A Central-Bank Mandate for Our Time:
The Fed's *De Facto* Fiscal Role and Its Anti-Equality Impact

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- Even extra-stimulative fiscal policy will do little to reduce near-term economic inequality given the force of countervailing Fed de facto fiscal intervention.
- The Fed consistently describes its "dual mandate" in purely monetary-policy terms, but the manner in which it executed policy since 2008 has direct fiscal impact by virtue of market-valuation, credit-allocation, debt-monetization, and even new money-creation effects.
- There is in fact no pure monetary-policy mandate for the U.S. central bank. Its express mandate demands not just maximum employment and price stability, but also moderate long-term interest rates. This express mandate comes in concert with an over-arching one governing the federal government and the Fed focused on "general welfare," "full employment," "real income," and like-kind objectives.
- The Fed should honor its full mandate as now dictated in law and quickly reduce its anti-equality fiscal footprint.
- Should it fail to do so, an increasingly-populist Congress will turn to confiscatory fiscal policy and an expressly-political central bank.

When I finished my book[1] on the Fed's economic-equality impact in June of 2020, I was only able to touch on the Fed's burst of extra-ultra accommodative policy and market support and the parallel fiscal boost embodied in the CARES Act,[2] although I did show in broad terms how monetary and fiscal policy were likely to fight each other to, at best, a standstill. Since then, this has sadly proved the case. The Fed has stayed a course that, while essential at the outset of a crisis, now prolongs U.S. economic inequality despite the trillions Congress threw to combat it. The net result is a nation that avoided macroeconomic and financial cataclysm but is now even more unequal than its record-breaking numbers demonstrated in late 2019[3] along with slow growth and frightening financial markets. This is perhaps the most critical conundrum of our time: how could all these good intentions backed by so many trillions have had such a perverse result on the inequality that frustrates growth,[4] increases the odds of renewed financial crisis,[5] impoverishes so many Americans, and makes the nation ever more ungovernable?

This paper builds on my earlier discussion of the inequality bottlenecks to monetary policy transmission,[6] to demonstrate how post-2008 policy has given the U.S. Federal Reserve enormous fiscal sway. This comes partially from the new money created by sovereign obligations as a result of ultra-low rates and quantitative easing (QE) and from how these policies combine with post-2008 bank regulation and all the recent market interventions also to give the Fed the final word on credit allocation and market valuations. QE's monetization of U.S. debt also has direct fiscal impact as does the simple power of the Fed's market footprint to frustrate fiscal policy.

One might say that debt monetization and credit allocation are inevitable features of QE, but they are instead affirmative Fed choices with direct fiscal impact. This is particularly problematic given the destructive social-welfare, macroeconomic, and systemic implications of persistent downward mobility. This paper thus concludes with a discussion of how best not just to understand, but also to frame the Fed's mandate in light of its significant de facto fiscal impact.

Importantly, recognizing that monetary policy not only has fiscal impact, but often trumps fiscal efforts is not saying that a central bank should attempt directly to exercise fiscal influence in areas such as credit allocation or investment choice. Instead, it is an acknowledgement forced upon us by what the Fed and many other central banks have done in the name of their mandates and the far-reaching impact this has on output, financial-market valuation, and income and wealth distribution.

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[1] Karen Petrou, *Engine of Inequality: The Fed and the Future of Wealth in America* (Hoboken: John Wiley & Sons, 2021), 132.

[2] Coronavirus Aid, Relief, and Economic Security (CARES) Act, Pub. L. No. 116-136, 134 Stat. 281 (March 27, 2020), available at https://www.govinfo.gov/content/pkg/PLAW-116publ136/pdf/PLAW-116publ136.pdf.

[3] Board of Governors of the Federal Reserve System (FRB), "Distribution of Household Wealth in the U.S. since 1989," *DFA: Distributional Financial Accounts*, (2019:Q4), accessed October 22, 2021, available at https://www.federalreserve.gov/releases/z1/dataviz/dfa/distribute/table/.

[4] Federico Cingano, "Trends in Income Inequality and its Impact on Economic Growth," *OECD Social, Employment and Migration Working Paper No. 163*, (December, 2014), available at https://www.oecd.org/els/soc/trends-in-income-inequality-and-its-impact-on-economic-growth-SEM-WP163.pdf.

