Social Conditions Are an Increasing Consideration for How the Economy Will Be Managed

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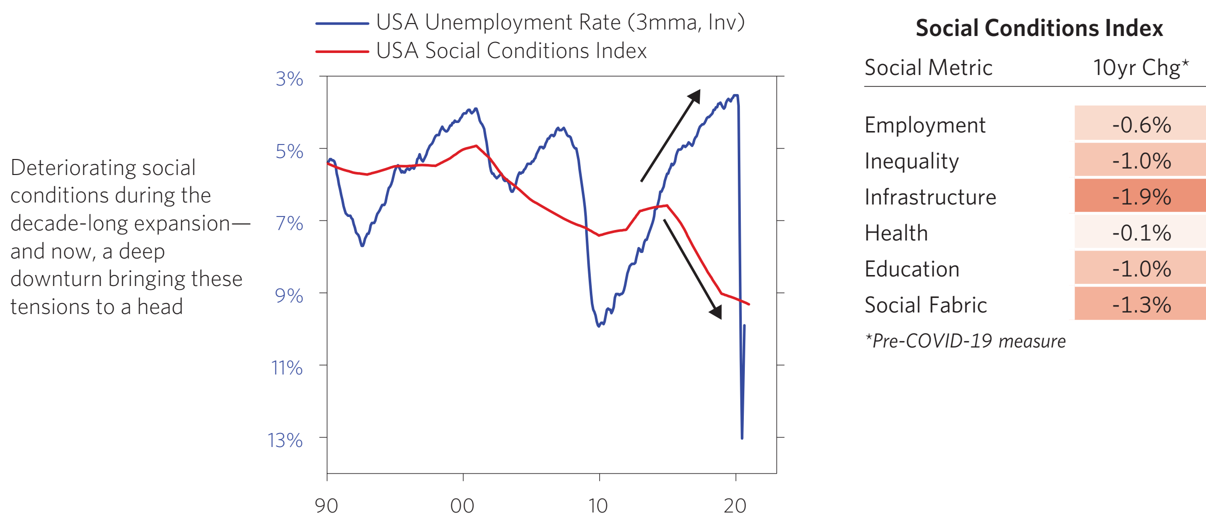
The ultimate goal of economic policy is simple and timeless—to ensure prosperity and maximize living standards. Broad macroeconomic measures such as GDP growth, the unemployment rate, and inflation had for decades been a good proxy of rising prosperity, so they have dominated economic policy making and are enshrined in most central bank mandates. But even before the COVID-19 crisis, it had become clear that traditional economic measures have increasingly diverged from social outcomes. The economic expansion of the past decade was a success according to traditional measures of full employment, but it was accompanied by deteriorating social conditions across a variety of measures (inequality, health and safety, educational attainment, infrastructure quality, housing affordability, and so on). With the COVID-19 crisis, the pressures have come to a head as the worst economic downturn in decades is hitting the most vulnerable the hardest.

Looking ahead, social conditions will have rising impacts on markets as policy evolves to more explicitly consider such issues in evaluating its goals. After a decade of money printing and with rates at zero, fiscal policy is likely to be at least as impactful as monetary policy in the decade to come (a shift to what we've called coordinated "MP3 policies"), and fiscal policy is inherently distributional. Fiscal policy is now driving a bigger share of spending than at any time since the New Deal or World War II, and it is likely to be more active in managing the economy going forward—and Congress has a wide mandate to address deteriorating social conditions as an explicit part of its policy goals. And with regard to monetary policy, in an environment of weak cyclical inflation where a low unemployment rate has not translated to price pressures in many years, the Fed is increasingly taking into account social disparities in its policy considerations.

The chart on the left below shows the rising divergence between US social conditions and the unemployment rate heading into the COVID-19 crisis. The unemployment rate, one of the most used traditional measures of economic health, fell to lows during the decade-long expansion coming out of the financial crisis as a broad range of social conditions deteriorated. The virus has now led both to deteriorate rapidly.



