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ECONOMIC VIEW

## To Build Confidence, Aim for Full Employment

By ROBERT J. SHILLER

IN the current crisis, discussions of economic policy have often centered on uninspiring, short-term goals. To restore confidence in our economic future, we need appropriate, firm targets that will clearly put us where we want to be.

For example, President-elect [Barack Obama](#) has framed his economic [stimulus package](#) in terms of the number of jobs he will create. The goal is to add 2.5 million jobs, he says, by hiring people to improve our highways, fix up our schools and do other infrastructure work around the country. All of that is fine, but it does not represent a commitment to full employment — providing a job for everyone who is willing to work. As a result, confidence remains abysmal.

If the new president had a target of full employment, and if Americans believed that he could reach it, the confidence problem could be quickly solved.

[The Great Depression](#) provides an analogy. Presidents Herbert Hoover and [Franklin D. Roosevelt](#) had at least a vague idea that economic stimulus would help the situation, but even Roosevelt lacked clear targets for such policies during the New Deal. The economic stimulus applied was inconsistent and inadequate. Confidence waned, and the depression was longer and deeper than it needed to be.

People still remember aspects of that depression history. The [Works Progress Administration](#) and the Civilian Conservation Corps tackled infrastructure projects, much as Mr. Obama proposes — but these New Deal programs were not enough to restore full employment. That history reduces the current credibility of Mr. Obama's target of 2.5 million jobs.

On the other hand, there have been some worthwhile targets in monetary policy in recent years. A number of central banks have adopted firm inflation targets, which has helped to contain inflation expectations. Those expectations have tended to coincide roughly with the targets.

At the moment, of course, inflation is no longer the fundamental risk. Our current problems are [deflation](#) and recession — possibly even depression — and so we must rethink our targets.

An immediate shift to a full employment target may not be possible, simply because there is no confidence right now that we can hit it. While people seem to believe that central banks can control inflation, there is little consensus that central banks can prevent a depression under circumstances like this.

In a forthcoming book I've written with Professor George A. Akerlof of the University of California, Berkeley, we argue that current circumstances call for a couple of intermediate targets. If we can hit them, we may credibly be expected to hit the ultimate target of full employment — and keep inflation at bay. The intermediate targets should be announced forcefully, with an immediate effort to achieve them.

First, there should be an intermediate target for conventional fiscal and monetary policy, one ambitious enough to restore full employment in a typical recession. (Fiscal policy is the taxation and expenditure

proposed by the president and voted by Congress; monetary policy is the province of the [Federal Reserve Board](#).)

This target may be inadequate, however, because we are not in a typical recession. Conventional fiscal and monetary methods may fizzle, as they did in the 1990s in post-bubble Japan. After its stock market and real estate debacle early in the decade, the government of Japan moved its budget into deficit and brought interest rates down to zero. But the economy never entirely recovered, and in due course the government debt rose to 1.71 times the annual [gross domestic product](#), versus a current multiple of 0.74 in the United States.

Similarly, we just do not know whether these measures will work in this country. That is why we also need a second intermediate target, for credit. The ability to borrow should be restored to an appropriate level for a normal economy at full employment.

This is crucial because the most salient problem in our institutions is the drying up of credit. Without credit, companies that count on outside finance will go bankrupt, requiring an impossibly large fiscal and monetary policy stimulus to achieve full employment.

Furthermore, as long as the [credit crisis](#) continues, the economy's response to conventional fiscal and monetary policy may be drastically reduced. A person who cannot borrow, for example, is unlikely to buy a car, even if a generous fiscal policy has provided him with the needed down payment. Under the current circumstances, the Keynesian "multiplier," the economy's response to fiscal policy, may be unusually low. Our best econometric models just won't tell us how low.

FOR months, the Fed has been working to expand credit, and has invented some good methods for doing so. On Nov. 25, it announced a smart method to jump-start credit, called the Term Asset-Backed Securities Loan Facility, which would issue loans, using securities backed by newly issued consumer and small-business loans as collateral. The Fed has started paying interest on reserves to control the inflationary impact of such a policy.

This plan and others like it are promising. But all the government loan programs announced so far represent only a tiny fraction of the \$52 trillion of total credit market instruments outstanding. We will need to go much further and extend credit to households and businesses that would otherwise be ignored.

Along with fiscal and monetary policy, credit needs to be targeted on a scale that would get us out of our current economic mess. That's what Washington should do now.

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