[5] Pascal Paul, "Historical Patterns of Inequality and Productivity around Financial Crises," Federal Reserve Bank of San Francisco, *Working Paper 2017-23* (March 2020), available at https://www.frbsf.org/economicresearch/files/wp2017-23.pdf.

[6] Karen Petrou, "How Monetary Policy Made Most of Us Poorer," in *Engine of Inequality: The Fed and the Future of Wealth in America*, 73.

The Fed's Fiscal Footprint

My book lays out how post-2008 monetary and regulatory policy in the U.S. directly and significantly reduced U.S. economic equality. In response, I've often heard that monetary policy must proceed on an independent course guided by objective economic insights in fulfillment of a mandate not only described as "dual" despite the law's triple injunctions but all too often read far too narrowly with regard to what Congress means by full employment and price stability.[7]

Federal Reserve Board chairs since Ben Bernanke have all clung to this version of an above-it-all mandate, going on to say that, if their actions have adverse distributional impact, then it is up to fiscal policy to tidy up the mess. Chairman Powell has been considerably more vocal about the need for specific policies than his forebears, but he is at least as resolute that monetary policy has no income or wealth inequality impact that isn't for the better.[8] However, fiscal policy cannot overcome a sharp, downward equality drag from monetary policy when monetary policy exercises so much control not only over interest rates, but also over the economy as a whole and financial markets in their virtual entirety.

There are three main reasons why anti-equality financial policy cannot be corrected by even the ultra-stimulative fiscal policy seen after the great financial crisis and again after the 2020 COVID crash.

The Fed's Giant Footprint

Although the Federal Reserve has begun to "taper" its huge portfolio, its holdings now stand at $8.6 trillion,[9] or about 36 percent of U.S. GDP as of the end of the second quarter.[10] It will take a long, long time to get this back to the $800 billion or so the Fed held to handle its open-market operations before 2008 even if the Fed figures out how to exit a financial market partially of its own making without corrections that turn systemically cataclysmic. Interestingly, when asked on November 3 about the impact of all this QE,[11] Chairman Powell admitted that, while theory suggests a huge portfolio allows for interest-rate control near the zero lower bound, its macroeconomic benefits remain unknown.

The composition of the Fed's portfolio exacerbates QE's overall market impact by targeting specific sectors. It consists of Treasury obligations and agency housing bonds. The Fed's huge holdings of

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[7] Karen Petrou, "How to Make Monetary Policy Make Us More Equal," in *Engine of Inequality: The Fed and the Future of Wealth in America,* 95.

[8] House Financial Services Committee (HFSC), "Hearing on Monetary Policy and the State of the Economy," at 2:00:20, July 14, 2021, available at https://financialservices.house.gov/calendar/eventsingle.aspx?EventID=408105.

[9] Federal Reserve Bank of St. Louis (FRB-StL), "Assets: Total Assets (Less Eliminations from Consolidation): Wednesday Level," FRED Economic Data Series WALCL, accessed October 22, 2021, available at https://fred.stlouisfed.org/series/WALCL.

[10] *Ibid*., and FRB-StL, "Gross Domestic Product," FRED Economic Data Series GDP, accessed October 22, 2021, available at https://fred.stlouisfed.org/series/GDP.

[11] FRB, "Transcript of Chair Powell's Press Conference, November 3, 2021," 20-22, (November 3, 2021), available at https://www.federalreserve.gov/mediacenter/files/FOMCpresconf20211103.pdf.

Treasury obligations ($5.5 trillion)[12] account for 28 percent of outstanding U.S. Treasury obligations[13] and combine with ultra-low rates to reduce taxpayer costs. However, the more the Fed "monetizes" federal debt via its purchases, the easier it is for Congress to ascribe to "modern monetary theory" and grow the deficit.[14] The Fed's Treasury holdings do not dictate how Congress chooses to spend the largesse borne of the Fed's portfolio, but fiscal policy is nonetheless directly driven by it – see for example many recent statements from the Administration and Congress that huge deficits are unlikely to have adverse inflationary or growth impact because low rates make it affordable.[15]

The Fed's $2.5 trillion of housing bonds[16] similarly drive up demand for these obligations and thus reduce the cost of mortgage lending. This is fiscal policy because credit is allocated to a preferred sector based not on a market's dynamics, but on what the Fed chooses to do as the most important player in it.

