

Should Inequality be a Concern for Monetary Policy ?

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Welfare Considerations Beyond Price Stability

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Why is inequality becoming increasingly relevant for MP?

Traditional view: Distributional issues are considered as *side effects* of CB's policies **stabilizing the economy as a whole**.

Alternative view: MP could have non-negligible *direct effects* on inequality at business cycle frequencies which interact with different channels of MP transmission mechanism.

Growing influence of micro-level heterogeneity (HANK) + search and matching frictions (SAM) frameworks on Monetary Policy (MP) macro-modelling **has put inequality centre stage**.

Focus here on the impact of **expansionary/contractionary** MP shocks on inequality (follow up to Dolado, ECB Forum Sintra 2021).

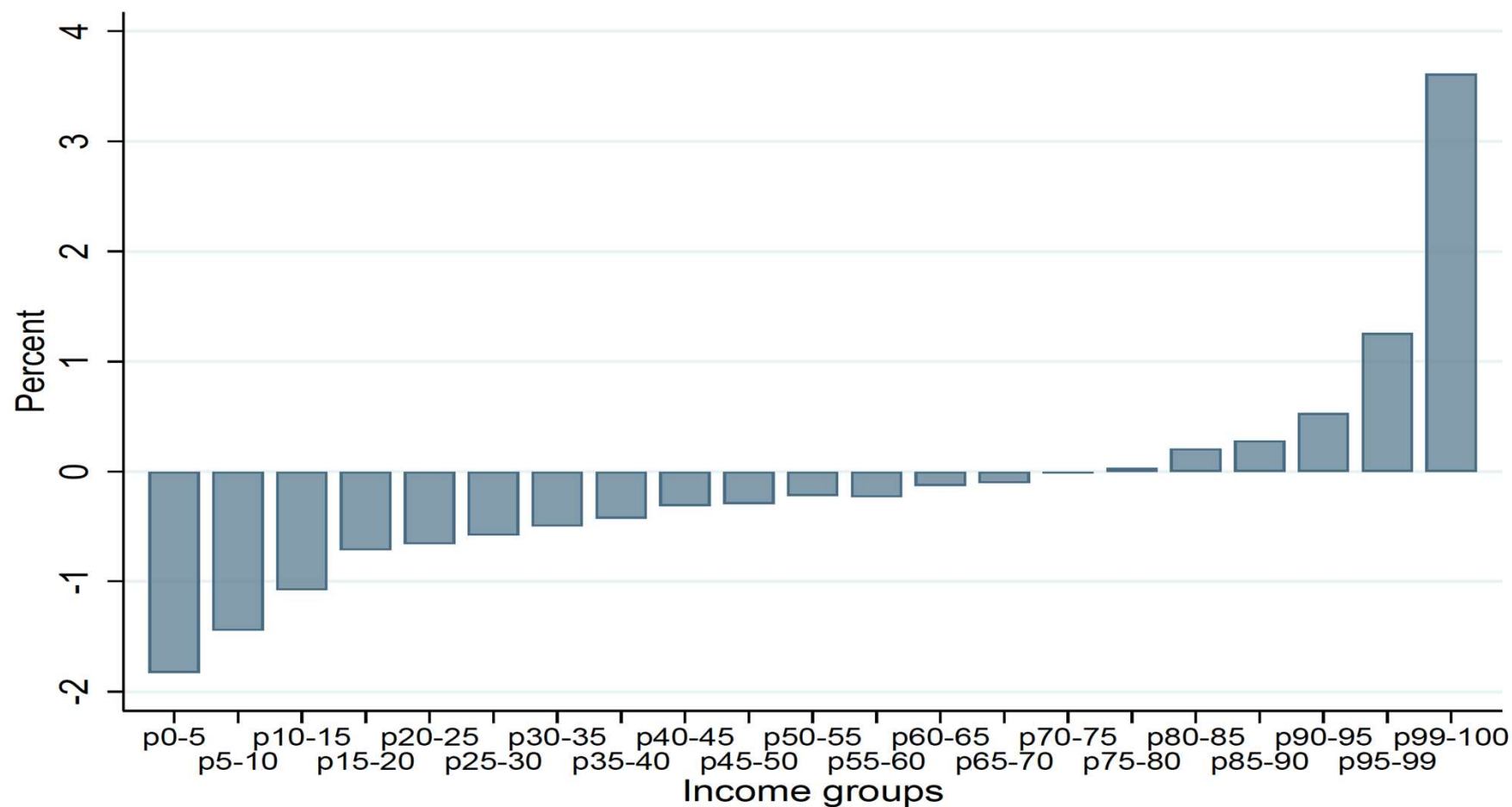
Direct & Indirect Channels (expansionary MP shock: $\downarrow i$)

