# The blind alley of monetary populism

By Jeffrey Frankel
October 25, 2016 – *Project Syndicate*

In the United States and elsewhere nowadays, populist politicians often claim that easy monetary policy is hurting ordinary workers, thereby exacerbating income inequality. But while inequality is a problem, raising interest rates is no way to address it.

To say otherwise is a strange claim for anyone to make, especially populists. After all, low interest rates benefit debtors and hurt creditors, as does the inflation that can be spurred by monetary easing. Throughout most of US history, for example, populists have supported easy monetary policy as a way to help the little guy against distant bankers with hard hearts devoted to hard money.

That was why the Andrew Jacksons of the nineteenth century fought the efforts of the Alexander Hamiltons to establish a national bank. It was also the argument William Jennings Bryan made during his 1896 presidential campaign, when he promised easier money to his core constituency: Midwestern farmers who had been hit hard by high interest rates and declining commodity prices. And it was the argument made by supply-siders who opposed US Federal Reserve Chair Paul Volcker's high-interest-rate policy in the early 1980s – an argument that spurred President Ronald Reagan to appoint two Fed governors to challenge Volcker in 1985.

Today, however, the script has switched – and not only fringe populists are working from it. British Prime Minister Theresa May, for example, declared earlier this month that low interest rates were hurting ordinary working-class people, while benefiting the rich. Falling interest rates help push up the prices of securities – both stocks and bonds – which are disproportionately held by the wealthy. "People with assets have gotten richer," said May. "People without them have suffered."

In a sense, May has a point. In the US, stock prices have reached near-record highs. And the Fed's 2008 decision to reduce the policy interest rate virtually to zero, together with the subsequent economic recovery, surely contributed to the strong stock-market rebound that began in early 2009. But there is little evidence that low interest rates have been behind the continued rise in equity prices from 2012 to 2015 – a period when markets were anticipating an interest-rate hike.

Populist arguments against easy monetary policy are flimsy, at best. But so are populist arguments for tightening monetary policy – in the US, Donald Trump, following Ted Cruz and other Republican leaders, has advocated a return to the gold standard. The truth is that monetary policy – which aims to promote overall economic growth, while maintaining price and financial stability – is not an appropriate lever for addressing income inequality. That is a job for progressive taxation, universal health insurance, financial reform, and other such tools.

This is not to say that monetary policy cannot affect inequality. An economy running hot enough to create jobs at a rapid rate – what some, most recently Fed Chair Janet Yellen, have called a "high-pressure economy" – will eventually lead to higher real wages and incomes for workers. This happened in the late 1990s, with a high-pressure economy eventually pushing the unemployment rate below 4%. And it is happening now.

Since early 2010, US employment growth has been running well above the natural rate of labor-force growth, with the economy adding more than 15 million private-sector jobs in the

longest continuous series of monthly employment increases on record. This job growth brought the unemployment rate down to 5% last year, from above 9% in 2009-10, and is now pulling previously discouraged workers back into the labor force. Thanks to increased demand for labor, workers' real wages – up 2.5% in the last year – have risen in this business cycle at the fastest rate since the early 1970s.

It was not until last month, however, that the full extent of these gains came to light, with the Census Bureau's annual economic statistics showing that median household income had increased by a record 5.2% ($2,800) in 2015. These gains were felt at every level of the income distribution, with the largest percentage gains going to those in the bottom tier and the smallest gains going to those at the top. These are big changes, and offer important confirmation that lower-income families are finally sharing in the economic recovery.

The unconventional monetary policies of recent years may also have some new effects. Low interest rates have lately been squeezing banks' profits. In Europe, this has become particularly pronounced, because banks are unable to pass negative interest rates on to depositors. Any self-respecting populist should like this squeeze on banks, especially one who is still angry about the 2008 global financial crisis.

Ultimately, easy money probably does more to reduce income inequality than to exacerbate it – an observation supported by econometric estimates. Nonetheless, it is not a particularly reliable tool for balancing income distribution. That should not be surprising: ensuring a more equitable distribution of income is not a central bank's job.

The Fed and other central banks are balancing rapid growth not against equality, but against the dangers of future overheating and financial instability. They view their jobs as managing the overall economy. They are right to do so.

*Jeffrey Frankel, a professor at Harvard University's Kennedy School of Government, previously served as a member of President Bill Clinton's Council of Economic Advisers. He directs the Program in International Finance and Macroeconomics at the US National Bureau of Economic Research.*