The Fed, Finance, and Inequality in Comparative Perspective

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The contributions to this symposium address several different streams of political science. Building on their recently published books (Binder and Spindel 2017; Jacobs and King 2016), Larry Jacobs and Desmond King as well as Sarah Binder and Mark Spindel argue that students of American politics should pay more attention to the Federal Reserve Board and monetary politics. By highlighting ways in which Fed policies have contributed to the rise of top-end income inequality, Jacobs and King not only take Americanists to task for failing to pay attention to the Fed. They also suggest that financial regulation and monetary policy represent a blind spot in recent comparative literature on the rise of inequality in Organization for Economic Co-operation and Development (OECD) countries. Understanding the role of the Fed, they argue, is critical for answering the question of why top income shares have grown more rapidly in the United States than in other OECD countries. Speaking to the comparative literature on central banks, Christopher Adolph joins Jacobs and King in emphasizing the distributive consequences of monetary policy.[1]

My commentary focuses on the implications of these articles for the comparative politics of inequality. My two basic objectives are to (1) provide a tentative assessment of the extent to which arguments proposed by Jacobs and King and by Adolph shed light on cross-national variation in inequality dynamics; and (2) suggest ways in which the research agenda of these authors might be advanced through comparative analysis.

POLITICIZING CENTRAL BANKS

Although all of the contributions to this symposium debunk the idea of the Federal Reserve Board as an impartial steward of the public interest, they represent different perspectives on why the Fed deserves the attention of political scientists. According to Jacobs and King, "[t]he Fed is a strategic and ambitious actor" characterized by "a strong sense of mission" and "clear lines of authority that spare it from the degree of infighting and external interference that saps other [federal] agencies." Most important, the Fed is relatively free from congressional oversight but structurally dependent on financial markets by virtue of the fact that it finances itself through returns on its investments. Although they do not describe much about how other central banks finance their operations, Jacobs and King strongly imply that the Fed is unique in this respect and that comparative measures of central-bank independence fail to fully capture its autonomy vis-à-vis elected government officials.

For Jacobs and King, then, the Fed is autonomous and political. By contrast, Binder and Spindel emphasize the interdependence of Congress and the Fed and the way that the larger political context—as reflected in congressional debates and legislation—shapes the Fed's behavior. In their words, the Fed is "political" because "successive generations of legislators have made and remade the Federal Reserve System to reflect a shifting set of partisan, political, and economic priorities." The implication of this perspective is that conventional measures fail to capture temporal variation in central-bank independence.

It is important to keep in mind that Jacobs and King's characterization of the Fed pertains to the recent period. In their book, they trace the emergence of the modern Fed as the outcome of political struggles (2016, ch. 2). They also stress that the Fed's technocratic legitimacy has been challenged in recent years (2016, ch. 4). For their part, Binder and Spindel presumably would agree that enhanced Fed autonomy characterizes the period from 1980 to the crisis of 2007–2009. (Note the historically low number of congressional bills pertaining to the Fed in their figure 1.) The contrast between Jacobs and King's perspective and that of Binder and Spindel is arguably less stark than it initially appears to be.

THE DISTRIBUTIVE IMPACT OF CENTRAL-BANK POLICIES

Setting aside conventional interest-rate manipulations, I comment briefly on the distributive implications of three types of policies pursued by the Fed and other central banks during the past two decades: (1) regulation of financial institutions before the financial crisis; (2) bailouts of failing financial institutions in 2007–2008; and (3) quantitative easing (QE) since 2009. I discuss these three types of "central-bank intervention" in reverse order.

Quantitative Easing

With interest rates in the "zero lower bound," the Fed embarked on a policy of stimulating economic recovery by large-scale asset purchases in March 2009, which also subsequently was adopted by the Bank of England and the European Central Bank (ECB). The articles by both Adolph and by Jacobs and King refer to a growing body of punditry and scholarship asserting that QE has served the distributive interests of owners of financial assets. Bivens' (2015) assessment of the US experience provides, I think, an important corrective to this view.[2] He argued persuasively that the macroeconomic effects of QE must be considered in gauging its overall impact on inequality. According to widely accepted estimates, the effect

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of asset purchases undertaken by the Fed from 2009 until the end of 2014 was to increase GDP by about two percentage points and to lower the unemployment rate by one percentage point. Predictably, the reduction in unemployment boosted the relative incomes of low-income households.

