SECTION IX

Moderated Conversation Among Federal Reserve Bank Presidents

Thoughts on Wealth Inequality, Financial Inclusion and the Racial and Other Wealth Gaps

A Conversation Between

JAMES BULLARD
President, Federal Reserve Bank of St. Louis

RAPHAEL BOSTIC
President, Federal Reserve Bank of Atlanta

PATRICK T. HARKER
President, Federal Reserve Bank of Philadelphia

NEEL KASHKARI
President, Federal Reserve Bank of Minneapolis

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1. ***President Bullard: Are you concerned about economic inequality, especially wealth inequality?***

President Kashkari: Yes, I am concerned. Economic inequality on several dimensions—from wages to wealth—has risen in recent decades. This makes for a less inclusive economy and more families living economically precarious lives.

That said, I'm glad you noted a distinction between inequality generally and wealth inequality specifically. It's important that we all keep in mind that inequality has many dimensions, and the way that we tackle one dimension might differ from how we tackle others. Clearly, the different dimensions are interrelated: For example, inequality in earnings has been an important driver of increases in wealth inequality.

One reason to be particularly focused on wealth inequality is that it can be viewed as a summary measure of many other forms of inequality and discrimination because it provides access to so many other pieces of well-being. In fact, I view wealth inequality as the cumulative effects of income inequality and discrimination over many generations (something that our Opportunity & Inclusive Growth Institute Advisor Sandy Darity has been emphasizing for a long time).

President Harker: In word, yes.

Highly unequal societies tend to be brittle. Their political systems are frequently unstable. Their periods of economic growth are often short lived and unimpressive. Indeed, research has found that when an additional 1% of income goes to the top 20% of income earners, GDP falls, but when the same gains are made by the bottom 20%, GDP rises.

A more equitable distribution of income and wealth in our country would mean a more durable society. And at some level, vast inequalities, in my view, are a moral issue and a profound challenge to our country's founding creed.

It's important to note, however, that when talking about inequality we are actually describing two distinct yet interrelated phenomena: income inequality and wealth inequality. Each requires different solutions.

Reducing income inequality will require, at a minimum, getting more people into jobs that pay family sustaining wages—jobs like "opportunity occupations" that pay above the median wage but don't require a traditional four-year college degree.

But reducing wealth inequality will necessitate a different approach.

It will require not only getting people into good jobs but also making sure they have access to those systems that produce true wealth, like home and/or small business ownership. Home and small business ownership—far more than income—are the greatest generators of wealth in our society. That's why deep inequities in, for instance, rates of homeownership—not to mention home values, which vary widely across communities—can end up compounding wealth inequality.

President Bostic: I *am* concerned because greater inequality means a larger fraction of Americans are on the economy's sidelines, and consequently the country and macroeconomy do not benefit from their talent, creativity and productivity. This means an economy that is less creative, resilient and robust than it otherwise could be.

A growing body of research makes a strong case that a more inclusive economy is a more prosperous economy. For example, a San Francisco Fed paper suggests that racial and gender inequities in employment, wages and education cost about $3 trillion a year in economic output as measured by GDP.[1]

Wealth inequality is particularly pernicious, for several reasons. At a basic level, it means more families are in a precarious financial position and unable to weather economic shocks. Furthermore, because existing wealth is an important factor in determining credit quality, those with low wealth struggle to access credit markets. This makes getting loans for education or to start a business more difficult and expensive. Wealth inequality acts as a deterrent to

1 Shelby R. Buckman, Laura Y. Choi, Mary C. Daly and Lily M. Seitelman, 2021. "The Economic Gains from Equity," Federal Reserve Bank of San Francisco Working Paper 2021-11. Available at https://doi.org/10.24148/wp2021-11.

entrepreneurship and to personal investments, which build a more productive and flexible labor force.[2]

2. President Bullard: Financial inclusion is a prerequisite for building savings and wealth. Many families, especially those of color, lack full access to basic financial services. Does the Fed have a role in promoting financial inclusion; if so, what is that?

