

BACKGROUNDER

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Inflation and the Fed: How Congress Should Approach Monetary Policy

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KEY TAKEAWAYS

The rise in the consumer price index and weak job growth, has stoked fears of 1970s style stagflation, an economy that exhibits both high unemployment and inflation.

Changes to the Fed's operating framework, including how it targets inflation, have made it hard to know exactly what the Fed will do as economic conditions unfold.

Congress should get federal spending under control and replace the Fed's mandate on stable prices and maximum employment with one to stabilize overall spending.

The recent rise in the consumer price index (CPI) has stoked fears of 1970s-style high inflation and even stagflation, an economy that exhibits both high unemployment and inflation. While it would be irresponsible for policymakers to dismiss the possibility of either occurrence, it would be just as imprudent to overreact to the recent increase in the CPI. Rather than panic, public officials should focus on long-term reforms that will help avoid this type of economic anxiety in the future. Even if the rise in the April CPI marks the beginning of a new upward trend, inflation will have to rise higher—and for longer—to be anything like it was in the 1970s.

Most importantly, Congress should sharpen the lines between fiscal and monetary policy and then replace the Fed's dual mandate with a single directive to achieve monetary neutrality. Though the situation

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can change quickly, the current data is not indicative of a return to the 1970s era of high inflation. To avoid such a problem, Congress and the Administration should reduce regulations that make consumer products more expensive, fix the federal government's structural spending problems, and ensure that the Federal Reserve normalizes monetary policy.

CPI Jumps After Pandemic Spending Adds to Uneasiness

The latest reports from the Bureau of Labor Statistics (BLS) show that the CPI rose 0.8 percent in April following a surge of 0.6 percent in March.¹ These figures are part of a clear upward trend *over the past few months*, starting with a monthly increase of 0.2 percent in December. The April increase in the CPI also coincides with a sharp jump in energy prices and an even steeper rise in gasoline prices.² The headline figure that seems to have caused the most angst is that the CPI increased 4.2 percent *over the previous 12 months*, representing the largest year-to-year increase since the period ending September 2008.³ The fact that this report comes near the end of the COVID-19 pandemic, with a large increase in federal deficit spending, has added to the public's fears.

Prior to President Biden's recent \$1.9 trillion COVID-19 relief package, the federal government had already increased the national debt by \$4.5 trillion in 2020.⁴ Even without this new package, the Congressional Budget Office projects that the federal deficit in 2021 will be "the second largest since 1945, exceeded only by the 14.9 percent [of gross domestic product (GDP)] shortfall recorded last year," and that publicly held federal debt will reach 102 percent of GDP by the end of 2021.⁵ In February, the \$1.9 trillion package drew a mild rebuke from economist Lawrence Summers, an advisor to both the Clinton and Obama Administrations. Summers, who shared the Administration's concern over failing to provide enough fiscal stimulus, argued that the new relief package appeared too large relative to the current economic shortfall. He warned that

while there are enormous uncertainties, there is a chance that macroeconomic stimulus on a scale closer to World War II levels than normal recession levels will set off inflationary pressures of a kind we have not seen in a generation, with consequences for the value of the dollar and financial stability.⁶

Soon after Summers' warning, the Administration announced two new spending proposals totaling an additional \$4.5 trillion.⁷ The recognition that persistently high levels of debt and deficit spending can lead to inflation

and economic instability is hardly new,⁸ and Congress has done essentially nothing in the past few decades to shore up the federal government's fiscal sustainability.⁹ In fact, soon after the new proposals were announced, Summers issued another warning, telling reporters, "Policymakers at the Fed and in the (White House) need to recognize that the risk of a Vietnam inflation scenario is now greater than the deflation risks on which they were originally focused."¹⁰

It certainly appears that the *risk* of higher inflation has now arrived, and the fact that the economy has not yet fully recovered from the pandemic adds to the apprehension. For perspective, the unemployment rate exceeded 14 percent at the height of the pandemic, and it has since fallen to 6.1 percent. Yet the number of unemployed persons remains well above the pre-COVID-19 figure (9.8 million in April versus 5.7 million in February 2020).¹¹ Moreover, the downward trend in unemployment appears to have leveled off, and the April employment report showed lower than expected job growth.¹²

Federal relief (deficit) spending for the pandemic has also left many households with unusually high disposable income, further adding to fears of future inflation. For instance, per capita disposable personal income increased 14 percent from January through March, far greater than the average first-quarter increase (0.43 percent) during the last decade.¹³ Given that this increase is largely due to deficit-financed federal spending, many people fear higher inflation due to the classic "too many dollars chasing too few goods" phenomenon as the recovery takes hold.¹⁴ Given this policy climate, it is hardly surprising that the recent unexpected rise in inflation has stoked fears of high inflation and even stagflation, an economy with both high unemployment and inflation.¹⁵ Nonetheless, the inflation numbers do not yet suggest that a return to the high inflation of the 1970s is imminent.

Inflation vs. Individual Price Increases

Inflation refers to a rise in the economy's *overall* price level, and the U.S. price level is typically measured by the CPI or the Personal Consumption Expenditure (PCE) index. The BLS publishes the CPI every month, and it is designed to broadly represent how much the average U.S. consumer spends on a market basket (a representative bundle) of goods and services. The Bureau of Economic Analysis provides the PCE index, a measure of prices based on personal consumption in the official National Income and Product Accounts.¹⁶ The Federal Reserve currently focuses on the PCE index to gauge inflation, but it relied on CPI inflation prior to 2000.¹⁷

High rates of inflation dilute the value of peoples' cash holdings and have been associated with stifled economic growth.¹⁸ Higher rates of inflation reduce purchasing power as time goes on unless wages and rates of return adjust along with inflation.¹⁹ Evidence suggests that, on average, income does tend to adjust along with inflation over time, although distortionary short-run effects cannot be ignored.²⁰