- **Savings-redistribution channel:** benefits borrowers and hurts lenders:
 \downarrow Inequality
- **Interest-sensitivity channel:** \uparrow asset prices & \downarrow interest costs (favours the richer)
- **Inflation channel:** \uparrow inflation (harms the poorer): \uparrow Inequality
- **Household/Firm-heterogeneity channel:** (access financial markets, discount rates, mortgagors, small young firms): \downarrow Inequality
- **Income-composition channel** (wages, profits, transfers): ?? Inequality
- **Labour earnings-heterogeneity channel** (skills): \uparrow Inequality

Granular Information: **Positive Income Gradient**

Andersen, Johannesen, Jørgensen & Peydró (2020): individual-level tax records and balance sheets for the entire adult population in Denmark (1987-2014)

2-year changes in income shares (across income percentiles) for ↓ 1pp. in interest rate



Novel MP Mechanism (**Labour-Earnings heterogeneity channel**): **Investment**

Dolado, Motyvzski & Pappa. (AEJ-Macro 2021): high (HS)-less (LS) skilled workers

- **Capital Skill Complementarity (CSC)** embedded in production function (KORV)
 - * **Capital equipment and HS-workers are complements**
 - * **Capital equipment and LS-workers are substitutes**

(similar reasoning applies to investment in AI & robots and decline of routine tasks)
Acemoglu & Restrepo (AER, 2018)

- **Asymmetries in SAM frictions (ASAM)**

LS-workers have:

- * **Higher separation rates,**
- * **Lower matching efficiency**
- * **Lower Nash bargaining power**

Insights & Results

- Expansionary MP shock → ↑ Investment & AD → ↑ Relative demand for complementary and more fluid HS-labour →
↑ Investment & AD → ↑ Relative demand for HS-labour →

Multiplier loop (*demand amplification effect*)

