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# Racial Inequities: Is there a role for the Fed?

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Pehaps responding to the racial tensions that rocked the country last year, policy makers in the Federal Reserve system and elsewhere have taken note of the stark reality of racial disparities in income and wealth in the US. Despite declines in overt labor market discrimination and gains in educational opportunities since the onset of the Civil Rights movement over 50 years ago, the gaps between black and white household income and wealth are as large today as they were in 1950. In 2019, the typical household with a white head had more than six times greater wealth and twice the income than its black counterpart.[1]

If it is time for policy to address racial wealth and income gaps, it is reasonable to ask whether the Federal Reserve has a role to play?

Raphael Bostic, the President of the Federal Reserve Bank of Atlanta, suggests that there is a role for the Fed. He said last year that the Federal Reserve

> "can play an important role in helping to reduce racial inequities and bring about a more inclusive economy…[It] acts to create a foundation upon which businesses, families, and communities can thrive. Our success means that businesses can grow faster and hire more workers and that more innovation can be supported, which would mean more opportunities for African Americans and others who have not been as attached to the economy."[2]

Mary Daly, President of the San Francisco Fed concuured. In a speech last year she asked: "How can we build a society that delivers on the promise of equal opportunity and inclusive success? " and her answer started with "the Fed has a critical role to play. "[3] President Daly also acknowledged that the Fed might have a role in generating economic inequality and importantly added that addressing inequality in the US will take more than just Fed action.

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[1] The 2019 Survey of Consumer Finances, conducted by the Federal Reserve indicates that the average white (black) household has an income of $113,300 ($58,100) and net wealth $951,300 ($139,800).

[2] https://www.atlantafed.org/about/feature/2020/06/12/bostic-a-moral-and-economic-imperative-to-end-racism

[3] https://www.frbsf.org/our-district/press/presidents-speeches/mary-c-daly/2020/october/is-the-federal-reserve-contributing-to-economic-inequality/

Even Fed Chair Jerome Powell indicates that the Fed might have a role to play in addressing distributional issues:

> "With regard to the employment side of our mandate, our revised statement emphasizes that maximum employment is a broad-based and inclusive goal. This change reflects our appreciation for the benefits of a strong labor market, particularly for many in low- and moderate-income communities." [4]

Policy makers outside of the Federal Reserve are even more specific. Jared Bernstein, now a member of the the Council of Economic Advisors, suggested that the Federal Reserve's tradtional mandate to maintain stable prices and promote full employment should be exapnded to include reducing racial disparities. On the campain trail, Joe Biden said that:

> "The Fed has a profound impact on our economy. . . [it] promotes maximum employment, and stable prices. . . the Fed should add to that responsibility, and aggressively target persistent racial gaps in jobs, wages, and wealth. . . "[5]

The concerns of these policymakers are not surprising given the stark reality of economic disparities. However, my recent research shows that it would be a mistake to think that loose monetary policies can be instrumental in improving the lot of black families. Our research project examines how an accomodative monetary policy affects racial gaps in income and wealth.[6]

A common line of thinking regarding the role of monetary policy in addressing racial disparities is that an easy monetary policy with sustained low interest rates and ample credit expansion will lower unemployment rates and increase labor income. Importantly, it does so more for blacks than for whites. The gap between the unemployment rate of black and white households, which was over 8 percentage points at the end of the financial crisis, was about 2 percentage points when the pandemic began. Indeed, the expansionary monetary policies that were introduced during the financial crisis and renewed during the pandemic had the beneficial effect of reducing the unemployment rate gap between blacks and whites.

Our econometric research shows that an accommodative monetary policy shock, a 100 bp reduction in the Federal Funds rate, will reduce the gap between black and white unemployment rates by about 0.3 percentage point. With some reasonable assumptions about the earnings of the additional workers who find employment, we can estimate the effect on average earnings. Remember that the policy expansion will increase employment and earnings for all groups; we are interested here in the differential effect. That is, how much more does

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[4] https://www.federalreserve.gov/newsevents/speech/powell20200827a.htm

[5] https://www.rev.com/blog/transcripts/joe-biden-racial-equity-plan-speech-transcript-july-28

[6] ***Monetary policy and racial inequality*** by **Alina Bartscher, Moritz Kuhn, Moritz Schularick and Paul Wachtel, Federal Reserve Bank of New York Staff Report, January 2021.** https://www.newyorkfed.org/research/staff_reports/sr959.html

black unemployment fall and how much does black average earnings increase relative to white average earnings. The monetary policy shock that reduces the unemployment gap by 0.3 percentage points has a very small effect on the gap in average earnings. Our estimate is that reduces the gap between average black and white household annual incomes by about $100 or 0.2% of the average black income.

Moreover, a closer look at the effects of loose monetary policy on black and white households indicates that this earnings effect (the small reduction in the income gap) is only one part of the story. A loose monetary policy also increases asset prices, particularly for equities and homes, giving capital gains to asset holders. These portfolio effects disproportionately benefit white households because 75% of them own a home and 64% own equities while the corresponding numbers for black households are 46% and 35%.

A one percentage point reduction in the Funds leads to increases in stock prices of almost 5% and house prices by a bit less. The wealth of the typical white household increases by about $30,000, about six times more than the gains to the typical black household. White households gain more from asset price increases because they are wealthier to begin with and are much more likely to own equities and other assets that rise in value when policy loosens. The run up of the stock market in the last decade – to a large extent driven by monetary policy – hardly benefited black households.

There is no doubt that the accommodative monetary policies of the last decade reduced the gap between black and white unemployment rates and resulted in somewhat larger earnings gains for black households. But the earnings effects pale in comparison to the portfolio effects that widen the wealth gap. Capital gains from the same accommodative monetary policy increases the wealth of the average white household much more than the average black household. To better compare the earnings and portfolio effects, we show that the differential in capital gains will result in an additional $800 in consumption expenditures for white households compared to black. The differential portfolio effect on consumption is about eight times larger than the earnings effect.

Our analysis does not bode well for the suggestion that reducing racial inequalities should be added to the mandate of the Federal Reserve. Such a mandate might make it impossible for the central bank to tighten monetary policy when macroeconomic conditions call for it. With the instruments available – all of which work through effects on asset prices and interest rates – a central bank is not able to design policies to reduce the racial income gap without increasing wealth inequality. Clearly, this does not mean that achieving racial equality should not be a prime objective for policymakers. But the tools available to central banks might not be the right ones and might possibly be counter productive. Policy makers concerned with racial gaps need to look beyond the blunt tools of monetary policy and consider approaches that address racial gaps directly such as child tax credits and reparations.