The Daily Dish

The Fed and a Terrible, Horrible, No Good, Very Bad Idea

DOUGLAS HOLTZ-EAKIN | AUGUST 6, 2020

Eakinomics: The Fed and a Terrible, Horrible, No Good, Very Bad Idea

According to the *Washington Post*, "Congressional Democrats introduced new legislation on Wednesday that would make reducing racial inequality in the U.S. economy an official part of the Federal Reserve's mission." Specifically, "The Federal Reserve Racial and Economic Equity Act requires the central bank to take action 'to minimize and eliminate racial disparities in employment, wages, wealth, and access to affordable credit.'"

Let's put aside for the moment the fact that eliminating all inequality is a nonsensical idea. It should not be the national objective to pay the same those who do and do not show up for work on a regular basis, for example. Instead, one might have the goal to eliminate all unmerited inequality. Unfortunately, until somebody can numerically identify that target, this goal is only hot air and not about formulating actual policies.

Let's also put aside the irony of this moment. If you did believe that all (unjust) inequality must be rooted out of U.S. society and that it was the role of federal policymakers to do so, the most natural place for this responsibility to reside is the U.S. Congress with its power of the purse and taxation. Evidently the durable gaps in employment, wages, and wealth are Congress's fault, so naturally they have decided to point the finger at the Federal Reserve (Fed).

Instead, let's note that the Fed's primary policy instrument is the federal funds rate – the interest rate on overnight borrowing. It influences – it does not set – this rate by buying and selling Treasury securities. Those actions are color blind, age blind, gender blind and are intended simply to influence the overall financial conditions and environment for aggregate growth. They *do* produce winners and losers, as higher rates are better for savers and worse for borrowers, but their mandate is neither to help the savers nor hurt the borrowers; it is to support full employment and price stability.

Now the Fed would have to use interest rate policy – or quantitative easing, or margin requirements, or reserve requirements – to "eliminate racial disparities in employment, wages, [and] wealth." In the most recent jobs report, the unemployment rate for Blacks was 15.4 percent and that for Whites was 10.1 percent. As it turns out, the employment report is also a monthly advertisement for getting an education. The unemployment rate for those without a high school diploma was 16.6 percent, while that for college graduates was only 6.9 percent. At least part of equalizing 15.4 and 10.1 is to change the fraction of (native born) Blacks who graduate from college upwards from roughly 16 percent closer to the roughly 30 percent for Whites. How is the Fed going to accomplish this using the traditional tools?

It cannot, of course. Those policies work through market mechanisms and do not directly determine outcomes. Instead, the Fed would be forced to employ all sorts of intrusive regulations in an attempt to reach the unreachable equality. This, I believe, reveals the most troubling issue. Despite the fact that market incentives, albeit with all their imperfections, have produced the largest and most powerful economy the globe has ever

seen, progressives have no belief in markets and prefer direct government allocation of everything. Since government allocation is fundamentally political, it means that every wage, every job, every college degree, and every loan will become a political issue. No thanks.

Alfred Nobel once said, "If I have a thousand ideas and only one turns out to be good, I am satisfied." Evidently the modern progressive corollary is "And I turn the rest into legislation."