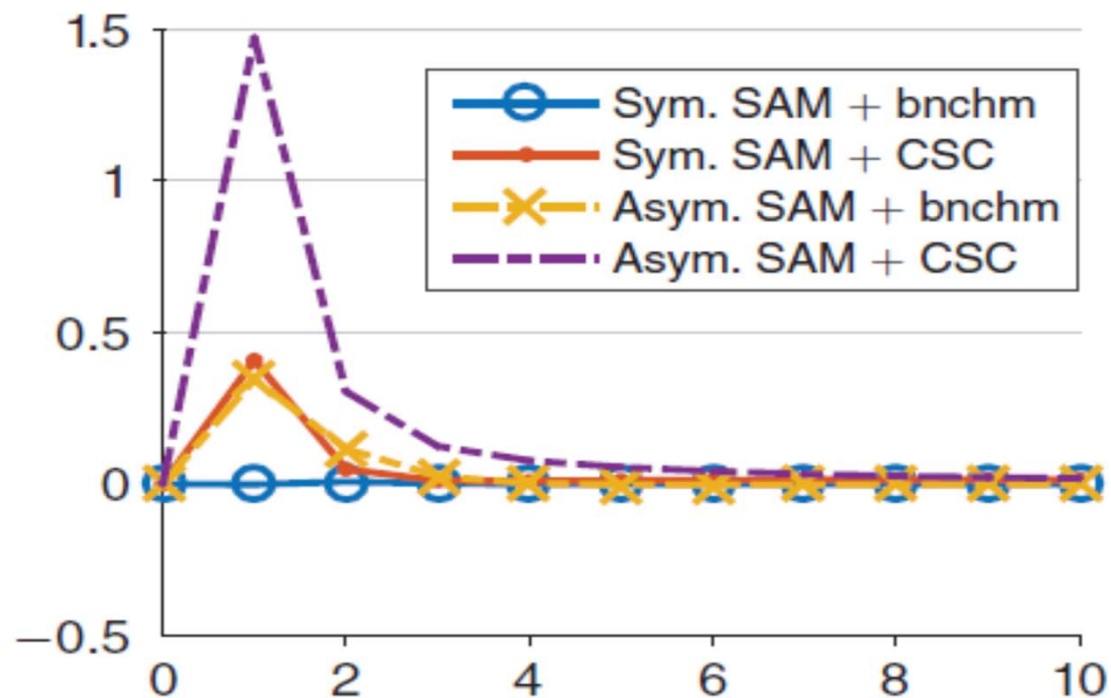
- CSC+ASAM → ↑ relative income of H-workers vs. L-workers (skill premium \times relative employment rates).
- Interaction of CSC & ASAM yields stronger effects on relative income shares than the aggregation of the two separate forces.

Monetary Policy shock (NK+CSC+ASAM): \downarrow 1 pp in i .

CSC vs Cobb-Douglas (benchmark)

ASAM vs Symmetric SAM

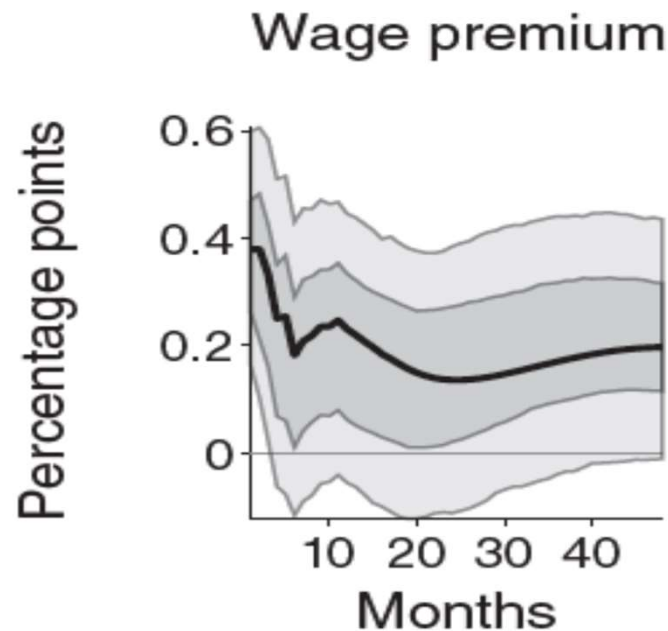
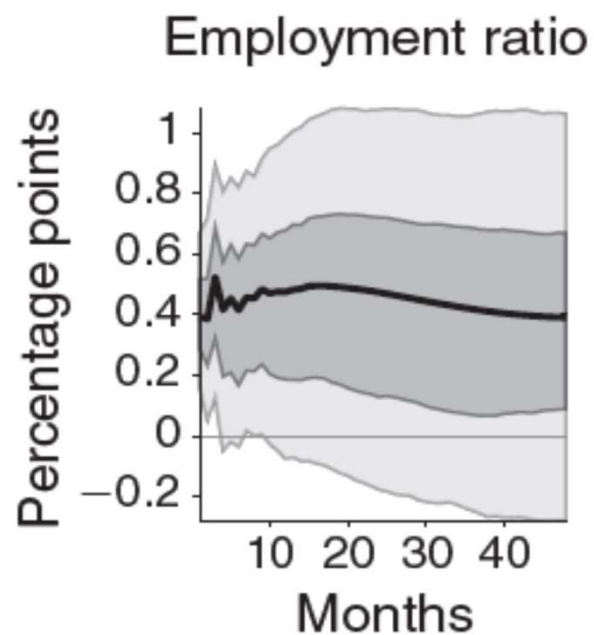
Panel D. Relative income share of H versus L



Confronting CSC+ASAM mechanism with US (CPS) data: $\downarrow i$ by 1 pp.

