Getting and Keeping a High-Pressure Economy
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Good morning. I am delighted to be joining all of you for this important conference at the Federal Reserve Bank of San Francisco.

I am especially pleased to have been invited by my friend Mary Daly. I have known Mary for a long time and have always admired her research on economic issues, both because of its quality and because she insists on tackling questions that really matter to people's lives. Her commitment to high-quality work that can make the world better is why we are all fortunate that Mary has become such an important figure in economic policymaking for our country. Thank you, Mary, for all you have done and all you will do.

Today's conference on the "Costs and Benefits of Running a Hot Economy" addresses a topic of fundamental importance. In the late 1990s, I had the opportunity to be in the cheap seats for part of a meeting of the Federal Open Market Committee. Of course, I will not reveal any secrets. But I remember clearly that one of the Reserve Bank presidents commented on the low unemployment rate by saying "In my district, everybody who wants a job has one, and some people who don't want a job have one anyway." That is what I think we mean by a "hot" economy—an economy in which the demand for workers is strong enough that everyone who wants a job has one, and even some people who don't really want a job have been offered one that is too desirable to turn down. As a synonym for the term "hot economy," I will generally refer to a "high-pressure economy," and you might picture a job market that is a pot of water bubbling vigorously.

The United States is currently enjoying a high-pressure economy. The unemployment rate is under 4 percent, and prime-age individuals are entering the labor force in larger numbers than they are leaving it. Moreover, strong demand for workers has pulled up wage growth to roughly its fastest rate in a dozen years. So, a high-pressure economy clearly has significant benefits. Unfortunately, getting and keeping a high-pressure economy may also have significant costs. Understanding those benefits and costs is important for policymakers and for concerned citizens, and that is why we have gathered here today.

I have been asked to set the stage for the discussions to come, and I will do this in four steps: First, I will briefly summarize the evidence about why a high-pressure economy is good. Second, I will explain why textbook economics implies that the Federal Reserve System can raise economic pressure for a short period but cannot keep pressure high on a sustained basis. Third, notwithstanding the textbooks, I will offer some reasons for hope that the Federal Reserve can keep economic pressure somewhat higher for a sustained period than we used to believe. And fourth, I will speak briefly about what policymakers besides the Federal Reserve could, and I think should, do to create a sustained high-pressure economy. Let me start with my first topic:

Why is a high-pressure economy good?

The answer, simply put: We want a high-pressure economy because strong demand for workers means that more people can have jobs and that people are paid more for those jobs—and those effects are especially strong for groups of people who have fared less well than others in economic terms over the past few decades. Let me elaborate.

Jobs are important, of course, for the income they provide. That is especially true because cash benefits from our government safety net programs for people who are not working are quite limited.[1] Jobs are also important for the sense of purpose and identity and dignity they offer. People want to do meaningful things with their lives, and they want to contribute to their families and their communities; working in a job is one of the foremost ways to achieve those goals.

A high-pressure economy not only provides more job opportunities for people who are looking for work, it also pulls people into the labor force who were not looking for work. As I noted, more prime-age people have been entering the labor force than leaving it during the past several years. This effect is especially important because it is persistent: Between 2008 and 2013, a high unemployment rate caused a significant number of people to stop looking for work; some have never returned to the labor force, and others have found their way back only gradually.

In addition to increasing the availability of jobs, a high-pressure economy increases the compensation for jobs. The share of total national income going to labor has fallen markedly over the past 25 years, while the share going to capital has risen. This trend probably stems from multiple factors, but a high rate for workers with more education, but this gap also is smaller when the overall unemployment rate is low. Moreover, a reduction in unemployment seems to be especially important for wage growth in the lower part of the distribution.

These effects on groups of people who tend to do less well economically deserve particular attention in our policy discussions. Over the past several decades, and in contrast to some earlier periods of American history, a rising economic tide has not been lifting all boats in a comparable way: Most Americans below the top part of the income distribution have benefited only a little from overall economic growth.[2] Empowering those people to advance economically is both a moral and practical imperative, so our economic policies should be guided much more by what would boost the standard of living for middle- and lower-income Americans than by what would

And that is not all: Inflation depends not only on the pressure businesses feel from costs such as wages, but also on businesses' <u>expectations</u> of future inflation. If a business manager thinks that

Thus, in the jargon of the economics profession: If the economy has an accelerationist Phillips

learn how low the NAIRU really is. The unemployment rate has been below previous estimates of the NAIRU for almost three years now, and wage growth has never been rapid during this time and may have already leveled off, which suggests that the NAIRU might be a good deal lower than we used to think. Yet another advantage is that inflation would probably rise a little, which would be good. Federal Reserve Chairman Jay Powell has explained that the Federal Reserve views its inflation target of 2 percent symmetrically—not wanting inflation to be below 2 percent any more than above 2 percent. And some leading economists outside the Federal Reserve System have argued for raising the inflation target to give the Federal Reserve mor2 ( )]TJ-0.004 Tc ar00

pressure is increased when businesses are competing intensely for workers and driving up wages. But many of the other tools I listed would increase the number of workers with the needed capabilities in the appropriate places, and that increase in supply would not generate inflationary pressure.

Another advantage of these other tools over Federal Reserve policy is that they can be targeted at different regions and at workers with different characteristics. Pressure in the labor market can be measured on average across the country, but actually it varies by potential worker. For example, the unemployment rate differs significantly across states and between people of different races, with(an)-4 (d)-4 (u)-4 (r)-1 (e p 0 -1.32peen3575 -1.32 6 (g)10 (e)-12 (a)4 (l)-2 (u(r)-17v)]TJ-0.