One problem for policymakers is that there is no objective measure of what constitutes "high" inflation. Moreover, *temporary* increases in inflation tend not to cause widespread economic problems, and it is easy to find above-average monthly rates of inflation in the U.S. data during the past several decades. It is also common to find that individual components of the overall price index rapidly rise on occasion, but such movements do not, by themselves, constitute high inflation. For instance, gasoline prices are up 49 percent from April 2020 to April 2021, an increase that is largely explained by basic supply and demand factors separate from any recent policy changes.²¹

Although sustained price increases of this sort *could* ultimately contribute to an upward long-term trend in overall prices, large swings in gas prices are not uncommon. For instance, gas prices fell 39 percent from April 2008 to April 2009 and rose 38 percent from April 2009 to April 2010.²² Similarly, on a calendar-year basis (from January to December), between 1990 and 2020, U.S. gas prices have typically fluctuated 19 percent, with a decrease of 44 percent in 2008 and an increase of 48 percent in 2009.²³ Yet the overall annual change in the CPI averaged just 2.13 percent during this period, with a high of 5.25 percent in 1990 and a low of 0.37 percent in 2008.²⁴

More broadly, prices of all sorts of goods and services typically rise—and fall—based on conditions in their individual markets. While these individual price changes contribute to the overall level of inflation, they do not, by themselves, constitute inflation.²⁵ They represent important price signals for producers to supply more (or less), and government interference with those price changes in the name of reducing inflation—or some other policy goal—tends to do more harm than good.²⁶

Naturally, many consumers will not care that overall inflation is mild if, for instance, gas prices suddenly double. Nonetheless, to the extent that unique factors (including harmful regulatory policies) cause such individual price fluctuations, it would be counterproductive for policymakers to address the situation by trying to change the overall price level. Monetary policy, particularly, is a blunt instrument that affects prices broadly over time. Regardless, it is impossible to determine which goods categories are driving trends in the overall price level without examining changes in the components of the overall price index.

The 1970s Have Not Yet Returned

Despite the unexpectedly large uptick in annual inflation in April, it remains too early to determine whether the rise is transitory or the beginning of a long-term trend. Based on movements in some of the individual components of the CPI, there is still good reason to believe that the overall increase is transitory. For instance, the recent increase in gas prices (from April 2020 to April 2021) explains 29.33 percent of the increase in the overall CPI.²⁷ The gas price increase, in turn, is driven in part by a steep decline at the beginning of 2020 to nearly a four-year low, when gas prices declined 30 percent from January to April.²⁸

Separately, several categories of price changes related to the COVID-19 pandemic explain a large amount of the overall rise in the CPI. For instance, many car rental companies sold off their fleets during the pandemic, and now used car prices have surged as demand has picked up.²⁹ The April-to-April rise in used car and truck prices accounts for 12.88 percent of the rise in the CPI. Another 12 percent is explained by the following categories, each of which experienced major economic difficulties during the pandemic: full-service meals (2.8 percent), limited-service meals (4.05 percent),³⁰ other lodging away from home including hotels and motels (1.57 percent), car and truck rental (1.9 percent), and airline fares (1.45 percent).

Thus, price increases in just seven categories explain 54 percent of the April-to-April increase in the CPI. The increases in some of these categories, such as lodging, are more pronounced than normal because they are occurring amidst a demand resurgence *after* price declines during the pandemic. Other increases, such as restaurant prices, are at least partly explained by extremely tight labor conditions, a problem that COVID-19 relief spending has likely worsened.³¹ While idiosyncratic factors are clearly driving these increases, there is certainly no guarantee that inflation will not continue to rise. Still, even though policymakers must remain vigilant, the broader CPI trends look very different from those in the 1970s.

April CPI in Broader Context

It is too soon to know whether the recent inflationary surge is merely transitory, but annual changes during the past decade show that the latest change is not yet part of a larger trend. For example, in the past 10 years, the highest *annual* (January to December) increase in the CPI was in 2011 at 2.73 percent. Although the Fed did not change its policy stance, the annual CPI inflation rate fell for the next three years, falling to 0.41 percent in

2014.³² The PCE index, the Fed’s preferred inflation measure, displayed the same trend over this period.³³ In fact, inflation has been low by historical standards for the past two decades. Between 2000 and 2020, average annual inflation was 1.89 percent using the CPI and 1.59 percent if measured with the PCE.³⁴

In contrast, the *lowest* annual increase in the CPI between 1966 and 1980 was 3.01 percent (in 1971), and the highest annual rate of inflation during this period was 12.26 percent (in 1979). The average annual increase between 1970 and 1980 was 7.18 percent. Even the month-to-month changes across these two periods are radically different. The average monthly change in the CPI between 1970 and 1980 was 0.63 percent, but between 2010 and 2020 the average was just 0.14 percent.³⁵ Inflation trends can change suddenly and unexpectedly,³⁶ but these comparisons show that the United States has a long way to go to repeat the awful experience of the 1970s.

Nonetheless, the April inflation report does suggest that the *risk* of higher inflation outweighs that of lower inflation for the first time in perhaps the past decade. Aside from the figures already discussed, CPI inflation from January to April 2021 was 1.75 percent, the highest rate over these four months since 2011 (1.31 percent).³⁷ While there is no doubt the April CPI rose very fast by *recent* historical standards, there is not yet any reason to think inflation will get out of control. There is, in fact, very little chance that the Fed would change its policy stance in response to an increase in the CPI such as the April surge.

How the Fed Relies on Its Mandate

There is no way to perfectly predict whether (or when) a long-term increase in inflation might begin. Thus, Federal Reserve officials are in the unenviable position of trying to gauge when inflation is “too high” for “too long,” thus requiring a policy response that would contract the economy. Naturally, the Fed tends to view *sustained* price level increases—rather than short-term/transitory increases—as the type of inflation that requires it to change its policy stance. Fed officials do not, however, base their decisions on a straightforward formula. This fact, most likely, is contributing to the current anxiety over the April CPI report.

