Executive Summary

of a report to the Federal Reserve Bank's Board of Governors

Fed Listens: Distributional Consequences of the Cycle and Monetary Policy

A conference at the Federal Reserve Bank of Minneapolis

Organized and hosted by the Opportunity & Inclusive Growth Institute

April 9-10, 2019

On April 9 and 10, 2019, the "Fed Listens: Distributional Consequences of the Cycle and Monetary Policy" conference was held at the Federal Reserve Bank of Minneapolis. It was one in a series of Federal Reserve Board of Governors outreach sessions to broadly review the strategy, tools, and communication practices the Board uses to pursue the monetary policy goals established by the Congress: maximum employment and price stability.

It served as the Spring Conference for the Opportunity & Inclusive Growth Institute, which is headquartered at the Minneapolis Fed.

Board Vice Chair Richard H. Clarida was the keynote speaker with his remarks titled: *The Federal Reserve's Review of Its Monetary Policy Strategy, Tools, and Communication Practices*.

The framing question for the research and policy panels was presented by Institute Director Abigail Wozniak, who asked: "What does the Fed need to know about how different households fare over the business cycle and under alternative monetary policy actions?"

The conference included research panels each composed of four formal 30-minute presentations by economists followed by 30-minute question-and-answer sessions involving audience participants. After each of the research presentations, two other presenters then focused on related policy issues, also with a half-hour of audience questions.

The first day closed with a dinner speech by Vice Chair Clarida. The second day ended with a spirited panel discussion with a diverse group of community leaders.

Videos of all of the panels and sessions, along with the slide decks of presenters, are available on the conference web page. What follows are excerpts from the panel participants. A complete report on presentations and the extensive question-and-answer sessions is included in the full conference report.

Conference Agenda

Day One, April 9

Research Panel 1

Context: Trends and Driving Forces in U.S. Inequality

- Fatih Guvenen, University of Minnesota
  The Great Micro Moderation
- Greg Kaplan, University of Chicago
  Monetary Policy, Markups and Labor Market Inequality
- Moritz Kuhn, University of Bonn
  Wealth and Income Inequality in America, 1949-2016
- Isabel Cairo, Board of Governors of the Federal Reserve System
  Market *Power, Income Inequality, and Financial Instability*
- Moderator, Abigail Wozniak, Director, Opportunity & Inclusive Growth Institute

Policy Panel 1

- Aparna Mathur, American Enterprise Institute
  Addressing Old and New Challenges in the Labor Market

- Josh Bivens, Economic Policy Institute
  The Progressive Benefits and Retreating Risks of High-Pressure Labor Markets
- Moderator, Mark Wright, Senior Vice President and Research Director, Minneapolis Fed

Dinner keynote address

- Introduction, Neel Kashkari, President, Federal Reserve Bank of Minneapolis
- Richard H. Clarida, Federal Reserve Board Vice Chair
  The Federal Reserve's Review of Its Monetary Policy Strategy,
  Tools, and Communication Practices

Day Two, April 10

Research Panel 2

Heterogeneity: How Different Households Fare over the Business Cycle

- Alisdair McKay, Federal Reserve Bank of Minneapolis
  Household Heterogeneity and Monetary Policy
- Martin Schneider, Stanford University
  Monetary Policy and the Revaluation of Debt
- Hannes Schwandt, Northwestern University
  Long-Term Impacts of Short-Term Fluctuations
- Marianne Bitler, University of California – Davis
  Cyclicality of Our Safety Net
- Moderator, Jonathan Heathcote, Minneapolis Fed

Policy Panel 2

- William Spriggs, Howard University
  Questions I Hope the Federal Reserve Could Answer
- Susan Houseman, Upjohn Institute
  Independent Contract and Informal Work

- Moderator, Alessandra Fogli, Minneapolis Fed

Perspectives from the Community

- Tawanna Black, Center for Economic Inclusion
- Myron Frans, Minnesota Management and Budget
- Michael Goze, American Indian Community Development Corporation
- Sean Kershaw, Wilder Foundation
- Gloria Perez, Jeremiah Program
- Moderator, Lee Schafer, StarTribune

Day One: April 9, 2019

Research Panel 1
Context: Trends and Driving Forces in U.S. Inequality

Fatih Guvenen presented findings that, contrary to broad consensus, volatility in individual earnings and in firm employment have both *declined* by about one-third since 1980. This calls into question theories based on the idea that volatility was rising. Moreover, since income *inequality* has increased significantly, the volatility decline means unequal incomes are also more persistent, potentially because new cohorts are unequal when they enter labor markets. Income inequality among 25-year-old males tripled from 1970 to 2010. Cause is unclear; perhaps education. Separate observation: This micro moderation may be linked to well-known moderation in the macroeconomy.