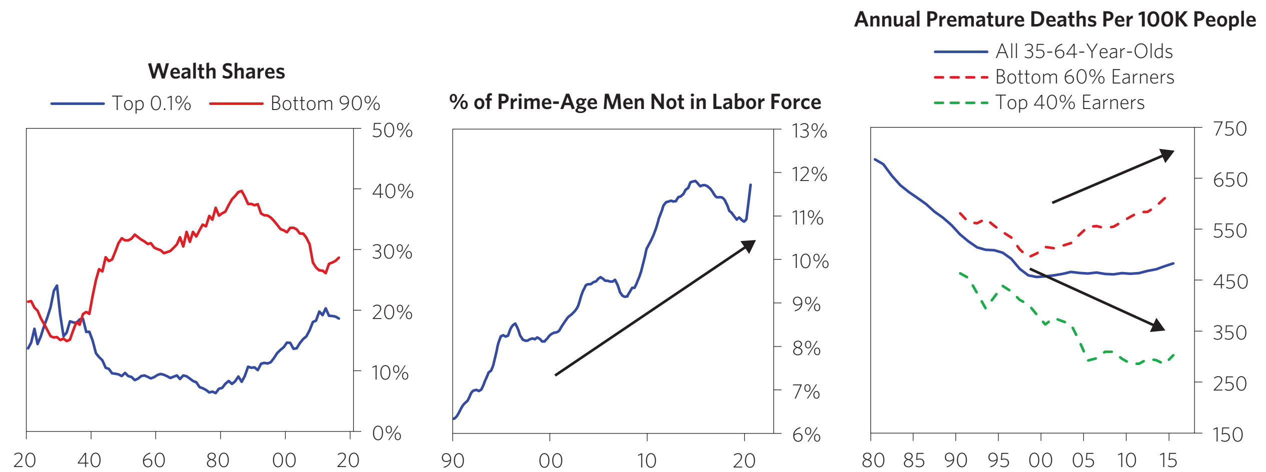
Social Conditions Index

Social Metric	10yr Chg*
Employment	-0.6%
Inequality	-1.0%
Infrastructure	-1.9%
Health	-0.1%
Education	-1.0%
Social Fabric	-1.3%

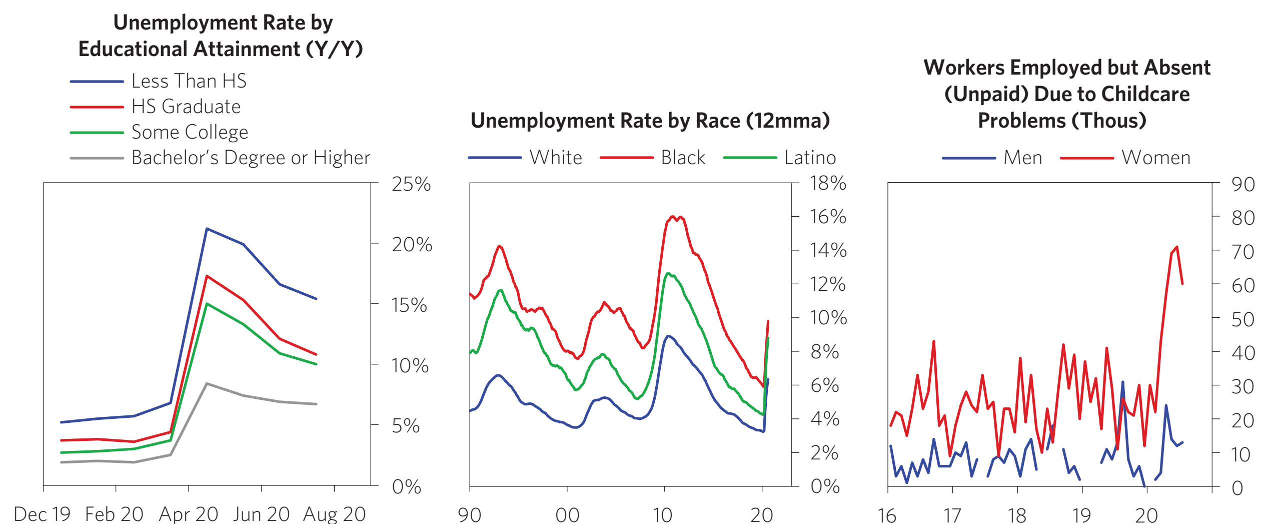
Pre-COVID-19 measure

Below are a few charts illustrating the deterioration in social conditions over recent decades, showing some of the measures we have utilized to capture the concept. No individual statistic is especially valuable, but collectively the indicators are helpful in tracking the broader social dynamics. Our goal was to address the inadequacy of traditional macroeconomic measures, as conveyed by Simon Kuznets, the economist who developed the first GDP measures, in his report to US Congress in 1934:

> *"Economic welfare cannot be adequately measured unless the personal distribution of income is known. And no income measurement undertakes to estimate the reverse side of income, that is, the intensity and unpleasantness of effort going into the earning of income. The welfare of a nation can, therefore, scarcely be inferred from a measurement of national income as defined above."*