Proxy SVAR (US 1979:1-2007:12): Wieland and Yang (2016) update of Romer & Romer

SVAR (ff, u-rate, emp-rate (H), emp-rate (L), real wage (H), real wage (L), CPI inf) across different sectors



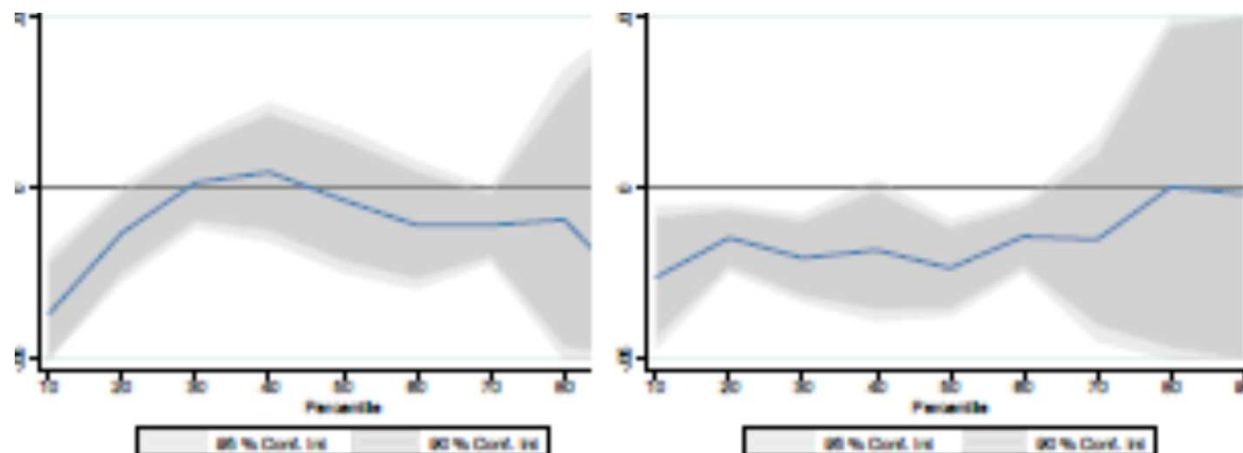
Alternative mechanism: CSC+ Internal liquidity constraints in the face of (+) credit-supply shocks (Aristizábal-Rámirez and Posso, 2021).

LP (Colombia 2008:1-2018:12): Lending from bank b to firm f

High-liquidity firms are able to expand in scale

Firms with less internal resources increase capital and HS workers to substitute LS workers.

Figure 4: A Positive Credit-Supply Shock Reduces the Value of the Wage Deciles on the Bottom Half of the Distribution



A new scenario: Will CB's tapering/tightening reduce wage inequality?.

- Taper tantrum at the time of “**gasflation**”: ↓ Investment & ↓ HS employment and wages relative to LS
- But unemployed HS *trickle down* to LS job segments: ↑ LS L supply → ↓ LS wages. Same with automation & AI: middle skilled worker in routine tasks move to LS jobs.
- Is CB's put dead if Ukraine' invasion persists ? The combined fiscal and monetary stimulus efforts in the major developed countries has increased aggregate money supply by \$20 trillion over 2020 and 2021 to a record \$102.5 trillion (Bloomberg). Yet, “gasflation” is not likely to respond to a general tightening of MP.
- **MP (+) supply shock**: Need of a targeted approach: accelerate green energy transition and slow down inefficient automation by redefining TLTRO operations from a blunt toolkit to a targeted one.