President Bostic: The Atlanta Fed has a long history of working to increase financial inclusion through research, education and engagement, and I have been happy to help advance this legacy. For example, the Bank has an economic inclusion agenda aimed at lifting up economically vulnerable citizens such as the unbanked and underbanked. In 2019, the Bank began a "safer payments" initiative, working with financial technology companies and pursuing a research agenda that views payments innovation through an economic mobility and resilience lens.[3] Then in 2021, we launched the Special Committee on Payments Inclusion to formulate recommendations that help ensure that innovations in payments are inclusive rather than exclusionary.[4]

Though our Bank's efforts have been important, we must recognize that the Fed's commitment to financial inclusion has been systemwide. For example, the Community Reinvestment Act (CRA) requires the Federal Reserve and other banking regulators to encourage financial institutions to help meet the credit needs of the communities where they do business, including in low- and moderate-income neighborhoods. Responses to the CRA have helped advance financial inclusion along multiple dimensions.

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2 Jared Bernstein, 2015. "Financial Vulnerability Is a Problem: An Economist's View," *What It's Worth*, Federal Reserve Bank of San Francisco and Corporation for Enterprise Development (Prosperity Now). Available at www.strongfinancialfuture.org/essays/financial-vulnerability-is-a-problem/.

3 For details, see "As Fintech Transforms Payments, the Atlanta Fed Seeks to Guide Innovation," the Federal Reserve Bank of Atlanta's 2020 annual report, at https://www.atlantafed.org/economy-matters/annual-report/2019.

4 New Committee to Advance Safe, Efficient, Inclusive Payments, Federal Reserve Bank of Atlanta press release, May 12, 2021. Available at www.atlantafed.org/news/pressreleases/2021/05/12/new-committee-to-advance-safe-efficient-inclusive-payments.

President Harker: Yes, the Fed certainly has a role in promoting financial inclusion.

At perhaps the most fundamental level, we can encourage financial inclusion through our vast research apparatus, our economic education programs, and through our engagement efforts that disseminate best practices to encourage inclusion.

Another of the Fed's important roles is our supervisory responsibility. It's on us to make sure that banks are treating individuals, families and small business owners fairly and that their customers—or potential customers—have access to capital. Moreover, under the CRA, the Fed is in fact *required by law* to encourage financial institutions to help meet the credit needs of the communities in which they do business, especially in low- and moderate-income communities. Continuing to pursue CRA modernization, as we are now, will only strengthen these efforts.

We know there remains a lot of work to be done on this score. That became painfully obvious during the COVID-19 pandemic when the CARES Act's PPP loans were disbursed.

According to data submitted by applicants to the Small Business Administration, which managed the program, during the height of the pandemic, fully 83% of PPP loans went to businesses owned by white entrepreneurs. Black business owners, by contrast, received only 1.9% of the loans issued. Furthermore, not only did Black business owners apply for PPP loans at a lower rate than other groups, but their applications were also turned down at higher rates—even when controlling for revenue and credit.

President Kashkari: Promoting financial inclusion is an important priority for the Federal Reserve. Over the last two decades, important progress has been made in reducing the number of households who do not have access to the mainstream banking system (the "unbanked"). Recent estimates place the number of unbanked households at around 5.4% of all households in the United States, or approximately 7.1 million households. These rates are higher for lower-income, Black, Hispanic and American Indian or Alaska Native households as they are disproportionately more likely to be unbanked.

One of the important ways the Federal Reserve encourages the inclusion of more people into the banking system is by giving banks credit under the CRA for offering low-cost deposit accounts to low- and moderate-income individuals. In addition, through the Federal Reserve's Community Development function, we promote financial inclusion through our research and outreach efforts. In our District, for example, the Minneapolis Fed's Community Development program actively supported the Financial Access in Reach (FAIR) initiative that focused options for developing low-cost bank accounts and opportunities to build credit for unbanked households. This effort led to the recently launched Fair Financial accounts, a promising partnership between a local nonprofit and financial institution.