Greg Kaplan discussed his model linking monetary policy, markups, and labor market inequality. He distinguished between “overhead” work (management, marketing, sales, R&D) and “production” work. *Overhead* work creates new markets or product models, shifting demand curves outward by selling more without lowering product prices. *Production* work generates revenue by moving output along firms’ current demand curves. When markups (difference between price and cost) change—through a policy or aggregate demand shock—that shifts demand between these types of workers. Changes in markups thus redistribute income between overhead and production labor. A rise in markups, for example, would reduce the share of labor income going to production workers and increase the share for overhead workers. Importantly, these observations apply equally to monetary and demand shocks. Takeaways: The aggregate effect of monetary policy depends on what workers are doing. And policy shocks have very different effects on consumption and labor income for production- and overhead-intensive jobs.

Moritz Kuhn described the joint evolution of U.S. income and wealth distribution from 1949 to 2016. He noted an unprecedented rise in wealth inequality, driven in large part by asset price changes and differences in household asset portfolios. Equities and bonds are the primary portfolio holdings of the top 10 percent of the wealth distribution; housing is a small portion. The opposite holds for the bottom 90 percent. After the financial crisis, housing prices recovered slowly, but the stock market quickly. So wealth stagnated for the bottom 90 percent of households by wealth and soared for the top 10 percent. U.S. wealth dynamics have constituted a race between the stock and housing markets.

Isabel Cairo elaborated on research concluding that increased market power in product and labor markets can explain five 40-year trends: declining labor share, rising profit share, rising income and wealth inequalities, rising household sector leverage, and financial instability. Greater power in *product* markets has far more explanatory strength than in *labor* markets. Cairo also derived policy implications, finding that "carefully designed redistribution policies can be quite effective macroprudential policy tools."

Q&A

Questions following these presentations concerned how these models would affect policy decision-making; policy implications of empirical findings on wealth distribution and market power; the importance of including labor as an asset affected by monetary policy; looking more carefully at how inequality is measured, especially among lower-earning or lower-wealth households; considering labor share as a business cycle indicator; valuation of self-owned businesses as capital or human capital; whether excessive focus on markups and market power distracts from other potential mechanisms of inequality; and clarifying the distinction between production and overhead work activity.

Policy Panel 1

Aparna Mathur spoke of challenges in the current labor market, noting that broad improvement in the aggregate employment picture hides significant heterogeneity. Blacks, Hispanic/Latinos, the very young, those 20-24 years old, and the disabled still experience high unemployment rates. Older workers are doing far better but, as they retire, the problem will be to increase participation by others and make growth inclusive. Challenges include worker-job mismatch (skills, geography, and racial discrimination), boosting women's labor force participation, assimilating those formerly incarcerated, and addressing barriers like residential segregation, lack of education and social networks, and opioid abuse. Declining male labor force participation is a particular concern. Policy should address skills, training, segregation, mismatches, education, and incarceration. Boosting income for low-wage workers through safety net programs is also critical.

Josh Bivens spoke about high-pressure labor markets, the idea that higher economic growth improves job markets, especially for the least advantaged. He described the "progressive benefits" of high-pressure labor markets: faster wage growth for low- and middle-wage workers, erosion of racial gaps in employment-to-population ratios and hours worked, and potential declines in poverty. Moreover, potential risks of high-pressure labor markets, particularly inflation, are retreating: There's less "tinder" in productivity and wage growth, unemployment, and labor bargaining power. This scenario suggests absence of strong Phillips curve dynamics and that policymakers should pursue tighter labor markets to improve wage growth and promote more inclusive growth.

Q&A

Questions focused on whether macroeconomic policy might be more effective than eliminating structural barriers from a cost-benefit standpoint; the role of structural barriers and macro policy in persistence of earnings shocks; possible asymmetry in demographic impact of unemployment rate shifts; obstacles to apprenticeship programs in the United States; possible link between rise of natural rate hypothesis and anti-inflation bias; impact of relative pay trends in manufacturing;

whether informal labor arrangements have fragmented the labor market and weakened labor's bargaining power.

Dinner keynote address

In his remarks, Vice Chair Clarida outlined the purpose of the Fed's review of its monetary policy strategy and the reasons for the ongoing "Fed Listens" series of events across the System. He said: "With the U.S. economy operating at or close to our maximum-employment and price-stability goals, now is an especially opportune time to conduct this review. … The review of our current framework will be wide ranging, and we will not prejudge where it will take us."