Although the differences are of scale – not kind, central banks now buying into the Bank for International Settlements' program encouraging green-bond portfolio investments are still more powerful agents of fiscal policy.[17] One might think this outside the Fed's statutory mandate, but see the $750 billion backstop it created in 2020 for a preferred segment of the corporate bond market for a demonstration of the Fed's now-explicit fiscal role in action.[18]

The 2020 entry into the corporate-bond market was also an expansive reading of the Fed's charter. As recently as 2016, then-FRB Chair Yellen suggested the Fed hold corporate obligations, but she later indicated that doing so was outside its statutory mandate.[19] Five years on, the mandate is no impediment to direct market intervention even though the central bank continues to cling to public protestations about how limited this dual mandate is when it comes to anything it decides not to do. A case in point: the Fed set up a huge backstop even for junk corporate exchange-traded funds at the same time it refused to support state and local government debt without direct Congressional direction and, even when it got that, the Fed backed this sector in far smaller amounts than many Members of Congress believed they had required.[20]

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[12] FRB-StL, "Assets: Securities Held Outright: U.S. Treasury Securities: All: Wednesday Level," FRED Economic Data Series TREAST, accessed October 22, 2021, available at https://fred.stlouisfed.org/series/TREAST.

[13] Dr. Edward Yardeni and Mali Quintana, "US Government Finance: Debt," *Yardeni Research*, 6 (October 21, 2021), accessed October 22, 2021, available at https://www.yardeni.com/pub/usfeddebt.pdf.

[14] Stephanie Kelton, *The Deficit Myth: Modern Monetary Theory and the Birth of the People's Economy* (New York: PublicAffairs, 2020).

[15] Kate Davidson and Aubree Eliza Weaver, "Morning Money: Manchin's debt worries belie brighter budget picture," *Politico*, October 26, 2021, available at https://www.politico.com/newsletters/morning-money/2021/10/26/manchins-debt-worries-belie-brighter-budget-picture-798459.

[16] FRB-StL, "Assets: Securities Held Outright: Mortgage-Backed Securities: Wednesday Level," FRED Economic Data Series WSHOMCB, accessed October 22, 2021, available at https://fred.stlouisfed.org/series/WSHOMCB.

[17] Bank for International Settlements (BIS), "BIS plans Asian Green Bond Fund for Central Banks," October 21, 2021, available at https://www.bis.org/press/p211021.htm.

[18] FRB, "Federal Reserve announces extensive new measures to support the economy," March 23, 2020, available at https://www.federalreserve.gov/newsevents/pressreleases/monetary20200323b.htm.

[19] David Harrison, "Janet Yellen Sees Benefits to Central Bank Stock Purchases," *Wall Street Journal*, September 29, 2016, available at https://www.wsj.com/articles/fed-committed-to-diverse-workforce-and-senior-leadership-yellen-says-1475179202.

[20] HFSC, "Virtual Hearing – Examining the Role of Municipal Bond Markets in Advancing – and Undermining – Economic, Racial and Social Justice," April 28, 2021, available at https://financialservices.house.gov/calendar/eventsingle.aspx?EventID=407537.

The Nature of Money

As a new paper from the Bank for International Settlements convincingly demonstrates,[21] rates at or near zero in inflation-adjusted terms also blur the distinction between what we used to think of as the money supplied by a central bank – bank reserves – with the money now minted by finance ministers such as the U.S. Treasury Department through the bonds floated to fund federal operations. When government-issued bonds are used as money by global markets – and Treasury bonds are now money in every sense of the word – the difference between central banking and sovereign obligations ceases to be a question for public debate – now, it's a fact of life.

Fiscal Policy's Smaller Footprint

The third reason monetary policy must be held accountable for inequality instead of expecting fiscal policy to offset its impact is that any fiscal policy taxpayers are likely to endorse will surely be insufficient in the face of all the market forces dictated by the changing nature of money, Fed's own holdings, ultra-low rates, and continuing interventions and even bail-outs.