3. President Bullard: My colleagues in our Institute for Economic Equity have documented large and enduring racial, educational, gender and generational wealth gaps among households—many of them exacerbated by the Great Recession and likely further exacerbated by the pandemic. Does the Fed have tools to promote family wealth or to build it up for those that never had much? And what can those outside the Fed do to address these wealth gaps?

President Harker: As I said earlier, income inequality and wealth inequality are distinct yet related phenomena. Reducing income inequality will not, in and of itself, reduce wealth inequality. But we also cannot reduce wealth inequality in a sustainable way without reducing income inequality. I say "in a sustainable way" because we could actually crush wealth inequality tomorrow by sharply raising interest rates and depressing the stock market. But that would make income inequality worse by curtailing job growth.

So how do we reduce income inequality? The Federal Reserve can use all its tools—research and monetary policy, most prominently—to ensure a robust job market that gets as many people as possible into solid jobs with good wages.

As for wealth inequality, our supervisory function can make sure all Americans have fair access to capital. Our research can inform strategies to boost homeownership and access to job training and higher education. The latter is important because many families go into debt to finance their children's education—thereby having the perverse effect of actually increasing intergenerational wealth inequality in an effort to boost income. And our community development function can support activities that enhance wealth generation, such as small business ownership.

Let me cite one example: Here at the Philadelphia Federal Reserve, we are launching a Research in Action Lab in the State of New Jersey in partnership with the New Jersey Economic Development Authority that focuses on research and support for firms that have been hardest hit by the pandemic—microbusinesses employing fewer than 10 people and firms owned by people of color. We are conducting research using the Small Business Credit Survey to understand how those firms have this crisis.

And beyond quantitative analysis, we are doing listening sessions across the state to also hear from firms themselves. The goal of the Research in Action Lab is to bring together partners and regional stakeholders to identify innovative solutions to these challenges.

President Bostic: The mechanisms of monetary policy that promote maximum employment are clearly pertinent. The Federal Reserve also uses its research, convening ability and networks to inform efforts by practitioners and policymakers focused on career advancement and workforce development. After the Great Recession, for example, the Federal Reserve System, along with the Heldrich Center, the Ray Marshall Center and the Upjohn Institute, activated the Investing in America's Workforce initiative to help foster more investment in people, programs and policies that overcome barriers to people benefiting from good-quality jobs, family-sustaining incomes and pathways to wealth building.[5] More recently, Atlanta Fed researchers have studied how home refinancing propensities and laws associated with heirs property worsen wealth gaps.[6,7]

5 To access Investing in America's Workforce Initiative resources, visit www.investinwork.org.

6 Kristopher Gerardi, Paul Willen and David Hao Zhang, 2020. "Mortgage Prepayment, Race, and Monetary Policy," Federal Reserve Bank of Atlanta Working Paper 2020-22. Available at https://doi.org/10.29338/wp2020-22.

7 Thomas Mitchell, Sarah Stein and Ann Carpenter, 2020. "Expansion of New Law in Southeast May Stave Off Black Land Loss," Federal Reserve Bank of Atlanta Partners Update. Available at www.atlantafed.org/community-development/publications/partners-update/2020/covid-19-publications/201007-expansion-of-new-law-in-southeast-may-stave-off-black-land-loss.

Outside organizations also have an important role in strengthening wealth-building pathways. For example, recently launched partnerships with Social Finance, the U.S. Chamber of Commerce Foundation and others have resulted in case studies and workshops where public/private teams are experimenting and learning from new and scalable investment strategies to improve workforce development outcomes for workers and employers.[8,9] I hope innovative efforts like these will bring us closer to having wealth-building pathways and, more generally, an economy that works for all.

President Kashkari: The Federal Reserve has several tools to contribute here. As mentioned, the CRA helps the Fed provide access to high-quality financial services for low- and moderate-income communities. In addition, many Reserve Banks—St. Louis contributes a lot here—are active in developing better financial education tools at no cost for educators and community leaders.

The Fed also plays an analytical role by operating the survey that provides our best information about wealth gaps. The Fed also has a role, through its mandate to achieve maximum employment, in providing the basis for lower-income families to build wealth. But one thing to note is that there are very large racial wealth gaps even for Black and white families with the same incomes, in large part because of inherited wealth.

