Opinion **Free Lunch**

Welcome the wokeness of the Federal Reserve

Monetary policy should look at the margins, not just the aggregate economy

MARTIN SANDBU

Monetary policy influences how racist structures and institutions play out in economic outcomes © REUTERS

Martin Sandbu 5 HOURS AGO

My Washington colleague James Politi reported last week on the remarkable increase in US central bankers' willingness to show their emotional colours in the debate on racism, how it affects society — and the economy — and what can be done about it.

Chair Jay Powell included a statement on racism in his latest testimony to Congress, which includes a commitment to eliminate racism within the Fed as an institution and a condemnation of it in broader society. Raphael Bostic, president of the Atlanta Fed, has also issued a statement, that is well worth reading in full, setting out why racism is morally but also economically intolerable.

Here I want to dwell on the economic part of this. There may be many well-intentioned people who abhor racism, want the Fed to eradicate it inside its own institutions and at the same time think it does not have much bearing on the right way to do monetary policy, the chief task of central banks. I want to explain why they are wrong.

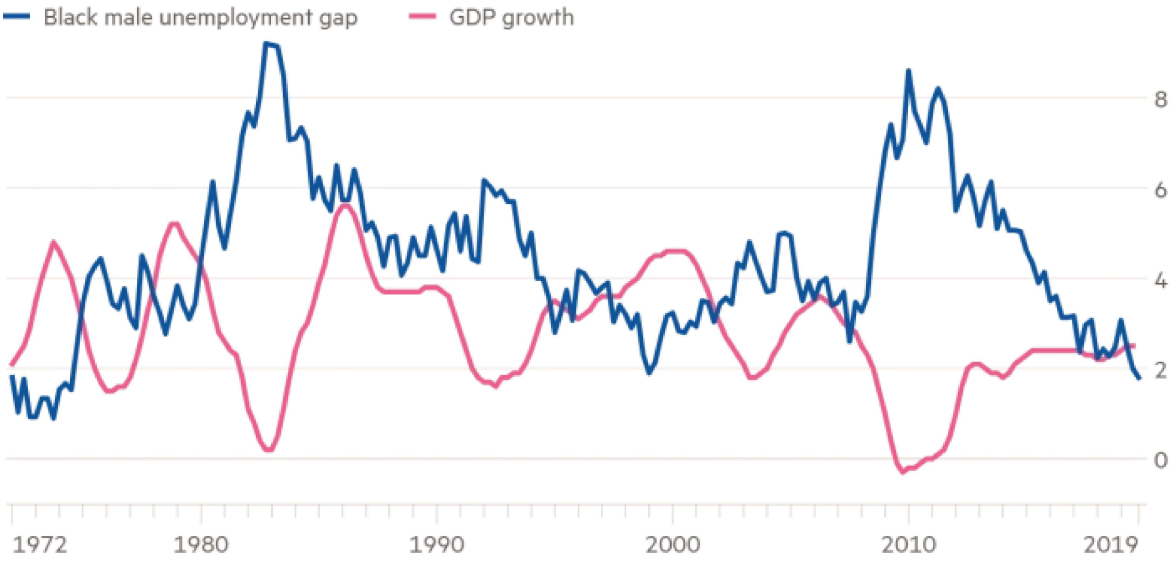
There should be no doubt that racism creates unequal economic opportunities and outcomes — consider the obstacles posed by the practice and legacy of redlining, by which black Americans have been systematically prevented from accumulating residential property and excluded from government policies designed to make it easier to buy a home. These structural inequalities must be overcome; as Bostic says, "a commitment to an inclusive society also means a commitment to an inclusive economy" — what I often call an economy of belonging.

Now it may not look like monetary policy — deciding benchmark interest rates and the quantity of central bank reserves — can itself address these problems, even though its efficacy and reach may also be impaired by it. (However, financial regulatory policy, which is often also within the remit of central banks, can presumably directly address some of them.) But monetary policy does influence how racist structures and institutions play out in economic outcomes. It can, and therefore should, help reduce the harmful effects of underlying inequalities that may themselves be beyond the reach of its particular policy tools.

The chart below shows why. It displays the economic cycle of the US economy, measured by annualised growth in gross domestic product average over the preceding three years, and the black male unemployment gap. This is the difference between the unemployment rate for black men and the unemployment rate for the average population. The former is always higher than the latter, but how much higher varies over time. More specifically, it also varies inversely with the economic cycle.