In the late 1970s, Congress gave the Fed its first formal price-stability mandate. Specifically, it required the Federal Reserve to “maintain long run growth of the monetary and credit aggregates commensurate with the economy’s long run potential to increase production, so as to promote effectively the goals of maximum employment, stable prices, and moderate

long-term interest rates.”³⁸ Despite this legislative mandate, the Fed has broad discretion to determine how to meet its requirements, particularly with how it chooses to define *stable prices*.

Just as there is no objective measure of “high” inflation, there is no independent definition of “stable” prices. At least since the 1990s, Fed officials have interpreted this portion of the mandate to require consistently low inflation, where “low” is approximately 2 percent.³⁹ The Fed did not officially target inflation until 2012, when it announced:

The Committee reaffirms its judgment that inflation at the rate of 2 percent, as measured by the annual change in the price index for personal consumption expenditures, is most consistent over the longer run with the Federal Reserve’s statutory mandate.⁴⁰

In 2020, under Chairman Jerome Powell, the Fed updated its official interpretation of the legislative mandate. This change, announced after the Fed completed an 18-month public review of its operating framework, was partly in response to the Fed’s consistent *undershooting* of its 2 percent inflation target.⁴¹ According to Powell, the goal was to better ensure that the public’s “longer-term inflation expectations remain well anchored at 2 percent.”⁴² The new interpretation says that the Fed

will seek to achieve inflation that averages 2 percent over time. Therefore, following periods when inflation has been running below 2 percent, appropriate monetary policy will likely aim to achieve inflation moderately above 2 percent for some time. In seeking to achieve inflation that averages 2 percent over time, we are not tying ourselves to a particular mathematical formula that defines the average.⁴³

Thus, the Fed is now following some type of flexible *average* inflation targeting, one that does not define a specific period for calculating the average. While its target inflation rate remains 2 percent, the Fed now appears committed to making up for undershooting its target by aiming to induce inflation that exceeds 2 percent “for some time.”

It is impossible to know precisely what this means for how the Fed will alter its monetary policy stance going forward or exactly how the unexpectedly high inflation in April figures into the Fed’s decision. The Fed could use April as the first month of a period for which to calculate average inflation, but they do not have to do so. Nor, for that matter, does the Fed have to base its policy stance on a 12-month average. Regardless, the public can now expect the Fed to tolerate inflation greater than 2 percent for an undetermined length of time.

While average inflation targeting (theoretically) has some merit,⁴⁴ it is far from clear exactly how the Fed will implement its new policy. One potential problem is that the Fed will, in the future, lack the political will to fully compensate for *overshooting* its inflation target by shifting to a contractionary policy stance.⁴⁵ This risk appears heightened given the Fed's new interpretation of the *employment* portion of its mandate.

The Fed's new policy statement displays a bias toward expansionary monetary policy when employment is too low relative to "maximum employment," another concept that lacks an objective definition. According to Powell:

[O]ur revised statement says that our policy decision will be informed by our "assessments of the shortfalls of employment from its maximum level" rather than by "deviations from its maximum level" as in our previous statement. This change may appear subtle, but it reflects our view that a robust job market can be sustained without causing an outbreak of inflation.⁴⁶

There is little doubt that this change was motivated, in part, by political pressure for the Fed to do more to boost employment rather than focus on inflation.⁴⁷ It seems perfectly rational, therefore, for people to be anxious over exactly how long the Fed will tolerate inflation greater than 2 percent. Naturally, the lower-than-expected job growth in April has only compounded this anxiety.⁴⁸

The Fed could easily calm the public's fears by stating, for example, that it will ensure that inflation averages 2 percent over the next 12 months, but it has not done so. Instead, several Fed officials have insisted that the recent spike in inflation is transitory and that they want inflation to remain above 2 percent "for a while."⁴⁹ Thus, combined with the fact that the United States has not dealt with consistently high inflation since the 1970s, it is hardly surprising that the recent uptick in the CPI has caused so much alarm. Separately, the Fed's current operating framework—completely untried during conditions of increasing inflation—even further adds to the anxiety.

Fed's Operating Framework Worsens Fiscal Outlook

Economists John Cochrane and Kevin Hassett recently argued that the current fiscal outlook means that it will be more difficult for the Fed to stop inflation than in the past. They pointed out, "Federal debt held by the public hovered around 25 percent of GDP throughout the 1970s. It is four times that large, 100 percent of GDP today, and growing."⁵⁰ Cochrane and

Hassett (correctly) referred to the fear of higher interest rates exploding the deficit even more, leading to more debt, but the problem is even trickier due to the Fed's new operating framework.

As part of its response to the 2008 financial crisis, the Federal Reserve purchased large quantities of long-term Treasuries and mortgage-backed securities.⁵¹ They also implemented a new operating framework, based on paying above-market interest rates on banks' excess reserves, that it has yet to end. One major problem with this framework is that it effectively divorces the Fed's monetary policy stance from the amount of assets it purchases. That is, the Fed can now purchase financial assets without creating the types of inflationary pressures that such purchases would have created prior to 2008.⁵² Thus, the new framework politicizes monetary policy in several ways.

