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Scope of work, year two

The previous summary is replicated below. The news on this front since our last meetings is that I am now involved in a collaboration among the Federal Reserve, the City of Boston, the New Commonwealth Fund, and Eastern Bank to pursue a multi-pronged follow-up to the 2015 "Color of Wealth" study. The work will entail:

1. Designing and implementing a follow-up to the Color of Wealth survey. The survey will collect much of the information contained in the previous survey. It will also include new questions that probe more the sources of the wealth inequities, including generational inheritance, generational experience with homeownership, significant health care expenditure disruptions, and access to relevant wealth-building policies over the family's history. The survey may also be able to obtain the same information from many of the "Gateway Cities" in Massachusetts, expanding the geography and demographic makeup of the respondents.
2. The data from the two surveys will be augmented wherever possible by administrative, individual-level data. Our hope is that the partnership with the City of Boston will allow us to gain access to such data, and we hope that we will gain access to state-level administrative data as well. This data will allow us better to design pilot programs, and critically to track the impact of programs on residents of the Commonwealth.
3. A report will summarize the results of the survey, focusing importantly on the new questions that attempt to get at generational and policy-driven sources of wealth inequity.
4. The follow-up to this report will consist of a number of pilot programs that aim to begin the process of reducing the racial wealth gap in the Boston metro area and beyond.
5. An exciting aspect of the project is that one of the original Color of Wealth lead researchers, Darrick Hamilton, is also working with the New York City mayor's office on the same issues. We hope to pursue some parallel data collection and program testing. This will have the benefit of increasing the sample size and broadening experience with pilot programs. It will also draw attention to the efforts, with an aim toward scaling those programs that show promise towards a regional or national level.

This work will take several years, but even so, assessing impact on the racial wealth gap over this relatively short horizon will be difficult. A key challenge will be to design medium-term measures that research has shown to be indicative of longer-term wealth improvements. At this point, the precise scope of this project is under discussion among all of the key partners, so this information is for internal use only.

(a) New work on the racial wealth gap. I have been speaking on this topic for the past several years, in part following up on work from the Federal Reserve Bank of Boston's 2015 "Color of Wealth" study, which I had a part in. The overarching topic I am interested in is inequality of economic opportunity, which in the US has been driven prominently by laws and institutions that were purposely set up and/or implemented to provide significant wealth-building opportunities for whites, and excluding people of color from those opportunities. Those barriers have been at work for many decades, across several generations, and the outcomes are striking.

There are a number of important counter-narratives to this story. The first holds that our market-based system rewards the hardest workers as they should be rewarded. The differences across outcomes are related to effort. Sadly, this narrative is far from true.

A parallel narrative suggests that those who pursue education, achieve higher income, become homeowners, save money and learn about financial markets can equalize the wealth gap. Interestingly, in the available data, families with equal levels of educational attainment, income, homeownership, and savings proclivities do <u>not</u> exhibit nearly similar levels of wealth. This simple look at the data suggests that the simple narratives above may be quite misleading. Personally, I think they're just bunk.

But very few studies have looked at individual household observations that allow us to examine jointly the outcomes across all these dimensions (along with other important dimensions, such as age, gender, inheritances, and so on). I am currently compiling 20 years of micro data from the Survey of Consumer Finances to perform this type of examination. In particular, with the data available, I can see whether outcomes for income, education, homeownership, savings behavior, inheritances, household structure and so on can <u>jointly</u> explain the vast differences in net worth. Importanty, I can also see whether these patterns have changed over time.

The preliminary results—and they're quite preliminary at this stage—suggest that the simple results from less formal studies hold up well. To be sure, many of these variables matter in determining wealth outcomes. But after controlling for all of these effects, families with Black heads of household still exhibit dramatically different wealth outcomes.

These results, coupled with the rather compelling historical record of legal and institutional discrimination, suggest it is way past time to change our narrative about the sources of the wealth disparity. Coupled with other research on the local geographic influences on destiny, the call into question the notion that ours is a "land of opportunity." Instead, it is an economic system that has been designed to benefit a (white, generationally wealthy) subset of our population, to the exclusion of all others.

This topic may well be of wider interest!

(b) A new paper that focuses on the role of expectations—especially but not exclusively long-run expectations—in the Fed's thinking about its policy framework. Importantly, the paper will also examine the role that long-run expectations <u>actually</u> play in the determination of inflation. This topic was discussed briefly in the working paper on the new policy framework, but requires a more in-depth treatment to do it full justice.

I am likely in the minority among current and former monetary policymakers and staff, but my sense is that the Fed significantly <u>over</u>-weights long-run inflation expectations in their setting of monetary policy. I believe this for both empirical and theoretical reasons. On the empirical side, the linkage between long-run expectations and realized inflation is (a) a fairly recent phenomenon; and (b) rests largely on the observation that both long-run expectations and actual inflation haven't moved much. The inference drawn is that those two relatively stable quantities are then causally related to one another. I have some empirical work that questions the reliability of that relationship.

From a theoretical perspective, it is not at all clear why it should be primarily long-run expectations that determine inflation. Such expectations are certainly a plausible indicator of the markets' or the public's beliefs that the Fed will ultimately return inflation to its announced goal. And should such expectations depart persistently from the 2% goal, that might be a concern to the Fed. But as a determinant of inflation, the theoretical arguments are much weaker. Both formal models of inflation—in which long-run expectations anchor very long-run movements of inflation, but not necessarily cyclical movements—and common sense suggest the link may be quite weak. To be specific: The prices that go into the aggregate price level and from which inflation measures are derived are set by a multitude of firms. A non-trivial question is: How many of them take long-run inflation expectations into account in setting their prices? How many have such expectations? If they do not do so explicitly, perhaps there is a contorted "as-if" argument about why it appears that they do, even if they're not aware of it. But I don't have too much faith in such arguments. Billiards players don' need to know the laws of physics to play well, but they may appear to have mastered geometry and physics. It's much harder to draw such an analogy for a price-setter's actions in response long-run inflation expectations, which are arguably well down the list of their concerns, compared to firm-, market- and product-specific factors that clearly loom large in setting prices.

This work will likely be of interest to many, but of deep interest to a few.