

Is the Federal Reserve Contributing to Economic Inequality?

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University of California, Irvine Virtual Event
Irvine, CA
October 13, 2020
5:00PM PT

Remarks as prepared for delivery.

* This speech is dedicated to the memory of Thomas Laubach,
a devoted public servant and tireless advocate for crafting policy that works for everyone.

Introduction

Hello everyone. Thank you so much for the opportunity to join you today. It means more to me than you might expect.

I've spent almost 25 years at the Federal Reserve Bank of San Francisco. And back in 2006, when I was working in our research department, I got a big opportunity.

Our president at the time, Janet Yellen, was coming to UC Irvine to deliver a speech on economic inequality right before the midterm election.¹ I had a chance to work on her remarks, and it was a defining moment in my career.

So to be here again, at UC Irvine, as the current president of the San Francisco Fed, delivering a speech of my own on inequality, weeks before another important election, feels like a full-circle moment for me. And I thank you very much for the opportunity.

¹ Yellen (2006).

Now, I'd like to say that we've made a lot of progress since Janet's speech in 2006. But inequality is still a pressing issue for our nation—one that feels even more urgent in the wake of the health and economic hardships caused by COVID-19, and the social reckoning sparked by the deaths of George Floyd, Breonna Taylor, and too many others.

Not every American gets the same chance at life, liberty, and the pursuit of happiness. And this difference in opportunity translates into differences in outcomes. It leaves us with two Americas: one for those who have, and one for those who have not. This is our shared reality, a reality we have to acknowledge and confront—as individuals, as institutions, and as a nation.

As a monetary policymaker and the leader of the San Francisco Fed, I'm regularly—and rightly—asked about how the Federal Reserve contributes to the inequality we observe. So today, I will take this on directly: inequality, the role of the Fed, and how we must collectively move toward a better, more inclusive economic future.

But before I begin, I'll remind you that the remarks I'm delivering are my own, and do not necessarily reflect the views of anyone else within the Federal Reserve System.

The root of the question

Let's start by looking at a few recent facts that suggest the Federal Reserve might have a role in generating economic inequality.

COVID-19 hit our shores in January. And by March, we saw severe impacts on health and economic activity. Both the Fed and Congress took immediate and unprecedented action.

The Federal Reserve cut the federal funds rate to close to zero and implemented a wide array of measures to facilitate the flow of credit in the economy.² Congress provided almost \$3 trillion in fiscal support to shore up households, businesses, and state and local governments. Together these measures were a bridge through the immediate economic hardships caused by COVID-19.

But what has happened since then?

As the economy has slowly reopened, employment growth has rebounded, exceeding most expectations. But this growth has erased only about half of the original losses. In September, employment was still down by almost 11 million people from its recent peak. Those are bigger losses than we saw during the Great Recession. In contrast, after dropping nearly one-third of their value in February and March, financial markets have completely recovered, with all major U.S. stock indexes retracing their declines.

Looking at the two recoveries I have just described—the economic one and the financial one—it seems unfair. Another example of Wall Street winning and Main Street losing. Of a few advancing while so many others fall behind.³

So how do we alter this imbalance? What can we do to ensure the proceeds of economic growth are more equitably distributed in our society?

This is the right question to ask of policymakers. And while I can't provide a simple playbook or recipe, I will lay out the issues I see before us and discuss what the Federal Reserve, our fiscal agents, and each of us must do if we are going to create a more equitable future.

² Board of Governors (2020a, 2020b).

³ Kuhn, Schularick, and Steins (2020).

This isn't just a COVID-19 phenomenon

First, it's important to note that, while COVID-19 has spotlighted and magnified the inequities in our nation, these disparities have existed for decades. Income and wealth inequality in the United States have been rising almost without pause since 1980. Let me offer a few illustrations.

Over the past 40 years, the income of households near the bottom of the distribution—the 10th percentile—rose by about 20 percent. In contrast, households near the top of the distribution—the 90th percentile—saw their incomes rise by 66 percent.⁴

These differences in returns have added up to more inequality. In 2019, the top 10 percent of adults in the United States took home almost half of the pretax income generated in the economy—nearly five times their share of population.⁵

Looking at wealth, the disparities are even wider. About one-quarter of Americans have essentially no wealth—near zero or even a negative net worth.⁶ The remainder of households have some wealth, but this is quite unevenly distributed. At the end of 2019, the top 10 percent of American households owned nearly 70 percent of all wealth held in the United States.⁷

We're not the only country experiencing these trends. Inequality has increased in countries with economic systems similar to ours, like the United

⁴ Semega et al. (2020).