First, the Fed will come under increasing pressure to absorb new U.S. debt and accommodate new types of federal spending.⁵³ While Fed officials were once able to rely on its price-stability mandate to fend off congressional attempts to engage in massive spending programs, they can no longer do so. Second, increased political pressure is also likely to hamper the Fed's ability to control high inflation because of the way the Fed's key policy instrument works in this new framework. Specifically, the Fed must increase the interest rate that it pays on reserves to keep inflation in check, because interest payments on reserves are now its primary control mechanism.⁵⁴

As inflation rises, leading to higher market interest rates, the Fed will have to pay higher and higher amounts to large financial institutions. Given that total reserve balances now exceed \$4 trillion, the Fed could easily have to pay more than \$200 billion per year to large financial institutions to tighten its policy stance and slow down inflation.⁵⁵ In other words, the Fed would not be able to slow down inflation without paying billions of dollars to banks to hold onto their reserves. It is extremely difficult to see how these payments would be politically sustainable in any economic environment, much less one in which inflation is spiraling upward. Hopefully, the long-term structural forces that have kept inflation in check will continue to do so while giving the Fed more time to normalize its policies.

Another Reason for Hope: Chronically Undershooting Inflation Targets

As alluded to previously, the Federal Reserve has generally undershot its inflation target for decades. Between 2000 and 2020, for instance, average annual PCE inflation was 1.59 percent. Since the 1990s, in fact, most major central banks have experienced the same sort of problem: They have had

difficulty reaching their inflation target.⁵⁶ This pattern has coincided with a long-term secular decline in interest rates, complicating monetary policy operations as short-term interest rates have remained close to zero.⁵⁷

There are several reasonable explanations for these long-term trends, but economists are uncertain exactly why these phenomena have occurred. Reasons include higher productivity, increased economic development throughout the world, an aging population, and a corresponding safe-asset shortage.⁵⁸ Obviously, the structural forces that have been causing persistently low inflation could change at any time. Still, at least some of these factors are likely to influence inflation for the near future, reinforcing the point that policymakers should not panic over the latest CPI report. Instead, they should help avoid this type of economic anxiety in the future by focusing on long-term reforms that address U.S. fiscal and monetary policy problems.

Traps to Avoid

Many people are concerned about the recent spike in inflation, and it is critical that policymakers remain vigilant. However, implementing poorly designed policies—and failing to enact beneficial policies—during a panic will only make matters worse. The following are several mistakes that policymakers should avoid as the recovery from the pandemic takes off.

Confusing an Increase in Individual Prices with an Increase in the Overall Price Level. Most consumers likely do not care that overall inflation is mild when, for instance, food or gas prices suddenly spike upward. Some may also worry that price increases in certain goods, such as fuel or basic commodities such as steel, will eventually translate into higher overall prices. While these fears should not be dismissed, it is vital to realize that prices of all sorts of goods regularly fluctuate, and those price changes serve a fundamental function for allocating resources in markets. It is also true that, in general, commodity price increases do not automatically lead to higher overall consumer prices.⁵⁹ Unlike inflation, individually fluctuating prices do not (by themselves) erode consumers' purchasing power over time. Rather than authorize a government agency to constantly adjust consumer prices, it is far better to let prices fluctuate so that markets will function properly. Of course, many poorly designed regulatory policies that increase consumer prices—beyond the energy sector—and have other harmful effects should still be eliminated.⁶⁰

Fearing Inflation Because the Fed Has Created Too Much Money. Several reports demonstrate that many people fear inflation because of

the large spike in the M2 monetary aggregate that began in March 2020.⁶¹ It may seem natural to fear inflation because so much additional money is now in the economy, but the historical relationship between annual changes in M2 and inflation (using either an overall or core price index) shows that inflation has been low and stable for decades even following large increases in M2. This fear also ignores changes in the *velocity* of money, a term that indicates how rapidly each dollar in the economy is being spent. If, for example, the velocity of money is decreasing, then individuals in the economy are conducting fewer transactions.⁶² Because a rapid decline in velocity offsets the inflationary effects of an increase in the money supply, proper monetary policy requires the Fed to offset changes in velocity with changes in the money supply. The data, in fact, indicate that the Fed appropriately offset a decline in velocity during the pandemic.⁶³ In any case, it does not follow that an increase in the monetary aggregates—such as the recent spike in M2—will automatically translate into inflation.⁶⁴

Requiring the Fed to Maintain Price Stability. Monetary policy is a very blunt instrument in that the central bank has very little control over where additions to the money supply are spent. An inflation-targeting central bank, therefore, runs the risk of causing some goods' prices to no longer reflect their true scarcity at any given point in time. If, for instance, the Fed tries to grow the price level at 2 percent each year, it could mask the underlying conditions that some prices would otherwise signal to buyers and sellers.⁶⁵

Absolving Federal Officials of Enacting Poor Fiscal and Regulatory Policies. The federal government has enacted countless regulatory policies that lessen economic opportunities for Americans. Congress should start removing these harmful regulations regardless of the latest CPI reports.⁶⁶ Regardless of the recent CPI figures, elected officials must curb rising U.S. debt and the growth in entitlement spending.⁶⁷ The risk of a fiscal crisis and higher inflation are heightened by persistently increasing debt and deficits. Such a fiscal path ultimately causes people to lose confidence in the nation's ability to service debt. Similarly, people lose confidence in the ability of the United States to finance deficits as the Fed purchases a higher and higher share of outstanding Treasury debt. Long before the COVID-19 pandemic, the United States was on an unsustainable fiscal path due largely to entitlement spending.⁶⁸ Perhaps worse, the Fed's new operating framework replaces a market-determined federal funds rate with bureaucratically administered interest rates, thus distorting private markets and jeopardizing the Fed's ability to regulate the economy's overall liquidity. If the Fed does not revert to its traditional (pre-2008) operating framework on its own, Congress should require the Fed to do so over a specific period.

Congress Should Focus on Long-Term Reforms

Regardless of whether the latest CPI figures represent the beginning of a new upward trend in inflation, Congress can implement several reforms that improve monetary and fiscal policy. These reforms would also help to reduce the type of uncertainty that has contributed to economic anxiety over the recent surge in the CPI. In particular, Congress should enact the following reforms.

