemployment. But what's very interesting is these measures of unemployment, if you use the broader measure of unemployment, it tracks what's going on with the more usual form of unemployment pretty closely. So if you go back to December 2007, the usual unemployment rate that you hear was around 5 percent nationwide. It doubled by the end of 2009. It's come down now to about 7.4 percent. So it's about halfway back to where it was.

If you use a broader measure that includes folks who are marginally attached, it also doubled pretty much from late 2007 toward the end of 2009, and it's come down slowly. It's come down, but not as much, so the rest of the question is right on target. If you used this measure, you wouldn't be as comfortable with the state of the labor market even as unemployment is 7.4 percent. But it certainly has come down. So it's maybe about 30 to 40 percent on the way back as opposed to 50 percent on the way back.

Again, that's a long way of saying we do look at this, but even if you use these broader measures, it's telling us similar stories qualitatively.

This next question—I had to summarize it a lot, but it asks, are we doomed to repeat the past? The question really asks about what we're going to get back to. There's a lot of conversation about getting back to the previous unemployment rate. This person brings up the fact that the unemployment rate when I started here, I think the unemployment rate was 4.9 percent nationally. It was very low. Is this what we're trying to get back to, sort of the pre-bubble era? Or what are we trying to get back to?

This is another question that troubles us a lot at the Federal Reserve because we know there are a lot of examples throughout history where you get to an unemployment rate of 4 percent, and you can't get back to 4 percent without creating huge amounts of inflation, which is certainly not what we want to do. So we try to figure out, on an ongoing basis, where we think the unemployment rate will go in the longer run. Those estimates change.

So if we go back to the beginning of the recession, I just talked about it, in late '07, those estimates were somewhere between 4.5 percent and 5 percent. Now those estimates have moved upward to somewhere between 5.2 percert and 6 percent, as I described. So we have adjusted our measures of the long-run unemployment rate upward, indicating that we do think there's been some permanent damage to the labor market associated with the recession we just went through.

On the other hand, we do think at the same time that there's considerable room for the unemployment rate to decline without having much impact on the inflation rate. And there's a number of ways we try to go after this. We're looking at micro and macro data on the labor markets. But a simple way to see this is the fact that compensation growth is low, as I just mentioned. As long as compensation growth remains that low, it's hard to see labor market pressures creating undue levels of inflation.

**This is kind of a follow-up. Is it a good idea in the long run to keep interest rates artificially low?**

The answer is no. But I think it's important when we answer this to answer the question according to what the word "artificial" means. I think about artificial only in terms of how we're doing on our objectives. So, right now interest rates are artificially high. Why do I say that? Because unemployment is too high, inflation's running too low, and that means we're not providing enough stimulus. Seems like interest rates are actually not artificially low; in fact, they're artificially high.

You should not keep interest rates artificially low. Should we be keeping interest rates low in order to achieve our objectives? Yes. Have we made them low enough? No.

Now, I think when people ask this question, what they have in mind is, boy, interest rates have been low for a very long period of time. Or they might be thinking that interest rates have never been this low before, why do you have to have interest rates this low? I think the right analogy, at least the analogy I find helpful—economists always find weird analogies helpful—is really in terms of winter clothing. Suppose you see someone walking outside. It's May, and they're wearing a parka. You might say, you're wearing artificially too much clothing at that point. Well, it wouldn't be true in Minneapolis. We had snow in May in Minneapolis. So you should be wearing a parka in May in Minneapolis.

So it really depends on what the conditions are, what kind of clothes you need to put on to keep yourself warm. The parka in my example is the interest rate. It really depends on what the conditions are, not the time of year or how long it's been and all those things. So I think the issue of artificial … of course not, you should not keep interest rates artificially low. Should we be keeping interest rates low in order to achieve our objectives? Yes. Have we made them low enough? No.

**So this next question I'm sure is from a group that doesn't exactly appreciate low interest rates as much as I do. Why are you punishing the elderly citizens who primarily use CDs for savings?**

Yes, monetary policy is a tool that is designed to achieve these macroeconomic objectives I have described, low inflation and maximum employment. And it's definitely a tool that has distributional consequences. So that means there are going to be distributional consequences.

The way I think about these kinds of questions, though, is that the Fed is merely responding to economic conditions. We are facing the same environment that the elderly citizens mentioned in this question are facing. The problem we face is this: After the recession of 2007, the financial crisis that took place five years ago, people are nervous and uncertain and they want instruments for saving. They want to save. These aren't just people in the United States. Everyone around the world wants to save, and they want sources of safety. They don't want to save by buying a random mortgage-backed security that's issued by some Wall Street firm now. They might have been happy doing that in 2005. They want to be buying something that's safe. And everyone wants to do that.

That's why we have to lower interest rates as much as we do to try to hit our targets. That's why the interest rates that you face as someone who is saving—if you try to do the same thing as everyone else in the economy, you always pay a high price and get a low return. That is what's happening to these [elderly citizens the question refers to]—everyone else is trying to do the same thing they would normally want to do anyway. So they're going to have to pay a high price, and it translates into a low yield. The thing we need to get to is a more secure world, a safer world where people don't feel such a pressure to save for the future. R