In simple terms, the two most important forces determining economic equality are the extent to which low-and-moderate income households see appreciable wage gains or government transfer payments and whether wealth grows from accumulated savings and home ownership or from financial-market investment. Fiscal policy in part determines take-home pay, transfer payments, and direct federal subsidies for housing and other income or wealth generators and thus has a significant role firing up U.S. output. However, other than the direct impact of near-term changes to tax law, fiscal policy takes time to take hold. In contrast, the Fed now overwhelms fiscal policy's long-term impact by driving much, if not all, of what the private sector does every day with every dollar. The Fed hand is now not only the heaviest in the market, but also the one with the greatest power over the short-term decisions that lay the foundation of the longer-term investment and growth fiscal policy may seek to foster.

In the manufacturing-based economy that once defined the U.S., the Fed did not need directly to support financial markets because financial markets supported long-term capital formation, with this ebbing and flowing in concert with monetary policy delivered through traditional bank channels via robust real interest rates. In the financialized and service economy the U.S. has become,[22] wealth comes from private-equity, venture-capital, and speculative investments (think bitcoin) focused on short-term or even instantaneous return. Patient investors there are a 'plenty, but the long-term, stable, low-risk investments on which they counted have evaporated as Fed-driven rates plummet and investors go for the quick buck because there isn't a long-term one to better it.

One of the most important insights in Thomas Piketty's paradigm-busting book, *Capital in the Twenty-First Century*,[23] demonstrates that inequality is cumulative – the richer you are, the richer you get and

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[21] Boris Hofmann, Marco J Lombardi, Benoît Mojon, and Athanasios Orphanides, "Fiscal and monetary policy interactions in a low interest rate world," *BIS Working Paper No. 954*, (July, 2021), available at https://www.bis.org/publ/work954.pdf.

[22] Statista Research Department, "Percentage added to the Gross Domestic Product (GDP) of the United States of America in 2020, by industry," *Statista*, June 3, 2021, available at https://www.statista.com/statistics/248004/percentage-added-to-the-us-gdp-by-industry/.

[23] Thomas Piketty, *Capital in the Twenty-First Century* (Cambridge: the Belknap Press of Harvard University Press, 2014), 704.

the poorer you are, the poorer you get unless or until something breaks the cycle. Sometimes the engine-buster is someone who breaks loose via an invention, a lottery, or a similar fluke and sometimes it's a catastrophic event such as war or devastating financial crisis. Mostly, though, the engine of inequality either reverses or revs up due to policy intervention.

Recent U.S. history demonstrates the negative feedback loop between fiscal and monetary policy, although the net impact of the two depend on applicable distributional and policy factors. In the 1930s, a notorious Fed-policy mistake short-circuited the New Deal.[24] It occurred again after the 2007-2009 great financial crisis. The Obama Administration enacted then-unprecedented fiscal stimulus, but the Fed maintained its ultra-accommodative policies and financial-market bulwarks in place long after the crisis, leading to the weakest economic recovery since the Second World War[25] and a stunning spike in both income and wealth inequality.[26]

While U.S. fiscal policy since the pandemic has been awesomely accommodative, it did not reverse the inequality engine, only slowed it down a bit thanks to short-term household economic assistance and small-business lending. Fixing many causes of American inequalities such as pre-K education are critical, but the economy these children enter in twenty or more years will be still more unequal and they will have still less of a chance unless the anti-equality policies driving financial markets every day are quickly reversed. Because these policies are principally of the Fed's making, only the Fed can undo them to give lower-income households a fighting chance at inter-generational economic advancement.

The Federal Reserve Mandate As It Is

Questioned often about inequality by Members of Congress and the public, Fed leadership says that the central bank's hands are tied by law from doing more than hoping for the best.[27] Its congressional mandate permits, so the Fed says, only limited efforts to ensure maximum employment and price stability. However, the Fed has fallen short on its mandate as it understands it as well and even more importantly on the actual mandate as articulated in federal law.

Analyses from the Federal Reserve Banks of Richmond,[28] St. Louis,[29] and Kansas City[30] provide useful historical context for the statutory requirements that define what the Fed must do. Importantly and as these analyses make clear, the mandate is not just four words in the Federal Reserve Act but these

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[24] Amity Shlaes, *The Forgotten Man: A New History of the Great Depression,* (New York: HarperCollins, 2007

[25] Eric Morath, "Seven Years Later, Recovery Remains the Weakest of the Post-World War II Era," *Wall Street Journal*, July 29, 2016, available at https://www.wsj.com/articles/BL-REB-36300.