Replace the Fed’s “Dual” Mandate. Congress can greatly improve monetary policy by replacing the Federal Reserve’s current legislative mandate to promote stable prices and maximum employment. Instead, Congress should give the Fed a mandate with the *single* goal of achieving monetary neutrality by stabilizing overall spending in the economy. A central bank that targets total spending has the best chance of achieving monetary neutrality because it effectively requires it to respond to changes in money velocity.⁶⁹ This framework would be superior to inflation targeting—particularly in the face of supply shocks to the economy—because it would allow prices to better reflect goods’ actual scarcities and because it would avoid major information problems faced by inflation-targeting central banks.⁷⁰ Similarly, the central bank would no longer directly respond to changes in unemployment, which is a benefit because maximum employment is largely determined by non-monetary factors.⁷¹ Targeting total spending also allows the price level to decline as productivity improves, thus allowing people to enjoy the benefits of a growing economy, with more goods for sale at lower prices.

Normalize Monetary Policy. The Fed has breached the traditional boundaries between the monetary and fiscal authorities, thus making it easier to engage in strictly fiscal quantitative easing operations, the type of financing favored by supporters of large-scale infrastructure projects and helicopter money proposals.⁷² Regardless of the recent CPI figures, elected officials should curb rising U.S. debt and the growth in entitlement spending.⁷³ If the Fed does not revert to its traditional (pre-2008) operating framework on its own, Congress should require the Fed to do so over a specific period.

Conclusion

The latest inflation report from the BLS has created fear that the United States might be on the verge of returning to the high inflation of the 1970s, or even stagflation. Rather than panic, Congress and the Administration should focus on long-term reforms that will help avoid this type of economic anxiety in the future. They should fix the federal government’s

structural spending problems, sharpen the lines between fiscal and monetary policy, and replace the Fed's dual mandate with a single directive to achieve monetary neutrality. Congress and the Administration should also reduce harmful regulations and ensure that the Federal Reserve normalizes monetary policy.

Recent changes to the Fed's operating framework, including how it intends to target inflation, have made it difficult to know *exactly* what the Fed will do as economic conditions unfold. This problem will only get worse if conditions unfold along an unexpected path. Unless Congress takes back its authority to set monetary policy, lessening the Fed's policy discretion, this type of downside to the Fed's current framework will remain.

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18. Robert Barro, "Determinants of Economic Growth: A Cross-Country Empirical Study," National Bureau of Economic Research *Working Paper* No. 5698, August 1996, <http://www.nber.org/papers/w5698.pdf> (accessed May 19, 2021), and Javier Andres and Ignacio Hernando, "Does Inflation Harm Economic Growth? Evidence for the OECD," National Bureau of Economic Research *Working Paper* No. 6062, June 1997, <http://www.nber.org/papers/w6062> (accessed May 19, 2021).
19. The standard view in macroeconomics is that inflation does not itself reduce purchasing power because nominal incomes rise to keep pace with price increases. In the long run, money is "neutral" in that the nominal value does not have an effect on incomes or production. See N. Gregory Mankiw, *Principles of Economics* (Orlando, FL: Dryden Press, 1998), p. 623.