Many of the tools for addressing these problems lie outside the Fed: for example, tax policy (especially of inherited income) and investments in children (which can reduce intergenerational inequality). But the Federal Reserve has a deep set of research resources that can help shed light on this full range of policy tools and options.

8 The Talent Finance initiative (2020), a partnership of the U.S. Chamber of Commerce Foundation Center for Education and Workforce, WorkingNation, and Greater Houston Partnership, is helping employers and the financial services community identify new private sector tools for financing talent development. Learn more at www.atlantafed.org/cweo/funding-workforce/talent-finance.

9 *Workforce Realigned: How New Partnerships Are Advancing Economic Mobility* (2021) is a book—a joint effort of Social Finance and the Federal Reserve Banks of Atlanta and Philadelphia—that offers 19 case studies and new ideas about how to prepare the future workforce. The case studies are written by leaders from government, higher education, business and social service organizations. Learn more at https://socialfinance.org/workforce-realigned/.

4. President Bullard: The racial wealth gap—especially the Black-white wealth gap—has received a lot of attention, including within the Fed. Should the Fed act in some way to address wealth gaps? If so, how can the Fed do so most effectively given its statutory responsibilities and the tools at its disposal?

President Kashkari: The Black-white wealth gap is concerning because we have strong historical evidence that at least part of it is due to explicitly discriminatory policies. We may also have to grapple with the possibility that our support and stabilization of the financial system doesn't always benefit everyone equally. That's not a reason to abandon that mission, but it does deserve study and may mean that we need to work harder to reduce inequality through other means. So one thing the Fed should continue to do is to study the evolution of wealth and wealth gaps and the role that our own policies play in that.

President Bostic: A good job is critical for building wealth, and Fed policies that contribute to sustained macroeconomic growth increase the ability of families to get such jobs. Indeed, the monetary policy framework that the Federal Open Market Committee adopted in August 2020 articulates the Fed's maximum employment mandate as a broad and inclusive goal. So, we aim to spread employment opportunities widely, including to those people traditionally on the margins of the labor force.

The Federal Reserve can also use its tools—establishing facilities to provide liquidity to financial markets, conducting research on pressing issues, convening experts to facilitate solution-oriented discussions and promoting effective policies and practices—to help local policymakers make progress tackling barriers to progress and success. The experience during the recent pandemic has shown how, in times of crisis, the Federal Reserve's tools and networks can limit the pain that families with limited wealth experience. The Fed used its Section 13 authority to establish lending facilities—the Paycheck Protection Program Liquidity Facility (PPPLF) and the Main Street Program—to support the Paycheck Protection Program lenders and lending to midsized firms.

By listening to community and industry experts, we recognized that smaller businesses and businesses owned by people of color struggled to participate in relief programs because many lacked relationships with traditional banking institutions. This knowledge drove our effort to ensure that institutions serving such businesses, like community development financial institutions and members of the Farm Credit System, were granted access to the PPPLF and thereby increased access in underserved communities.

President Harker: As the country's central bank, the Federal Reserve's mission is to promote a healthy economy and a stable financial system. To ensure those goals are met, we need to foster an economic environment in which all Americans can thrive—and, ultimately, in which racial identity will no longer be a predictor of economic outcome.

It is the Fed's role to first and foremost collect, analyze and understand the data on this issue. And what we do know shocks the conscience: The typical white family has around eight times the wealth of the typical Black family. This is not only, in my opinion, inherently unjust but also a hindrance to us achieving our full economic potential as a nation.

Reducing the racial wealth gap will mean using all of the tools outlined above—monetary policy, our path-breaking research, our supervisory function and our community development responsibilities—to ensure fair treatment and engage with communities.

Lastly, we need to move beyond conversations about "financial literacy" and financial planning—it's difficult to plan when you have little income or wealth to plan for—and move toward systemic solutions that address historic disparities in wealth, particularly along racial lines and access to capital.

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