**CHAIRMAN KEVIN BRADY**

**JOINT ECONOMIC COMMITTEE**

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***The Fed at 100: Can Monetary Policy***

***Close the Growth Gap and Promote a Sound Dollar?***

This year marks the centennial of the Federal Reserve, so it is appropriate for the Joint Economic Committee to examine the Fed’s role in the current economic climate as well as its focus for the next 100 years.

Today’s hearing on monetary policy is the third in a series that touches on our most vexing economic challenge: the growth gap.

We’re all rooting for America to bounce back, but regrettably the U.S. economy is missing 4.2 million private sector jobs and $1.3 trillion in real output due to the gap that exists between this weak recovery and the average recovery of the last 70 years.

For every American, the growth gap means he or she has $2,935 less in real disposable income at this point in the recovery.

This gap persists despite extraordinary actions by the Federal Reserve to stimulate growth and employment as part of its dual mandate.

Even more troubling, the Congressional Budget Office projects that the future growth rate for America’s potential real GDP will be a full percentage point below its post-war average – which may not sound like much, but the consequences are alarming.

With one-percent lower growth, our economy will be $31 trillion smaller in 2052, and the Treasury will collect $97 trillion less in tax receipts over the next four decades – making it significantly harder to balance the budget and reduce America’s risky level of debt.

The question before this Committee is whether the extraordinary actions taken by the Federal Reserve are capable of closing the growth gap, and if a focus instead on price stability and establishing a sound dollar will provide a stronger foundation for economic growth over the long term.

Since 2008, beyond the appropriate role of lender of last resort to financial institutions and markets, the Federal Reserve has selectively bailed out investment banks, maintained interest rates at an extraordinary low level for almost five years, engaged in three rounds of quantitative easing by buying massive amounts of Treasuries and mortgage-backed securities, and indicated that the Fed will continue this accommodative monetary posture until the unemployment rate falls to 6.5 percent.

But can the Federal Reserve boost real economic growth over time through discretionary monetary policy?  Or should the Federal Reserve adopt a rules-based monetary policy to achieve price stability and let Congress and the President determine the combination of budget, tax, regulatory and trade policies that will boost real economic growth to close the growth gap?

In 1977, Congress established a dual mandate for monetary policy that gave equal weight to achieving long-term price stability and the maximum sustainable level of output and employment.

During the 1970s, as you may remember, the Federal Reserve’s monetary policy was discretionary and interventionist.  The results were accelerating inflation, short expansions, frequent recessions, and rising unemployment.

In the early 1980s, Chairman Paul Volcker broke the back of inflation.  Over the next two decades monetary policy became increasingly rules-based.  The results were outstanding: low inflation and two long and strong expansions, interrupted only by a brief, shallow recession.

Since the Great Moderation, however, monetary policy has again become discretionary and interventionist.  Not surprisingly, the results are disappointing.

From 2002 to 2006, Chairman Alan Greenspan kept interest rates too low for too long which helped to inflate an unsustainable housing bubble.

Chairmen Volcker and Greenspan correctly believed monetary policy could contribute to achieving full employment – if and only if – the Federal Reserve focused solely on price stability. Beginning in 2008, however, the Federal Reserve explicitly deviated from this view, invoking the employment half of its dual mandate to justify its extraordinary actions.

In January 2012, the Federal Open Market Committee correctly observed in its *Longer-Run Goals and Policy Strategy* statement:

*The maximum level of employment is largely determined by nonmonetary factors that affect the structure and dynamics of the labor market.*

Despite the clear admission of the limits of monetary policy to spur employment, in December of the same year the Federal Open Market Committee announced that it would (1) expand its current round of quantitative easing, and (2) retain its extremely low target range for federal funds for “at least as long as the unemployment rate remains above 6-1/2 percent.”

To achieve a policy objective, Nobel laureate economist Robert Mundell stated, policymakers must use the right lever.  Monetary policy affects prices over the medium and long term.  In contrast, budget, tax, and regulatory policies are what affect real output, real investment, and employment.  Monetary policy cannot solve the problems that poor fiscal policy has helped create.

By targeting the unemployment rate, the Federal Reserve is attempting to use monetary policy to achieve what the Fed acknowledged eleven months earlier that it cannot achieve through monetary policy – full employment – while risking what economists acknowledge that the Fed can achieve through appropriate monetary policy – long-term price stability.

To close the growth gap, my belief is that we must refocus the Federal Reserve on a rules-based monetary policy, which is a necessary, but not sufficient, condition for robust real economic growth and job creation.  This is not a false choice between jobs or stable prices – it is the proven acknowledgement that stable prices and a sound dollar create the best foundation for job growth over the long term.

Congress, which has delegated its constitutional authority to coin money and maintain its value to the Federal Reserve, should provide it with a clear direction to return to an achievable mandate for price stability.

The Federal Reserve should also ensure a soft-landing for the housing market by initiating a slow and orderly unwinding of its $1.1 trillion position in federal agency residential mortgage-backed securities.  Gradually reducing the excess reserves that could be the fuel for future inflation will reduce market uncertainty, strengthen the foundation for non-inflationary economic growth, and reduce the likelihood of undue political interference in Federal Reserve policy.

Looking to the future, today’s hearing provides this Committee with the opportunity to hear from two of the most  distinguished monetary economists in the world on their recommendations for the role of the Federal Reserve during its second 100 years.

Dr. John Taylor is the creator of the Taylor rule, which central banks have used to implement a rules-based monetary policy.  Dr. Adam Posen served on the Monetary Policy Committee of the Bank of England and is a widely acknowledged expert on Japan. We are fortunate to have them with us today.

With that, I look forward to their testimony.