20. For the long-run effects, see Arthur M. Okun, William Fellner, and Michael Wachter, "Inflation: Its Mechanics and Welfare Costs," *Brookings Papers on Economic Activity*, Vol. 1975, No. 2 (1975), pp. 351–401, <http://www.jstor.org/stable/pdfplus/2534106.pdf> (accessed May 20, 2021). There is much more controversy over the distortionary impact that inflation can have on relative price changes in the short run. For more on this issue, see Laurence Ball and N. Gregory Mankiw, "Relative-Price Changes as Aggregate Supply Shocks," *Quarterly Journal of Economics* (February 1995), pp. 161–193.
21. Nick Loris, "Rising Gas Prices: A Look Under the Hood," Heritage Foundation *Commentary*, March 26, 2021, <https://www.heritage.org/energy-economics/commentary/rising-gas-prices-look-under-the-hood>.
22. These figures refer to the BLS series "Gasoline (all types) in U.S. city average, all urban consumers, seasonally adjusted." From 2000 to 2021, the standard deviation in the April-to-April rate of change is 23 percent.
23. Using the BLS series "Gasoline (all types) in U.S. city average, all urban consumers, seasonally adjusted." From 1990 to 2020, the standard deviation in the January-to-December rate of change is 18.55 percent.
24. The overall rate of inflation has been low for at least the past 25 years as measured by both the CPI and PCE. The same holds true for the CPI when certain volatile component prices are withheld from the calculation. See William R. Emmons, "Excluding Housing Costs, U.S. Inflation Is Well Below 2%," Federal Reserve Bank of St. Louis, January 17, 2020, <https://www.stlouisfed.org/publications/regional-economist/fourth-quarter-2019/housing-costs-inflation> (accessed May 18, 2021).
25. Similarly, many commodity prices (and indexes of commodity prices) regularly move up and down based on conditions in individual markets. Although such price movements *can* contribute to changes in the overall inflation rate of consumer products, commodity price changes provide little—if any—predictive power for forecasting the overall rate of inflation. See Galina Hale, Bart Hobijn, and Rachna Raina, "Commodity Prices and PCE Inflation," Federal Reserve Bank of San Francisco, May 7, 2012, <https://www.frbsf.org/economic-research/publications/economic-letter/2012/may/commodity-prices-pce-inflation/> (accessed May 21, 2021); Kevin L. Kiesen, "Commodity Price Indexes: Can They Predict Inflation?," Federal Reserve Bank of St. Louis, July 1, 1994, <https://www.stlouisfed.org/publications/regional-economist/july-1994/commodity-price-indexes-can-they-predict-inflation> (accessed May 21, 2021); Roy H. Webb, "Commodity Prices as Predictors of Aggregate Price Change," Federal Reserve Bank of Richmond, November/December 1988, https://www.richmondfed.org/-/media/richmondfedorg/publications/research/economic_review/1988/pdf/er740601.pdf (accessed May 21, 2021); and C. Alan Garner, "Commodity Prices: Policy Target or Information Variable?," *Journal of Money, Credit and Banking*, Vol. 21, No. 4 (November 1989), pp. 508–514.
26. Hugh Rockoff, "Price Controls," Library of Economics and Liberty, 2019, <https://www.econlib.org/library/Enc/PriceControls.html> (accessed May 19, 2021).
27. Author's calculations based on news release, "Consumer Price Index Summary," Table 7: Consumer Price Index for All Urban Consumers (CPI-U): U.S. city average, by expenditure category, April 2021, U.S. Bureau of Labor Statistics, May 12, 2021, <https://www.bls.gov/news.release/cpi.nr0.htm> (accessed May 14, 2021). The calculation follows the BLS's methodology, whereby the contribution of an individual category to the overall CPI is calculated as the "effect" of that category (provided by the BLS on Table 7) divided by the increase in the "all items" index, in this case 4.2 percent. See footnote 1 on Table 7.
28. As mentioned previously, many regulatory and supply/demand factors help to explain the recent increase in gas prices. See Nick Loris, "Rising Gas Prices." Of course, the Administration is promoting many harmful policies that will likely lead to more expensive fossil-fuel-based energy products, so the risk is heightened that gas (and other energy prices) will be higher in the future. See, for instance, Kevin Dayaratna, Nicolas Loris, and David Kreutzer, "Consequences of Paris Protocol: Devastating Economic Costs, Essentially Zero Environmental Benefits," Heritage Foundation *Backgrounder* No. 3080, April 13, 2016, <https://www.heritage.org/environment/report/consequences-paris-protocol-devastating-economic-costs-essentially-zero>, and Kevin Dayaratna, David Kreutzer, and Nicolas Loris, "Time to Unlock America's Vast Oil and Gas Resources," Heritage Foundation *Backgrounder* No. 3148, September 1, 2016, <https://www.heritage.org/environment/report/time-unlock-americas-vast-oil-and-gas-resources>.
29. Scott McCartney, "Wait, Where Did All the Rental Cars Go?," *Wall Street Journal*, April 14, 2021, <https://www.wsj.com/articles/hertz-avis-enterprise-rental-car-shortage-11618335385> (accessed May 19, 2021).
30. *Full-service meals* refers to dine-in restaurants, whereas *limited-service meals* refers to fast-food establishments. Especially those in the latter category are, of course, still dealing with major labor shortages caused, in part, by the federal response to the pandemic.
31. Greszler, "Fact Check."
32. The Federal Reserve held its key policy rate, the rate it pays on excess reserves, at 0.25 percent from December 2008 to December 2015. See Board of Governors of the Federal Reserve System, "Interest Rate on Excess Reserves (IOER)," Federal Reserve Bank of St. Louis, <https://fred.stlouisfed.org/series/IOER> (accessed May 16, 2021). The CPI inflation rate refers to the CPI-U, All items in U.S. city average, seasonally adjusted. See U.S. Bureau of Labor Statistics, "Consumer Price Index (CPI) Databases," <https://www.bls.gov/cpi/data.htm> (accessed May 27, 2021).
33. See Board of Governors of the Federal Reserve System, Personal Consumption Expenditures: Chain-type Price Index, Index 2012=100, Monthly, Seasonally Adjusted (PCEPI), Federal Reserve Bank of St. Louis, <https://fred.stlouisfed.org/series/PCEPI> (accessed May 17, 2021).
34. For the entire post-World War II period, annual inflation has averaged more than 3 percent. See Norbert Michel, "Federal Reserve Performance: What Is the Fed's Track Record on Inflation?," Heritage Foundation *Backgrounder* No. 2968, October 27, 2014, <https://www.heritage.org/debt/report/federal-reserve-performance-what-the-feds-track-record-inflation>.
35. Between 2000 and 2020, the average monthly rate was 0.17 percent.
36. John H. Cochrane and Kevin A. Hassett, "Inflation: The Ingredients Are in the Pot, and the Fire Is On," *National Review*, April 26, 2021, <https://www.nationalreview.com/2021/04/inflation-the-ingredients-are-in-the-pot-and-the-fire-is-on/> (accessed May 17, 2021).

