PRESIDENT'S MESSAGE

Minority Unemployment and the FOMC

The Federal Reserve is getting critics' attention these days due to the debate over when and how rapidly it should raise its benchmark interest rate. Some have pointed to the fact that minority unemployment tends to be substantially higher than unemployment of whites, and they argue that these populations will be hurt the most if the Fed tightens monetary policy. To see these differences, we need to go back no further than the October jobs report, which estimated white unemployment at 4.3 percent, compared to 8.6 percent for blacks and 5.7 percent for Latinos.

This is a long-standing challenge. Narayana Kocherlakota, the former president of the Minneapolis Fed, has noted that for more than 40 years black unemployment has been roughly 1.9 times greater than the overall rate. In response to these disparities, some observers, such as AFL-CIO chief economist William Spriggs, have called for the Fed to continue keeping policy rates near zero to bring joblessness among minorities down and closer to the rate of whites. This, they argue, would be a better definition of "maximum employment" — half of the Fed's monetary policy mandate — than one based on just aggregate numbers. As an example, some point to the late 1990s and early 2000s: While aggregate unemployment fell below 4 percent, black unemployment dropped to an all-time low of 7.6 percent and real wage growth of blacks averaged 2 percent annually, compared to 1.7 percent for whites.

These historic disparities merit a serious discussion. But in this case, the proposed cure may well be worse than the disease. What the critics' argument overlooks is the risk that is posed if the Fed overshoots and runs the economy so "hot" that inflation pressures rise quickly. If this were to happen, the Fed would need to respond by raising rates to counteract those pressures. But when it's lifting rates rapidly, it can be difficult to calibrate the proper response. Rising inflation expectations may also require a more forceful Fed response. And history has shown that the Fed has sometimes gone too far in those situations, pushing the economy into recession.

A case in point was the early 1980s, under the chairmanship of Paul Volcker. In response to the spike of inflation of the late 1970s, the Fed aggressively sought to shrink the growth of the monetary base and allowed interest rates to rise. By December 1980, the effective federal funds rate reached almost 20 percent. These drastic measures eventually tamped down inflation, but they also led to a recession. And as was the case in previous recessions, minorities suffered far more than whites in the downturn. Whereas national unemployment climbed to more than 10 percent in 1983, it rose to almost 22 percent for blacks.

Once inflation stabilized in the early 1980s, the Fed sought to avoid a repeat of this scenario by seeking to anchor inflation expectations and act pre-emptively when necessary. One of the best-known examples was our decision to raise interest rates in 1994-1995, when headline inflation appeared calm and the economy had recently come out of a downturn. Despite that tightening, economic growth remained robust and unemployment dropped further.

More fundamentally, however, this debate is about what monetary policy can accomplish. Over time it can achieve price stability, which, in turn, can promote growth and employment by providing a steady environment that facilitates longer-term investment decisions. By contrast, the policy tools that are well-suited to target specific distributional outcomes are primarily fiscal, such as public spending on education, infrastructure, and workforce development — and these policies are outside the Fed's purview. Fiscal policy decisions are not just more powerful to achieve these ends; it is far more appropriate that they are made by elected officials, because the democratic process reflects the public's trade-offs and priorities.

In short, if we want to consider the effect of monetary policy on disadvantaged populations, we need to realize it cuts both ways. There may be greater short-term benefits from expansionary policy for those Americans, but they would also face greater long-term risk from those same policies. In light of this risk, it's not obvious that the Fed should tilt policy one way or the other. The underlying reality is that monetary policy is a blunt instrument — just one short-term interest rate — and as such, it's ill-designed to address a multiplicity of distributional issues. **EF**

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