EUROPE 19.03.2019 | Adam Tooze

What are central banks for?

10 years after the financial crisis, the eurozone remains mired in unemployment. We need a new approach to central banking

In January 2013 the US Federal Reserve made a remarkable statement. It announced that it would ramp up its monetary stimulus and keep interest rates low until America's unemployment rate fell to 6.5 per cent. The world's most important central bank was declaring that monetary policy affecting tens of trillions of dollars in financial assets around the world would be conditioned by America's labour market.

And the Fed was as good as its word. Its chair, Janet Yellen, did not raise rates until December 2015, by which time US unemployment had fallen to 5 per cent. Today it stands at 4 per cent.

The contrast with the eurozone is painful. In July 2012 the president of the European Central Bank, Mario Draghi, famously announced that he 'would do whatever it takes' to save the euro. But what this meant was stabilising Europe's sovereign-debt markets, not saving Europe's unemployed.

Over the following months, rather than providing stimulus, the ECB allowed its balance sheet to contract. It did nothing to offset the disastrous fiscal crunch imposed by the eurozone's budget straightjacket. By the end of 2013 eurozone unemployment had surged to a peak of 12 per cent, almost twice the Fed's target rate. But even that was not enough to trigger action.Formularbeginn

It was not until Europe was facing an acute threat of deflation that the ECB finally adopted the looser monetary policy of 'quantitative easing'. Since 2013 unemployment has eased but in the summer of 2018 it was still hovering above 8 per cent. Undaunted, the ECB declared that it would be ending bond purchases and projected interest-rate increases to come. The justification was a presumed trend towards accelerating inflation.

That turned out to be entirely without foundation. In early 2019 the eurozone is again at risk of sliding into recession.

One-eyed focus

If one asks why the ECB gives such scant consideration to unemployment, the stock answer is that full employment is not part of its mandate. By contrast, Yellen's predecessor, Ben Bernanke, could invoke the Humphrey Hawkins Full Employment Act of 1978. This gives the Fed a 'dual mandate', to pursue maximum employment as well as price stability. As everyone knows, the ECB's one-eyed focus on price stability is inherited from Germany's Bundesbank.

But, in fairness, the one-dimensional focus on inflation is not peculiar to Germany or the ECB. Independent central banks with a single mandate for inflation targeting were a worldwide vogue launched by the Central Bank of New Zealand in 1990.

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The consensus of policy opinion behind this model was strong. If one assumes that unemployment is determined in the long run by non-monetary, 'supply-side' factors, such as labour-market regulation, skills and training, using monetary policy to chase an employment target is not only a recipe for frustration. It also makes it harder for the central bank to commit credibly to pursuing its purportedly true task — price stability. At the margin, this lack of credibility means that 'the markets' will demand higher interest rates and that will be bad for growth and employment. In the long run the best employment policy would be a relentless focus on price stability.

Not well supported

Though superficially compelling, these arguments are not well supported by the evidence of recent decades. Despite its dual mandate, the Fed's record on inflation is unimpeachable. And experience suggests that inflation-targeting central banks are seldom as one-dimensional as advertised. Central bankers track labour markets closely — at the very least because wage growth feeds back into price setting. As the ECB demonstrates, a one-dimensional mandate simply makes it harder to

present policy as responsive and appropriately balanced.

This is not only bad for the clarity and honesty of central-bank communication. In a world in which the forces of inflation are no longer as strong as they were a few decades ago, it may also be risky. Against the backdrop of the high inflation of the 1970s, a dual mandate was a standing temptation to compromise on price stability. Today the risk is the reverse. Without due attention to slack in the labour market, the central bank may fail to provide a timely stimulus and risks a slide into deflation. Tellingly, in 2018 New Zealand decided to add employment as a second objective to its central bank's mandate.

No one would suggest, of course, that Europe's unemployment problem can be effectively addressed by the ECB alone. To tackle it in the entrenched form that we face today will require a combination of monetary, fiscal, labour-market and industrial policies. But widening the ECB's mandate would open the door to a more balanced policy stance.