As Adolph suggests, economic recovery instead could have been stimulated by fiscal means, and deficit-financed social spending surely would have been a more egalitarian option. However, his counterfactual conjecture that Congress would have engaged in progressive fiscal stimulus if the Fed had not engaged in QE seems questionable. In addition, evidence presented by Bivens (2015) indicated that QE during the period 2009–2014 boosted house prices more than equity prices, to the benefit of households in the lower three quarters of the wealth distribution. Even the direct distributive effects of QE would appear to be less straightforward than commonly supposed.[3]

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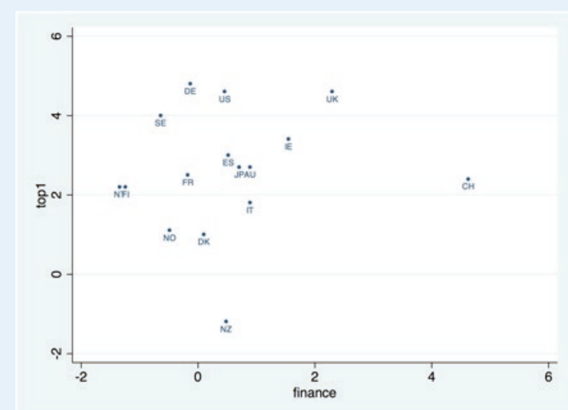
Furthermore, the fact that other central banks have also relied on large-scale asset purchases to stabilize financial markets and stimulate growth raises questions about Jacobs and King's interpretation of this policy as the expression of the Fed's unique autonomy and its dependence on financial markets. Of course, the Fed may have bought more financial assets than the Bank of England and the ECB, and its asset purchases may have taken forms that were more favorable to major financial institutions. More research is needed to address these issues and to ascertain whether such policy differences shed light on the recent evolution of inequality.

Figure 1
Percentage-Point Changes in the Top 1% Income Share and the Financial Sector's Share of Value-Added from 1995 to 2007



Sources: World Wealth and Income Database (http://wid.world; accessed January 5, 2018) and OECD Statistics (https://data.oecd.org/natincome/value-added-by-activity.htm; accessed January 5, 2018).

Financial Bailouts

Although most central banks engaged in some form of QE, there is substantial cross-national variation in the scope of bailouts undertaken during the financial crisis and the strings attached to them (Woll 2014). In their contribution to this symposium and their book, Jacobs and King (2016, 123–9) invoke the British case to argue that the bailouts undertaken by the Fed during the financial crisis were exceptionally favorable to the owners and management of the financial firms rescued from collapse. In contrast to the Fed, they write, the Bank of England insisted that financial institutions provide homeowners and businesses with credit at reasonable rates in return for recapitalization funds. As a result of the Fed's leniency, bank profits and top income shares bounced back more quickly in the United States.

The lessons that Jacobs and King draw from comparing the United States to the United Kingdom are strikingly different from the lessons that Culpepper and Reinke (2014) draw from the same pairwise comparison. Noting that all major US banks were required to recapitalize whereas doing so was voluntary for UK banks, Culpepper and Reinke argue that bank bailouts were more costly to British taxpayers. I have neither the space nor the competence to adjudicate between these two versions of the US–UK comparison. For purposes of this article, suffice it to note that data on top income shares (measured before taxes) are consistent with the Jacobs and King version. In the United States, the top 1% share fell from 20.1% in 2006 to 18.5% in 2009 and then fully recovered, standing at 20.2% in 2014. In the United Kingdom, by contrast, the top 1% income share held steady during the financial crisis, fell from 15.4% in 2009 to 12.6% in 2010, and stood at 13.9% in 2014.[4]

Financial Deregulation

The way that the Fed intervened in the financial crisis might explain the quick recovery of top income shares, but we also must explain why these shares rose so dramatically in the 15 to 20 years before the crisis. Observing that returns to bonds and equity have been the primary driver of rising top income shares, Jacobs and King argue that this is—first and foremost—about financial deregulation and that the Fed played a key role in promoting "financialization." Briefly, I want to raise two questions pertaining to this line of argument.

First, it is not clear how far Jacobs and King want to take the claim that the structure of the Fed—that is, its autonomy vis-à-vis Congress and its dependence on financial markets—explains

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financial deregulation. Consistent with Binder and Spindel's approach to monetary politics, they clearly recognize that financial deregulation involved congressional legislation (most notably, the repeal of the Glass–Steagall Act), as well as changes in the regulatory practices of the Fed. The Fed was hardly alone in pushing for financial deregulation, and the experience of other countries seems to indicate that a Fed-like central bank is not a necessary condition for financial deregulation to occur.