Now, these pressures are coming to a head as the coronavirus has led to the worst economic downturn in decades and is hitting the most vulnerable the hardest. Much has been written about the ways in which the COVID-19 crisis has disproportionately affected lower-income people, less-educated people, women, and racial minorities. As the charts below convey, (1) job losses have been much greater for racial minorities and less-educated people; (2) women are more likely to lose earnings in order to take care of children as schools shut down and move to online instruction during the crisis; and (3) lower-income people have been much more likely to contract COVID-19, as they are less able to work from home, and when they get sick they are more likely to have severe outcomes given that they are starting out with poorer health.



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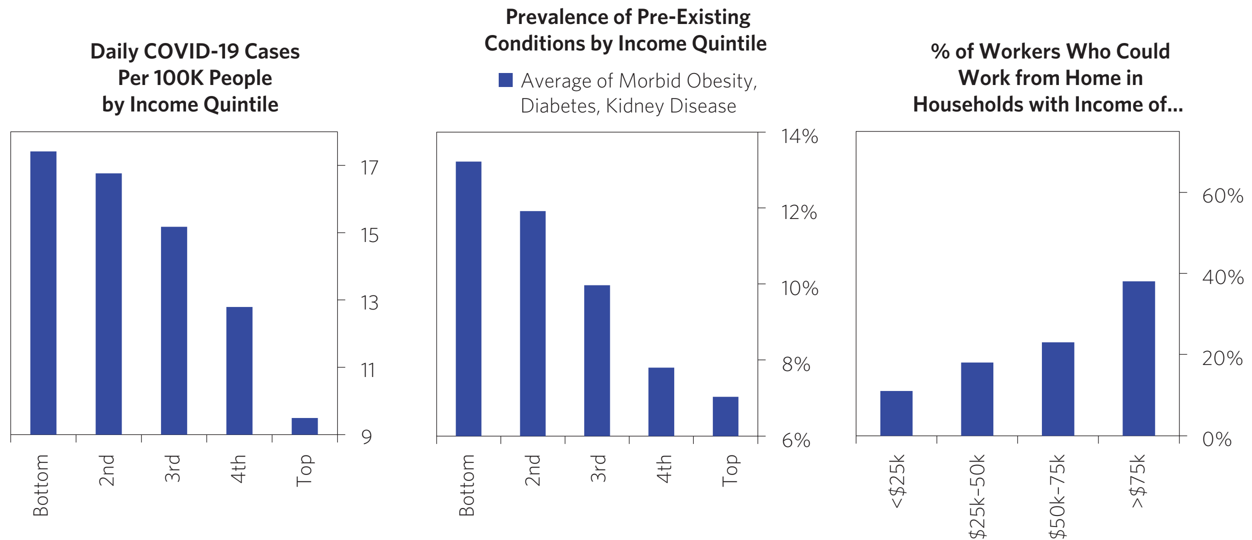
Disease Hitting the Most Vulnerable Hardest



As Fiscal Policy Rises in Importance, Social Conditions Play a Bigger Role

A decade into central banks' money printing and with interest rates at zero, governments control the most impactful policy levers that can be pulled in this environment. Unlike central banks, which are traditionally expected to be technocratic in nature, governments have the mandate to address what they perceive as social problems—and to direct money to specific players in the real economy who are likely to spend it, as well as to directly create real economic activity. The magnitude and the breadth of today's fiscal easing globally, financed in large part by money printing, already dwarf anything the world has ever seen in response to an economic crisis. Looking ahead, we expect that governments that don't face material constraints will continue proposing and enacting expansionary fiscal packages. In a world where fiscal policy is increasingly important, social conditions will naturally play a larger role in determining policy—and therefore play a larger role in markets.

As an example of how fiscal policies can directly address social conditions, so far in the COVID-19 crisis the large fiscal stimulation that has taken place in the US has primarily been directed to low- and middle-income households (in the form of stimulus checks, unemployment benefits, and indirectly through PPP loans that are enabling small businesses to continue making payroll). The table below shows the degree to which government transfers are bolstering incomes for low- and middle-income households (we show the 0-60th percentiles together) compared to those at the top of the income distribution. On the left, we show total incomes (inclusive of both private incomes and government transfers), then private incomes before the transfers, and then the transfers themselves.