Black men are fired first, hired last

US GDP growth and black male unemployment gap



Unemployment gap is absolute difference in unemployment rates of African-American men aged over 19 and whole labour force. GDP growth is 12-quarter average of annualised quarter-on-quarter per cent change in GDP.
Source: US Bureau of Labor Statistics
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The black unemployment gap goes up at the start of recessions and only comes down well into the recovery. While recessions cause both black and general unemployment to increase, in other words, black unemployment increases more, and when the recovery starts to bring general unemployment down, black unemployment takes longer to come down. To put it simply, black men are (on average) fired first in the slump and hired last in the boom.

The same inverse cyclical pattern can be seen for unemployment gaps constructed for other groups on the margins of the labour market, such as the young or those with low formal education, and for these groups in other rich countries. Add to this the fact that longer spells of unemployment permanently harm long-term earnings and employment prospects.

Economic cycles are something monetary policy is well placed to mitigate. As conventionally practised, monetary policy aims to minimise short-term economic fluctuations around the long-term growth trend — but understands those fluctuations in the aggregate. A monetary policy that took into direct consideration the fluctuations for specific marginalised labour market groups, such as black men, would be more aggressive in combating recessions and more tolerant of letting recoveries last, so as to shorten the bust and lengthen the boom, as John Maynard Keynes recommended.

The Powell Fed was already moving in this direction before the pandemic recession. Powell himself had been very publicly taking on board the fact that monetary stimulus continued to bring people in from the sidelines even a decade into the last recovery — people who had for a long time had poor job prospects — and was increasingly willing to let this process continue. Even before him, his predecessor Janet Yellen had opened up a discussion of whether the economy can take more demand stimulus than mainstream models predict, responding to high demand pressure with productivity growth rather than inflation. Both types of open-mindedness would support a more accommodative monetary policy.

That would be good for the groups disadvantaged by racism and other structural inequalities. But by giving them better opportunities for productive economic activity, it would be good for everyone else as well — and not just in a pandemic but in good times, too.

Coronanomics readables

- The economist Sébastien Miroudot usefully distinguishes between "resilience" and "robustness" against shocks (the latter is the ability to withstand the shock while it is happening, the former the ability to bounce back afterwards) and argues that "it is a mistake to equate self-sufficiency with robustness". As I have also argued, global supply chains are a help, not a hindrance, to being prepared for an epidemic.

- A new study decomposes demand and supply shocks during the Covid-19 lockdown. While the lockdown itself is, of course, a supply constraint, it turns out that demand declines (and, in some industries such as retail and information technology, demand booms) are significant as well.

Other readables

- George Akerlof, the Nobel-winning economist, has written a lament on the intellectual biases, blind spots and sins of omission caused by the incentives around publication and promotion in an economics profession that elevates the "hard" and denigrates the "soft".

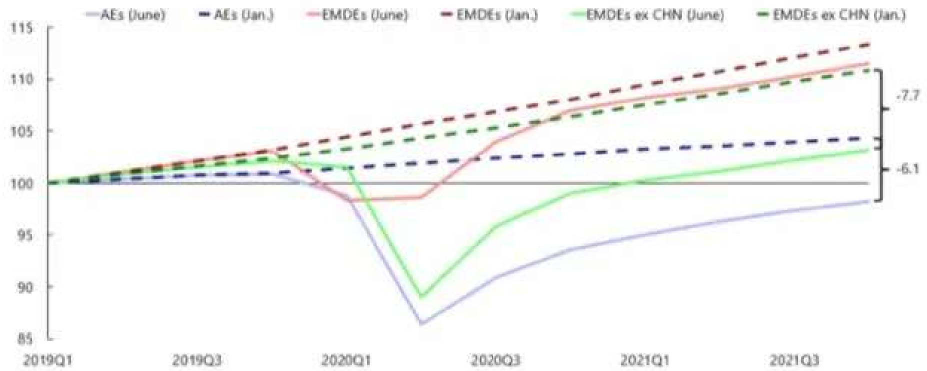
Numbers news

- The IMF has released the latest update to its World Economic Outlook. It makes for grim reading. The most striking news is not that it now foresees a deeper 2020 recession than it did a few months ago, but that the rebound it forecasts is so weak. In advanced economies (and emerging ones apart from China), the fund expects 2021 growth to be far less than what would make up for the contraction in 2020. By the end of next year, the cumulative output loss for the global economy will be $12tn.

Partial recovery

The cumulative hit to growth over 2020-21 for emerging and developing economies, excluding China, is expected to be larger than in advanced economies.

(real GDP forecast, 2019-2021, index, 2019Q1=100)



Sources: IMF, *World Economic Outlook*; and IMF staff calculations.
Note: Data go through the fourth quarter of 2021. AEs = advanced economies; EMDEs = emerging market and developing economies; and CHN = China.

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