⁵ Based on data from the World Inequality Database, developed by Thomas Piketty, Emmanuel Saez, Gabriel Zucman, and collaborators. <https://wid.world/>

⁶ Bhutta et al. (2020).

⁷ Calculated from the Federal Reserve Board's Distributional Financial Accounts. <https://www.federalreserve.gov/releases/efa/efa-distributional-financial-accounts.htm>

Kingdom. And it's also happened, albeit to a lesser extent, in countries with economic systems very different from ours, like Denmark and Sweden.⁸

A range of structural factors have contributed to the worldwide increases in inequality we observe. These include automation, growing demand for college-educated workers, and globalized labor, product, and capital markets.⁹

But global trends alone can't explain the severe run-up in economic inequality we're experiencing in the United States. We have additional and unique challenges—struggles we see play out on the news every day.

Systemic biases related to race, ethnicity, gender, and class have led to unequal access to education, jobs, income, and wealth.¹⁰ And these inequities have compounded over generations, as children born into poverty or low-income households carry that disadvantage through to adulthood and pass it on to their children.¹¹

These trends—and their persistence over time—reflect fundamental choices we've made about public education, taxation, and the social safety net. Fundamental choices about how we manage our society.

So if these are our choices, what can institutions like the Federal Reserve do to change the landscape? The answer is: quite a lot.

⁸ See the World Inequality Database. <https://wid.world/>

⁹ See, for example, Autor (2019), Nolan, Richiardi, and Valenzuela (2019), and Dabla-Norris et al. (2015).

¹⁰ See, for example, relevant chapters in Nolan, Salverda, and Smeeding (2011); also Aliprantis and Carroll (2019), Butler, Mayer, and Weston (2020).

¹¹ Bengali and Daly (2013), Chetty et al. (2014).

Inequality and monetary policy

The Federal Reserve has a dual mandate—full employment and price stability. We achieve these goals primarily by adjusting the short-term interest rate.¹² Our interest rate decisions make it more or less expensive for consumers and businesses to borrow money. This guides spending decisions, which impacts hiring, wages, and ultimately inflation.

When it's working well, our policies provide the foundation for a positive feedback loop—consumers spend, firms invest and hire more workers, and a wide range of households build income and wealth. This is the virtuous cycle of growth that ultimately delivers a strong, sustainable, and inclusive economy.

But how do our policies work in practice? To get a sense of this, let's consider the last expansion—the longest in recorded U.S. history. After taking significant measures to stabilize the economy in the wake of the 2008 financial crisis, the FOMC committed to a period of sustained low interest rates to support the labor market and return inflation to 2 percent.

The benefits were material. The length and strength of the expansion pushed the unemployment rate to near-historic lows. This created real opportunities for a large number of sidelined Americans, many of whom were thought to be permanently out of the labor force or lacking the right skills to work in an evolving job market.¹³

¹² The Federal Reserve has a variety of additional tools beyond simple interest rate movements. These include forward guidance and asset purchases, along with lender-of-last-resort activities under Section 13(3) of the Federal Reserve Act. See the complete list here: <https://www.federalreserve.gov/monetarypolicy/policytools.htm>

¹³ Aaronson et al. (2019), Abraham and Kearney (2020).

The expansion also boosted the prospects of people of color and those without a college degree. By early 2019, employers were hiring African American and Hispanic workers at rates equal to or higher than those of white workers.¹⁴ This reduced long-standing unemployment gaps, narrowing them to historic lows. The same thing happened for those with a high school diploma: hiring rates rose, unemployment fell, and gaps narrowed relative to college-educated workers.¹⁵

By the end of the expansion, these improved employment outcomes were leading to faster growth in wages and income. Between 2016 and 2019, median wage growth for low-wage workers was more rapid than for high-wage workers, reversing a pattern that had dominated in previous years. This narrowed the relative gaps in wages between those in the lowest earnings quartile and all other groups.¹⁶

The better-than-average wage growth translated into better-than-average growth in household incomes. In 2019, median household income for Black and Hispanic households rose by more than 7 percent, compared to less than 6 percent for white households.¹⁷

Finally, these improvements also showed through to wealth. As the economy continued to expand, so did the value of assets, including housing, businesses, and stock market holdings. Gains on assets were especially rapid for those at the bottom of the wealth distribution.¹⁸ Between 2016 and 2019, families with the lowest net worth saw the largest growth in their holdings.