[26] Karen Petrou, *Engine of Inequality: The Fed and the Future of Wealth in America*, 30.

[27] See, for example: FRB Chair Powell, "Monetary Policy and the Economy," *CSPAN*, at 1:03:50, February 20, 2020, available at https://www.c-span.org/video/?469082-1/monetary-policy-economy.

[28] Aaron Steelman, "The Federal Reserve's 'Dual Mandate': The Evolution of an Idea," *FRB Richmond Economic Brief 11-12*, (December, 2011), available at https://www.richmondfed.org/-/media/richmondfedorg/publications/research/economic_brief/2011/pdf/eb_11-12.pdf.

[29] Daniel L. Thornton, "The Dual Mandate: Has the Fed Changed Its Objective?," *Federal Reserve Bank of St. Louis Review 94*, no. 2 (March, 2012), available at https://research.stlouisfed.org/publications/review/2012/03/01/the-dual-mandate-has-the-fed-changed-its-objective/.

[30] George A. Kahn and Lisa Taylor, "Evolving Market Perceptions of Federal Reserve Policy Options," *Federal Reserve Bank of Kansas City Economic Review 99*, no. 1 (Q1 2014), available at https://www.kansascityfed.org/documents/1620/2014-Evolving%20Market%20Perceptions%20of%20Federal%20Reserve%20Policy%20Objectives.pdf.

words and four more ones in the Fed's charter considered in concert with the broader economic-policy mandate Congress has set for the federal government in general and the Fed in particular.

Dating back to 1946, Congress declared that,

> [I]t is the continuing policy and responsibility of the federal government to use all practicable means consistent with its needs and obligations and other essential considerations of national policy with the assistance and cooperation of industry, agriculture, labor, and state and local governments, to coordinate and utilize all its plans, functions, and resources for the purpose of creating and maintaining, in a manner calculated to foster and promote free competitive enterprise and the general welfare, conditions under which there will be afforded useful employment, for those able, willing, and seeking work, and to promote maximum employment, production, and purchasing power.[31]

In 1977, Congress gave the Federal Reserve a direct mandate, ordering it to do its best not only to achieve "maximum employment" and "price stability," as the Fed still describes its "dual mandate," but also to ensure "moderate long-term interest rates."[32] However, the 1977 Act does not obliterate the over-arching mandate of the Federal Reserve as a part of the federal government also to achieve Congress' express statutory mandate for the federal government as a whole.

Indeed, the Full Employment and Balanced Growth Act – more widely known as the Humphrey-Hawkins Act of 1978[33] expressly adds the Federal Reserve as a party responsible for achieving the broad, government-wide mandate by adding it to the entities cited in 1946 required to coordinate with U.S. fiscal authorities to achieve an array of policy objectives that continue to prioritize the "general welfare" and now go on to stipulate an array of additional objectives in areas such as trade, agriculture, and manufacturing. The Act also revised U.S. employment goals to include “genuine full employment” and “real income," now deleting "purchasing power" in favor only of price stability.

Unsurprisingly given the Fed’s focus on markets, the employment focus of the 1977 and 1978 mandates was only expressly reflected in regular FOMC statements after September of 2010. Each of the Reserve Bank studies noted above ponders the question of why the Fed waited so long to add maximum employment to its longstanding public prioritization of fighting inflation, but it may well have been due to the depth of the 2008 crisis, not to mention the acute political pressure on the central bank then to show that it was doing more than propping up big banks.

Although maximum employment and price stability are now a Fed mantra, moderate interest rates – another and equally binding statutory injunction – are still missing. In 2007, a Fed governor explained the complete disregard of this third mandate on grounds that neither maximum employment nor price

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[31] Employment Act of 1946, Pub. L. No. 79-304, 60 Stat. 23, 23 (February 20, 1946), available at http://www.legisworks.org/congress/79/publaw-304.pdf.

[32] Federal Reserve Reform Act of 1977 § 202, 12 U.S.C. §225a (2019), available at https://www.govinfo.gov/content/pkg/USCODE-2019-title12/pdf/USCODE-2019-title12-chap3-subchapI.pdf.