This would likely face opposition from monetary conservatives, who would harp on about the founding treaty. But the treaty is not as restrictive as they would like to think. Specifically, article 127 requires the ECB to 'support the general economic policies in the Union', which include 'full employment' and 'balanced economic growth'. Moving to a 'dual mandate' could easily be presented as a reform of existing practice, rather than a cultural revolution.

The question is whether it would make any difference. After all, what is needed is not a change in rhetoric but an actual shift in economic-policy priorities. An alteration in the ECB's mandate would matter if it was part of a general push to declare continued mass unemployment — particularly of young people in large parts of Europe — a crisis demanding urgent and relentless attention by every agency of economic policy. The force of that point is brought home if we examine the history of the Fed's dual mandate.

Explosive demand

The Full Employment Act was passed in 1978 but the campaign to write a full-employment mandate into American law began decades earlier, in struggles over the demand that government should ensure a general 'right to useful, remunerative, regular and full-time employment'. The first iteration of that battle came in the late stages of the New Deal, against the backdrop of the early cold war. The explosive demand that government guarantee full employment was neutralised by the passage of the Employment Act of 1946, which specified instead the objective of

'maximum employment, production and purchasing power' — in other words, economic growth.

In the United States, as in Europe, we generally think of the decades of the 1950s and 1960s as a period of rapid growth and full employment. But, even then, marginalised black communities suffered appalling rates of joblessness. As the civil-rights campaign gathered steam in the early 60s, it revived the demand for a jobs guarantee. The full title of the famous March on Washington in 1963 was the March for Jobs and Freedom. While Martin Luther King delivered his immortal 'I have a dream' speech, the placards waving on the Mall read: 'Civil Rights + Full Employment = Freedom'.

The call for a jobs guarantee is back.

King was assassinated in 1968 but his widow, Coretta Scott King — a major social rights activist in her own right— continued the struggle. Her demand for a jobs guarantee received no support from the trade-union confederation, the AFL-CIO, and it was bitterly opposed by employers' organisations. But she had backing from the more radical wing of the labour movement, led by the United Auto Workers, and key African-American leaders in Congress. Though as Democrat president Jimmy Carter was far from enthusiastic, the momentum was such that Humphrey-Hawkins was carried over the line in 1978. But once more it was an exercise in compromise and neutralisation.

A full-employment guarantee was replaced by the reiteration of the objective of maximum employment. Furthermore, it was left up to the Fed and the Carter administration to interpret how policy priorities should be ranked. In light of the decline in the dollar and surging inflation, their choice was predictable.

The painful irony is that, within a year of receiving its dual mandate, the Fed under the leadership of Paul Volcker would deliver the biggest interest-rate shock in the modern era. This sent the dollar surging and laid waste to a large part of American manufacturing, at the cost of millions of jobs.

Historic significance

The significance of a mandate depends on the political struggles that surround it. But this does not mean that the legislation was without historic significance. The mandate remained on the books. Efforts to repeal Humphrey-Hawkins have been resisted. And, faced with the national emergency of 2008, the lack of any serious inflationary pressure and an incipient crisis of legitimacy, Bernanke and the Fed — unlike the ECB — had a clear responsibility to act.

Indeed, not only did the Fed target national unemployment; it began to take an intensified interest in regional economic development and problems of inequality. More dramatically, the left wing of the Democrat party has revived the inspiration of Coretta Scott King and is demanding that the Fed be held to account for delivering truly full employment. The call for a jobs guarantee is back.

Legal mandates are not by themselves decisive. But they are enabling. They provide the opportunity for what the political philosopher Seyla Benhabib evocatively describes as democratic iterations — debates 'through which universalist rights claims and principles are contested and contextualized, invoked and revoked, posited and positioned throughout legal and political institutions, as well as in the associations of civil society'. In this process, legislative mandates act as ratchets, allowing each iteration of the debate progressively to change the self-understanding of political communities and institutions.

Given the disastrous failure of eurozone economic policy over the last decade to live up to the high expectations of the EU — calling into question its very legitimacy — it is high time the ECB's mandate was subjected to just such a thoroughgoing democratic re-evaluation.

The article is a joint publication by Social Europe and IPS-Journal.



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