Day Two: April 10, 2019

Research Panel 2
Heterogeneity: How Different Households Fare over the Business Cycle

Alisdair McKay discussed research on differences in monetary policy effectiveness over time. Current research—and central bank operations—assumes that past interest rate actions don't influence the power of current or future policy actions. McKay's research suggests that durable goods purchases upend this conventional belief, showing that monetary stimulus doesn't *create* demand, but rather *accelerates* it, shifting purchases from future to present. History of rates then matters, current rates matter more than future rates, and demand is less sensitive to stimulus during recessions. "There are reasons for a central bank facing an effective lower bound (on interest rates) to keep its powder dry."

Martin Schneider described research on interaction of monetary policy and revaluation of debt. When inflation lowers the real value of debt, wealth effects are good for borrowers and bad for lenders. Monetary policy thus redistributes household wealth. If the Fed announces a higher inflation target, for example, it affects long-term debt more than short-term. Quantitatively, this hurts older, rich households and benefits young and middle-aged middle-class households because they hold sizable mortgage debt, and future inflation lowers its value. There are moderate but persistent changes in macro aggregates because gains and losses don't cancel one another.

Hannes Schwandt spoke about research showing that business conditions when young adults enter the labor market have strong, persistent impacts on their health, employment, and earnings. A 1 percentage point increase in unemployment rate when entering the labor market would immediately cause a roughly 4 percent drop in earnings, fading out only gradually. Nonwhite and least-educated workers suffer larger earnings and employment losses than white college graduates; there are increasing impacts on mortality after age 35; and negative wage effects reappear in midlife, along with adverse family formation and fertility outcomes.

Marianne Bitler discussed her research on cyclicality of the social safety net, particularly the EITC. EITC is the most important antipoverty program for children, reducing poverty rates by over 6 percentage points. SNAP is important, while TANF's reach is minimal. Research found that EITC provides countercyclical protection for married couples with children but is weakly procyclical for single filers with children. When compared to food stamps, TANF, and UI, the EITC is the least responsive to business cycles. Thus, EITC provides an automatic stabilizer for married couples with children, but not for single parents with children, and it is less cyclical than other safety net programs such as UI, TANF, and SNAP.

Q&A

Questions concerned impact of consumer durables on timing of monetary stimulus; quandary of monetary policy redistributing to poor and middle-class but possibly causing contraction through different spending propensities; clarifying channels from recessionary labor markets to bad life outcomes; buffering inequality via taxes and transfers; preferred policy responses to next downturn; symmetry of consumer durable purchases to expansion and tightening; effect of forward guidance on assets affected by *long*-term rates; labor supply impact of safety net programs; avenues to improve EITC takeup or boost benefits; impact on labor outcomes of state economic conditions; and education enrollment and mobility responses to unemployment.

Policy Panel 2

William Spriggs challenged the Fed to answer the question, Does inequality hurt economic growth? The OECD and IMF have said it does. "If inequality hurts growth, then we do have to worry what policies at the Fed exacerbate inequality." He then discussed issues deserving greater attention: correlation between wage-productivity gap and rising household debt, rising share of finance in GDP, and rising compensation in the financial sector. He further argued that there is a relationship between financial sector compensation and the wage gap, and that the Fed has a role in this because it has a voice in and some authority over compensation and concentration of the banking sector.

Susan Houseman spoke about shortcomings in current research on the prevalence of informal work and independent contracting. She noted that alternative work arrangements have a bearing on monetary policy in light of debate over diminished strength of the inflation-unemployment relationship. Such arrangements may indicate slack in labor markets; to assess this, it is important to measure the full set of work activities an individual undertakes. Two current studies that probed deeply into informal work suggest that it is more prevalent than indicated by the Current Population Survey and that people in such situations are concentrated in vulnerable groups: youth, minorities, low-income, and likely to be under financial stress. "Development of consistent, high quality time series on contract and informal work would help … policymakers to better understand the degree of slack in labor market."

Q&A

Questions centered on whether improving safety nets or creating economic opportunities is more beneficial; what the Fed should do to improve average employment outcomes; measuring economic importance of rental and sale markets like Airbnb and eBay; time trends in informal work; most important indicators of inequality; whether inequality-growth is a chicken-egg causality dilemma; a "right" level of inequality; and significance of downtrends in new business starts.

Lunch Panel: Perspectives from the Community

This panel of Minnesota foundation, government, and community leaders placed a reality-based punctuation mark on the conference's research and theoretical conversations. Citing higher unemployment among people of color and various housing, health care, and child care needs for low-income families, members of this panel expressed hope that the Federal Reserve was indeed listening and could develop research that translates into action to positively affect the constituents of their struggling communities. The panelists expressed some concerns that research focused on the macroeconomy or broad trends and, so, missed important exceptions to other trends that characterize life in some communities. However, some also expressed new appreciation for the Fed's concern for a diverse set of communities as well as the policymaking challenges it faces.