[33] Full Employment and Balanced Growth Act of 1978, Pub L. No. 95-523, 92 Stat. 1887, (October 27, 1978), available at https://www.gpo.gov/fdsys/pkg/STATUTE-92/pdf/STATUTE-92-Pg1887.pdf.

stability is possible without moderate long-term interest rates.[34] That might well have been true before 2008, but it is now clearly incorrect – see for example the nexus now of ultra-low rates, slow growth, and spiraling inflation.

Even judged by only its three statutory mandates, the Federal Reserve failed on every count from 2008 to 2020. Up to the COVID crisis, employment was anything but maximum as the Fed belatedly acknowledged early this year.[35] Then as now, wages for low-, moderate-, and middle-class households were insufficient to make ends meet, many people worked part-time or several jobs, many families needed multiple wage earners, and more than a few Americans simply dropped out of the work force in total frustration. After 2010, the Fed failed consistently to meet the two percent inflation threshold it considers price stability, flunking this criterion so decisively that even the Fed acknowledged that its post-crisis policy needed redesign.[36] Now, inflation has risen sharply despite the Fed's assertions until late October[37] that it was only "transitory." And, of course, interest rates hovering at the zero lower bound or below it after taking even a small amount of inflation into account aren't "moderate."

Acute economic inequality and general macroeconomic malaise make it clear also that the FRB has failed to support "general welfare." It of course cannot be blamed alone for this failure also of fiscal policy, but U.S. law expressly requires more of it in terms not solely of an abstract dual mandate, but of policies advancing shared prosperity that work in concert with statutory fiscal goals, not against them to achieve increasingly-theoretical monetary-policy results.

A Meaningful Monetary-Policy Mandate

This paper has shown first that the distinctions Federal Reserve officials seek to draw between monetary-policy purity and fiscal-policy intervention are not only anachronistic, but also misleading. The sheer scale of monetary-policy intervention since the great-financial and COVID crises not only endow monetary policy with direct and indirect fiscal impact, but also out-gunned fiscal policy in several key respects.

Some have suggested that, given the Fed's unmatched powers to throw trillions of dollars as it sees fit, Congress should control this authority and stipulate that certain public-welfare objectives (e.g., climate-risk mitigation) be directly advanced by central-bank operations and/or asset purchases. To do so without subsequent political accountability is to give a central bank undue authority; to do so with accountability exposes the full scope of central-bank operations and activities to political control sure to seek not only to direct public-welfare investments, but also to set interest rates or other policies to enhance individual political prospects.

[34] Frederic S. Mishkin, "Monetary Policy and the Dual Mandate" (speech, Bridgewater, VA, April 10, 2007), available at https://www.federalreserve.gov/newsevents/speech/mishkin20070410a.htm.
[35] FRB Chair Jerome H. Powell, "Getting Back to a Strong Labor Market," (speech, New York, NY, February 10, 2021), available at https://www.federalreserve.gov/newsevents/speech/powell20210210a.htm.
[36] FRB, "Federal Reserve to review strategies, tools, and communication practices it uses to pursue its mandate of maximum employment and price stability," November 15, 2018, available at https://www.federalreserve.gov/newsevents/pressreleases/monetary20181115a.htm.
[37] Jeanna Smialek and Matthew Phillips, "The Fed chair strikes a wary tone on inflation, but says this isn't the time to raise interest rates.," *New York Times*, October 22, 2021, available at https://www.nytimes.com/2021/10/22/business/feds-powell-supply-chain.html.

To recognize the Fed as it has become and to forestall a politically-driven mandate, the Federal Reserve should honor its current, triple mandate and the overall context in which Congress has placed it in the federal economic mandate, abandoning its long, unsuccessful wait for the wealth effect somehow to work growth, resilience, and inflation wonders.

A full discussion of how equality-focused monetary policy should proceed is outside the scope of this paper (see Chapter 11 in my book). However, Congress's full mandate for the Fed expressly and directly orders it to recognize American economic inequality and, armed by better data and a clear sense of its mission, realign its employment, price-stability, and interest-rate goals to generate a "prosperity effect" – that is, growth that starts at the bottom of the income and wealth distributions to generate shared prosperity, stable growth, and market stability.