¹⁴ Petrosky-Nadeau and Valletta (2019).

¹⁵ Aaronson et al. (2019)

¹⁶ Robertson (2019).

¹⁷ Semega et al. (2020).

¹⁸ Bhutta et al. (2020).

This late-cycle pattern gave less-wealthy households a chance to reap some of the benefits that had been captured disproportionately by higher net-worth individuals earlier in the cycle.

Now, these are a lot of numbers. But they all point to a single thing: nearly 11 years of uninterrupted growth helped a broad range of Americans get a foothold in the economy—finding work, gaining income, and building wealth. These are unequivocally good outcomes.

But they are not enough. Simply chipping away at the mountain of inequality that has built up over the past several decades can only get us so far. Even with a historically long expansion, large differences in earnings, income, and wealth remain—especially for people of color. And these gaps are only being widened by COVID-19.

A framework for the future

So what more can we do? How can we build a society that delivers on the promise of equal opportunity and inclusive success?

First, the Fed has a critical role to play. Full employment, the idea that everyone who wants a job can get a job, is the foundation for ensuring more equitable outcomes.

To better achieve this goal, the Federal Reserve released a new strategic framework in August that lays out our approach to monetary policy for the next several years.¹⁹ A key component of this framework is the recognition that maximum employment is not a fixed target. It is a broad-based and inclusive goal that changes as the economy evolves.

¹⁹ Board of Governors (2020c).

We've committed to finding full employment experientially, by seeing it in wages and prices. When we've achieved 2 percent inflation on average, we will know that we have approached our maximum and that the economy is firmly on its sustainable path.

In other words, in the absence of sustained 2 percent inflation or emerging risks, such as to financial stability, we will not take the punch bowl away while so many remain on the economic sidelines.

But the most critical aspect of our new framework is not about specific policies. Rather, it is about commitment. The commitment to regularly review our strategy to ensure it continues meeting the needs of the American people.

The ingredients of this ongoing review are simple. We need to listen, research, and engage. Keep our minds open to what we hear, bring the best data and analysis to the problems we find, and have hard, action-oriented conversations around the issues holding us back from achieving our full economic potential.²⁰

A job for all

But even with all of these actions, the Federal Reserve cannot fully solve the inequity problems before us. For that, we need everyone.

Our social safety net was originally crafted in the wake of the Great Depression. It collectively recognized that, at any point, any one of us might

²⁰ Recent Federal Reserve System efforts include the *Fed Listens* initiative, summarized at <https://www.federalreserve.gov/monetarypolicy/review-of-monetary-policy-strategy-tools-and-communications.htm>, and the *Racism and the Economy* webinar sponsored by the Federal Reserve Banks of Atlanta, Boston, and Minneapolis, <https://www.minneapolisfed.org/events/2020/racism-and-the-economy-series-kickoff-event>.

need help. That safety net and its expansions over time have become integral to the stability of the economy.²¹

But a net that simply catches people when they fall is no longer sufficient. Too many people are left out from the start—without resources, without opportunity, without a fair chance. So we need a net that *lifts*.

How do we build this? We invest in infrastructure—opportunity infrastructure—that includes health, education, and digital connectivity. Healthy people are productive people. Education is a lifelong asset. And digital access is a public good. Investing in this critical infrastructure will help level the playing field, reduce inequality, and boost the potential output of our nation.²²

We are a rich enough country that we can afford to do this.

We are a poor enough country that we can't afford not to.

The challenge

Let me conclude with a reflection. I've been thinking a lot lately about the Pledge of Allegiance. I learned it in the first grade. I stood in the classroom with my hand over my heart, and I said the words, "with liberty and justice for all."

I believed those words. I cherished those words. But the world has disappointed.

Change is hard. But our current situation is untenable.

²¹ McKay and Reis (2016); Christiano, Eichenbaum, and Trabandt (2016); Boushey, Nunn, and Shambaugh (2019); Lansing and Markiewicz (2018). See also the panel discussion including Janet Yellen and others at the 2020 American Economic Association Annual Meetings: <https://www.aeaweb.org/conference/2020/preliminary/1357>

²² See Daly (2020) and citations therein.

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It is up to us to make it right.

Thank you.

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