The second question concerns the meaning of "financialization" and its relationship to inequality. Some of Jacobs and King's formulations seem to equate "financialization" with the size of the financial sector. Plotting changes in top 1% income shares from 1995 to 2007 against changes in the share of value-added produced by financial services (including insurance) during the same period, figure 1 shows that financial-sector growth is not a good predictor of cross-national variation in top-end inequality dynamics. With one exception (New Zealand), top income shares rose in all countries during this period, but the financial sector's share of value-added held steady or even declined in many countries.[5]

Cited favorably by Jacobs and King, Krippner (2011) argues for a broader concept of financialization, pertaining to changes in the behavior of households and non-financial corporations as well as the size of the financial sector. The relevance of financialization in this sense warrants further attention by comparativists who work on income inequality. However, it seems less obvious—from this perspective—that we should focus on central-bank regulation of financial institutions. The broad concept of "financialization" invites an exploration of the role of other government policies as well (e.g., taxation of corporate profits and capital gains).

Again, it is not difficult to imagine a fiscal-policy package that would have more effectively compensated for rising inequality while boosting macroeconomic performance to the same extent as the Fed did in the wake of the financial crisis.

THE RELATIONSHIP BETWEEN MONETARY AND FISCAL POLITICS

Again, it is not difficult to imagine a fiscal-policy package that would have more effectively compensated for rising inequality while boosting macroeconomic performance to the same extent as the Fed did in the wake of the financial crisis. In contrast to Adolph, however, I find it difficult to believe that the US Congress would have adopted such a package had the Fed refrained from financial bailouts and QE.

The ECB was slower to embrace QE than the Fed, and its overall policy stance was less expansionary than that of the Fed during the entire period from 2007 to 2014. The implication of Adolph's counterfactual conjecture seems to be that fiscal-policy responses to the Great Recession in Eurozone countries should have been more expansionary than in the United States. In fact, the opposite is true. It also should be noted, for the United States as well as many other OECD countries, that fiscal-policy responses to economic downturns became more reliant on tax cuts, as opposed to spending increases, as central-bank policies became more conservative from the early 1980s onward (Raess and Pontusson 2015). Across the OECD area, fiscal stimulus appears to have become less redistributive over time (Pontusson and Weisstanner 2017).

As noted by Adolph, the standard argument for central-bank independence is that it renders monetary policy more credible. Why should opportunistic politicians seek institutional solutions to the time-consistency problem? It seems more intuitive to argue that they have delegated monetary policy to autonomous central banks because they want to take credit for economic recoveries while avoiding blame for removing the proverbial "punch bowl" when the party starts getting rowdy. From this perspective, the experience of the Great Recession—in Europe as well as the United States—poses an interesting puzzle: central banks continued to pursue expansionary policies whereas fiscal-policy makers embraced austerity from 2010 onward.[6] Why have elected politicians recently delegated responsibility for macroeconomic expansion?

The contributions by Jacobs and King and by Adolph shed light on this puzzle by emphasizing distributive conflict. Arguably, elected politicians delegated expansionary policy to central banks because they want to minimize compensatory redistribution and to avoid ratchet effects commonly associated with fiscal stimulus (i.e., spending increases during downturns followed by tax increases during upturns). This formulation implies a different diagnosis of the underlying political problem from that articulated by Jacobs and King—to the extent that they emphasize the uniqueness of the Fed and its autonomy from democratic politics—and recovers insights by Binder and Spindel. The changing role of central banks should be seen, I submit, as an expression of the growing influence of affluent citizens and financial interests in democratic politics.

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NOTES

1. Like most of the comparative literature on central banks (usefully reviewed by Fernández-Albertos 2015), Adolph's (2013) book addresses distributive issues only indirectly.
2. As Research and Policy Director of the Economic Policy Institute, Bivens cannot be dismissed as an apologist for neoliberalism or financial interests.
3. Reviewing research by the ECB, Constâncio (2017) reports Eurozone estimates for the effects of asset purchases that are similar to those reported by Bivens (2015) regarding house prices, equity prices, and unemployment.
4. Source: World Wealth and Income Database (http://wid.world; accessed January 5, 2018).

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5. The data series on top income shares ends in 2009–2011 for most countries included in figure 1. Repeating the exercise with post-2007 data covering country-specific periods yields a similar picture, with no evidence of a correlation between changes in top 1% income shares and value-added shares of the financial sector. Canada is not included in figure 1 for lack of data on value-added. In their book, Jacobs and King (2016, 166–74) featured Canada as an example of more stringent financial regulation preempting the need for bailouts in 2007–2008. The top 1% income share nonetheless rose sharply in Canada from 1995 (10.9%) to 2007 (15.6%), more or less in line with increases in the United Kingdom (from 10.8% to 15.4%) and the United States (from 15.3% to 19.9%).
6. It is striking that the Great Recession is not included in Adolph's figure 1, showing that the timing of countercyclical Fed policies tends to favor high-income earners.

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