Pre-Tax Household Income Breakdown by Percentile

	Total Income	Private Incomes		Govt Transfers	
	% Change since Q1	% Tot Income	Contrib to Chg	% Tot Income	Contrib to Chg
Total	**8%**	**81%**	**-8%**	**19%**	**16%**
0-60%	23%	54%	-17%	46%	40%
60-80%	9%	86%	-11%	14%	20%
80-90%	2%	90%	-7%	10%	9%
90-100%	-4%	98%	-6%	2%	2%

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Monetary Policy: More Explicitly Considering Social Conditions in an Environment of Weak Inflationary Pressures

With regard to monetary policy, the traditional view of the Fed is of a technocratic actor agnostic to social/distributional outcomes. But a decade of quantitative easing that disproportionately supported large owners of financial assets—and the sense that in an environment of weak inflationary pressures the Fed can afford to be more aggressive—are raising new pressures on how the Fed's mandate should be understood going forward. A shift is already underway in terms of how the Fed interprets its current mandate, as reflected in the Fed's updated characterization of the maximum employment goal as "broad-based and inclusive" in its recent Review of Monetary Policy Strategy, Tools, and Communications:

> *"The role of monetary policy is to support a strong, stable economy that benefits all Americans. The* ***characterization of our maximum employment goal as broad-based and inclusive clarifies that the Federal Reserve seeks to foster economic conditions that benefit everyone****. It also* ***stresses the importance of understanding how various communities are experiencing the labor market*** *when assessing the degree to which employment in the economy as a whole is falling short of its maximum level."*

In an environment of weak cyclical inflation, where a low unemployment rate has not translated to price pressures in many years, a focus on closing inequalities and supporting the most vulnerable groups gives the Fed reasons to ease more aggressively than it otherwise would. This is the most direct way that social conditions are likely to have increasing impact on markets going forward vis-à-vis monetary policy. Also from the Fed's recent review:

> *"****The previous expansion demonstrated that a strong labor market can be sustained without inducing an unwanted increase in inflation.*** *To the contrary, when unemployment fell to levels that were previously thought to be unsustainable, the labor market proved remarkably adaptable,* ***bringing many benefits to families and communities that all too often had been left behind****. Accordingly, the new Statement on Longer-Run Goals and Monetary Policy strategy only refers to 'shortfalls of employment from its maximum level' rather than the 'deviations from its maximum level' used in the previous statement."*

Below are some recent comments from Fed members reflecting their increasing focus on social conditions as a reason for the Fed to ease more aggressively in this environment:

- Atlanta Fed President Raphael Bostic: *"The important thing about our mandate is that, to me, it says* ***we should be making sure the economy works for everyone, because that's the way you get to the largest maximum employment****. That's the way you get to the strongest, most resilient economy."*
- Minneapolis Fed President Neel Kashkari: *"Understanding these disparities is vitally important to us…****If we allow the labor market to heal and not preemptively tap the brakes, it turns out that's actually good for groups that are marginally attached to the labor force, those with less education, and minority groups****."*

Additionally, Democratic presidential nominee Joe Biden and Congressional Democrats have come out in support of widening the Fed's mandate to include addressing racial disparities and inequality and expanding reporting requirements. Democrats have proposed a bill to this effect, and, regardless of its chances of passage, the legislation and the discussion around it give a sense of the type of rethinking of the Fed's mandate that is taking place. The key tenets of the bill, the Federal Reserve Racial and Economic Equity Act, are as follows:

- "***Makes Reducing Inequality Part of the Fed's Mission:*** *This bill adds a new section to the Federal Reserve Act that would require the Fed to carry out its functions in a way that 'minimizes and eliminates racial disparities in employment, wages, wealth, and access to affordable credit.'"*

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- *“**Ensures That Racial Economic Disparities Are Not Ignored:** This legislation requires the Federal Reserve Chair to identify in his or her semiannual testimony before Congress: (1) the existing disparities in employment, income, and wealth across racial and ethnic groups and (2) how the Fed is using its authorities to reduce these disparities.”*
- *“**Requires Robust Reporting on Disparities in Labor Force Trends:** This bill requires the Fed’s Semiannual Monetary Policy Report that the Fed releases in conjunction with the Chair’s testimony to include recent labor force trends with ‘a comparison among different demographic groups, including race, gender, and educational attainment.’”*

Even if the Fed’s mandate is not officially expanded, the introduction of reporting requirements regarding the labor market that highlight whether racial minorities, women, or less-educated people are not enjoying the benefits of the expansion coming out of COVID-19 pushes such social issues into the policy conversation and allows them to influence policy and, therefore, markets.

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