37. Though the precise values are different, the same comparison holds using January to March (the latest monthly release for 2021) PCE index values.
38. 12 U.S. Code § 225a. The idea of promoting price stability as a policy goal was first introduced by Congress in the 1977 amendment to the Federal Reserve Act. Subsequent legislation, such as the 1978 Full Employment and Balanced Growth Act, expanded policy goals for the federal government (in general) to “promote full employment and production, increased real income, balanced growth, a balanced Federal budget, adequate productivity growth, proper attention to national priorities, achievement of an improved trade balance...and reasonable price stability.” Ultimately, the President of the United States was required to publish a timetable for achieving price stability and full employment in each year’s Economic Report of the President. See John Judd and Glenn D. Rudebusch, “The Goals of U.S. Monetary Policy,” Federal Reserve Bank of San Francisco, January 29, 1999, <https://www.frbsf.org/economic-research/publications/economic-letter/1999/january/the-goals-of-us-monetary-policy/> (accessed May 17, 2021).
39. Of course, there is no objective measure of “consistent,” either, though less variability is considered better than more variability. See Michel, “Federal Reserve Performance.”
40. Board of Governors of the Federal Reserve System, “Statement on Longer-Run Goals and Monetary Policy Strategy,” January 24, 2012 (as reaffirmed effective January 26, 2021), https://www.federalreserve.gov/monetarypolicy/files/FOMC_LongerRunGoals.pdf (accessed May 17, 2021).
41. Using the PCE measure, for instance, the annual rate of inflation from 2011 to 2020 was just 1.37 percent and from 2000 to 2020 was only 1.59 percent.
42. Jerome Powell, “New Economic Challenges and the Fed’s Monetary Policy Review,” at “Navigating the Decade Ahead: Implications for Monetary Policy,” an economic policy symposium sponsored by the Federal Reserve Bank of Kansas City, Jackson Hole, WY, August 27, 2020, <https://www.federalreserve.gov/newsevents/speech/powell20200827a.htm> (accessed May 17, 2021).
43. Ibid. Also see Board of Governors of the Federal Reserve System, “Current FAQs: Why Does the Federal Reserve Aim for 2 Percent Inflation Over Time?”, https://www.federalreserve.gov/faqs/economy_14400.htm (accessed May 17, 2021).
44. Under certain conditions, targeting average inflation could effectively be the same as targeting the price level or nominal spending, both of which would be better policies. See George Selgin, “Is the Fed Getting Warmer?”, Alt-M, September 10, 2020, <https://www.alt-m.org/2020/09/10/is-the-fed-getting-warmer/> (accessed May 27, 2021).
45. Selgin, “Is the Fed Getting Warmer?”
46. Powell, “New Economic Challenges and the Fed’s Monetary Policy Review.”
47. For months, Democratic Members of Congress had been urging the Fed to do more to shrink racial disparities in income and employment, an active policy that Powell has tried to resist. See Victoria Guida, “An Activist Central Bank? Dems Push the Fed to Fight Racial Inequality,” Politico, August 29, 2020, <https://www.politico.com/news/2020/08/29/federal-reserve-race-economic-activism-404560> (accessed May 20, 2021), and Norbert Michel, “Good Politics Versus Good Policy: The Fed’s New Average Inflation ‘Target,’” Forbes, August 31, 2020, <https://www.forbes.com/sites/norbertmichel/2020/08/31/good-politics-versus-good-policy-the-feds-new-average-inflation-target/?sh=1a5ea4f03493> (accessed May 20, 2021).
48. Cox, “Inflation Speeds Up in April”; Ben Winck, “Key US Inflation Gauge Climbs to 13-Year High as Reopening Supercharges Demand,” Business Insider, May 12, 2021, <https://www.businessinsider.com/inflation-consumer-price-index-april-cpi-economic-reopening-price-growth-2021-5> (accessed May 17, 2021); Anneken Tappe, “Major Disappointment: America Added Way Fewer Jobs Than Expected in April,” CNN Business, May 7, 2021, <https://www.cnn.com/2021/05/07/economy/april-jobs-report-pandemic-anniversary/index.html> (accessed May 17, 2021); and Jeff Cox, “April’s Expected Hiring Boom Goes Bust as Nonfarm Payroll Gain Falls Well Short of Estimates,” CNBC, May 7, 2021, <https://www.cnbc.com/2021/05/07/jobs-report-april-2021.html> (accessed May 17, 2021).
49. Jeff Cox, “Fed’s Evans Says Employment and Inflation Need to Pick Up Before Policy Changes,” CNBC, May 12, 2021, <https://www.cnbc.com/2021/05/10/feds-evans-employment-inflation-need-to-rise-before-policy-changes.html> (accessed May 14, 2021), and James Politi and Colby Smith, “Fed Governor Plays Down Inflation Risks as ‘Transitory Surge,’” Financial Times, May 11, 2021, <https://www.ft.com/content/98c211f4-f097-4ee6-b9da-593422b6a539> (accessed May 14, 2021).
50. Cochrane and Hassett, “Inflation.”
51. Similar to other critiques above, the fact that the Fed has been regularly purchasing Fannie Mae and Freddie Mac mortgage-backed securities has surely bolstered those asset prices and, in all likelihood, kept housing prices up/rising. While this policy is questionable, at best, it does not amount to inflation *per se*.
52. For a definitive account, see George Selgin, *The Menace of Fiscal QE* (Washington, DC: Cato Institute, 2020). Also see George Selgin, *Floored! How a Misguided Experiment Deepened and Prolonged the Great Recession* (Washington, DC: Cato Institute, 2018), and Norbert Michel, “The Crisis Is Over: It Is Time to End Experimental Monetary Policy,” Heritage Foundation Backgrounder No. 3265, November 9, 2017, <https://www.heritage.org/monetary-policy/report/the-crisis-over-it-time-end-experimental-monetary-policy>.
53. See Jim Dorn, “Fiscal Dominance and Fed Complacency,” Alt-M, April 8, 2021, <https://www.alt-m.org/2021/04/08/fiscal-dominance-and-fed-complacency/> (accessed May 20, 2021).
54. The new framework has all but eliminated the inter-bank lending market that the Fed used to target with open market operations. See Michel, “The Crisis Is Over,” and Selgin, *The Menace of Fiscal QE*, pp. 85–94.
55. Bill Nelson, “Big Genie, Small Bottle: Normalizing Abnormal Monetary Policy,” Bank Policy Institute, May 12, 2021, <https://bpi.com/big-genie-small-bottle-normalizing-abnormal-monetary-policy/> (accessed May 20, 2021).

56. See Rene Vollgraaff, Craig Torres, and Tracy Withers, "The World's Central Banks Are Debating Whether to Change Their Strategies," *Bloomberg*, July 23, 2019, <https://www.bloomberg.com/news/articles/2019-07-23/missing-their-inflation-goals-central-banks-study-moving-posts> (accessed May 20, 2021), and Nouriel Roubini, "Why Central Banks Are Not Hitting Their 2% Inflation Target," *The Guardian*, September 19, 2017, <https://www.theguardian.com/business/2017/sep/19/why-central-banks-are-not-hitting-their-2-inflation-target> (accessed May 20, 2021). The Bank of Japan recently raised its inflation target but not its inflation rate, and the Bank of Canada set a 2 percent target in 1993 but then refrained from setting specific targets in 1995. See Taisuke Nakata, "Raising the Inflation Target: Lessons from Japan," Board of Governors of the Federal Reserve System, January 8, 2020, <https://www.federalreserve.gov/econres/notes/feds-notes/raising-the-inflation-target-lessons-from-japan-20200108.htm> (accessed May 20, 2021).
57. David Beckworth, "Upgrading the Fed's Operating Framework," *Cato Journal*, Vol. 40, No. 2 (Spring/Summer 2020), <https://www.cato.org/cato-journal/spring/summer-2020/upgrading-feds-operating-framework> (accessed May 20, 2021).
58. Ibid., and Juan M. Sánchez and Hee Sung Kim, "Why Is Inflation So Low?," Federal Reserve Bank of St. Louis, February 2, 2018, <https://www.stlouisfed.org/publications/regional-economist/first-quarter-2018/why-inflation-so-low> (accessed May 20, 2021).
59. See Loris, "Rising Gas Prices."
60. See U.S. Bureau of Labor Statistics, "Consumer Price Index Summary," Table 7. Also see Daren Bakst and Patrick Tyrrell, "Big Government Policies That Hurt the Poor and How to Address Them," Heritage Foundation *Special Report* No. 176, April 5, 2017, <https://www.heritage.org/poverty-and-inequality/report/big-government-policies-hurt-the-poor-and-how-address-them>, and David Burton, "Improving Entrepreneurs' Access to Capital: Vital for Economic Growth," Heritage Foundation *Backgroundr* No. 3182, February 14, 2017, <https://www.heritage.org/jobs-and-labor/report/improving-entrepreneurs-access-capital-vital-economic-growth>.
61. See Gautam Khanna, "As the Inflation Debate Rages, Consider 'Buying the Dips,'" *Financial Advisor*, April 22, 2021, <https://www.fa-mag.com/news/as-the-inflation-debate-rages--consider--buying-the-dips-61660.html> (accessed May 20, 2021). The M2 aggregate is a broad money supply category that includes: currency held by the public, transaction deposits at depository institutions, savings deposits, small-denomination time deposits (those issued in amounts of less than \$100,000), and retail money market mutual fund shares. See Board of Governors of the Federal Reserve System, FAQs, "What is the money supply? Is it important?," https://www.federalreserve.gov/faqs/money_12845.htm (accessed May 27, 2021).
62. For an example, see Yi Wen, "What Does Money Velocity Tell Us about Low Inflation in the U.S.?" Federal Reserve Bank of St. Louis, September 1, 2014, <https://www.stlouisfed.org/on-the-economy/2014/september/what-does-money-velocity-tell-us-about-low-inflation-in-the-us> (accessed May 21, 2021).
63. Data from the Federal Reserve indicate that, in fact, as the M2 aggregate started increasing in March 2020, velocity correspondingly decreased.
64. Also see Dorn, "Fiscal Dominance and Fed Complacency."
65. Strictly speaking, in the absence of productivity changes, inflation targeting and nominal spending targeting would produce equivalent macroeconomic outcomes. However, when productivity changes, output prices relative to those of inputs change. Therefore, a central bank that targets nominal spending would better accommodate these relative price changes than one that tries to stabilize prices. See George Selgin, *Less Than Zero: The Case for a Falling Price Level in a Growing Economy*, 2nd ed. (Washington, DC: Cato Institute, 2018), pp. 21–54.
66. Burton, "Improving Entrepreneurs' Access to Capital."
67. Michel, Winfree, and Badger, "Potential Long-Term Economic Consequences."
68. Ibid.
69. Norbert Michel, "Give the Fed a Single Mandate: Monetary Neutrality," Heritage Foundation *Backgroundr* No. 3367, April 24, 2019, <https://www.heritage.org/monetary-policy/report/give-the-fed-single-mandate-monetary-neutrality>.
70. It is typically impossible for a central bank to determine whether shocks are supply driven or demand driven until long after the fact. Another practical advantage is that the central bank would no longer have to respond to estimates of potential output or the natural unemployment rate, which are unobservable variables. See David Beckworth, "The Knowledge Problem in Monetary Policy: The Case for Nominal GDP Targeting," Mercatus on Policy, July 18, 2017, <https://www.mercatus.org/publications/monetary-policy/knowledge-problem-monetary-policy> (accessed May 21, 2021), and Scott Sumner, "The Case for Nominal GDP Targeting," Mercatus Center, October 23, 2012, <https://www.mercatus.org/publications/monetary-policy/case-nominal-gdp-targeting> (accessed May 21, 2021).
71. Scott Sumner, "Don't Target Unemployment," Library of Economics and Liberty, May 5, 2017, https://www.econlib.org/archives/2017/05/dont_target_une.html (accessed March 4, 2019). According to the Fed, the "maximum level of employment is largely determined by nonmonetary factors that affect the structure and dynamics of the job market. These factors may change over time and may not be directly measurable." News release, "Federal Reserve Issues FOMC Statement Of Longer-Run Goals And Policy Strategy," Board of Governors of the Federal Reserve System, January 25, 2012, <https://www.federalreserve.gov/newsevents/pressreleases/monetary20120125c.htm> (accessed May 27, 2021), and Narayana Kocherlakota, "Monetary Policy Transparency: Changes and Challenges," Federal Reserve Bank of Minneapolis, May 10, 2012, <https://www.minneapolisfed.org/speeches/2012/monetary-policy-transparency-changes-and-challenges-20120523> (accessed May 21, 2021).
72. Selgin, *The Menace of Fiscal QE*, pp. 14–18 and 22–26.
73. Michel, Winfree, and Badger, "Potential Long-Term Economic Consequences."