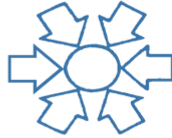
Purpose and Profit:
Reconsidering the American Banking Construct to Enhance Economic Equality



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- Each U.S. bank lives or dies by the ability of American households to save, invest, borrow prudently, and thereby accumulate wealth. That's indeed the mission of financial intermediation and the rationale behind federal benefits such as FDIC insurance and access to the Fed. This is an urgent mission and a sound rationale, but each is hollowed out by post-crisis Fed policy.
- There's a lot of talk these days about innovation as a way to advance financial inclusion. This should mean more than a new app on a mobile phone – new charters, new products, and a new goal – equitable capitalism – will make far more of the difference we need now.
- If we don't build out an equitable capitalism vision, I fear we'll face prescriptive socialism.

Thank you, Cecelia, not only for inviting me to address the opening dinner of your ABASA board meeting, but also to tackle the impact of economic inequality from the perspective of the senior capital-markets executives here tonight. I am very pleased to do so, but I can promise compliance with only one of the injunctions that should guide after-dinner talks: I'll be brief. I can't, though, promise also to be entertaining – this issue troubles me too much as indeed I know it worries all of you. The message I'd like to emphasize is that economic inequality isn't inevitable – it's in large part the result of poor regulatory and monetary-policy decisions that have also shaken banking to the core since the 2008 great

financial crisis. Inequality and increasing financial-market risk are not the facts of life many assume. As a result, my talk tonight isn't just about "too bad;" it's also about to dos for each of us economically and institutionally empowered to make a difference.

How Bad is U.S. Inequality?

First, though for a sobering – and I promise short – after-dinner excursion into just how unequal the U.S. has become since 2008. The wealth of the top ten percent is 19 percent higher than it was before the crisis, even taking occasional stock-price declines into account. In sharp contrast, middle-income family wealth is still below where it was before the financial crisis and lower-income families lost 16 percent of their pre-crisis wealth (not much to start with, of course).[1] Further, the average wealth of the top ten percent is 13 times higher than that of the middle class; it was only seven times higher in 1989 when inequality had already been rising for at least a decade.

Although America's legend is founded on equality and most Americans think they are middle-class, the U.S. is in fact the most unequal advanced economy in the world.[2] It's also the only advanced country in which the middle class is increasingly unable to support anything close to what most Americans think is a middle-class lifestyle – that is, one in which we live securely in a home of our own, pay our bills, save for the future, get medical care when we need it, and go out for dinner or for a vacation from time to time.[3] It costs thirty percent more now to be middle class in terms of housing, child care, education, health care, and other living costs than it did just twenty years ago.[4] To make ends meet, we're now floating day-to-day expenses – not occasional splurges or long-term investments – on debt. Households with less than fifty percent of median income now have more debt than assets, with the bulk of what wealth they have often to be found parked in their driveway.[5]

According to the U.S. Census Bureau,[6] U.S. income inequality is now the highest it's been since records began in 1967. The top one percent of households now holds more wealth than the bottom ninety percent,[7] with the wealth gains at the tippy-top coming principally from what was once the middle class. Those who are left have to struggle so hard to get by that one quarter of the middle class now skips medical treatment[8] and more than one third can't handle an unexpected $400 expense.[9] Diseases of despair – those due to alcohol, suicide, and drug addiction – are at their highest level ever even after discounting the effect of the opioid epidemic.[10]

Intermediation's Big Empty

What do these trends mean for your bank? Each of them is different in its focus, but each U.S. bank lives or dies by the ability of American households to save, invest, borrow prudently, and thereby accumulate wealth. That's indeed the mission of financial intermediation and the rationale behind federal benefits such as FDIC insurance and access to the Fed. This is an urgent mission and a sound rationale, but each is hollowed out by post-crisis Fed policy.

The combined, adverse equality impact of quantitative easing and ultra-low rates is all too evident in what happened to households able to invest in the stock market versus those trying to save at your banks. From 2007 to 2019, the S&P index for stocks rose 77 percent – that is, an investor with $10,000 in the market at the start of the crisis would have $17,700 to show for it by 2019, excluding any dividends received. Stock-market prices rose in lock-step with Fed decisions about the size of its portfolio – its growing portfolio makes safer assets scarce – and the ultra-low U.S. interest rates, which

make it virtually impossible for investors to earn a sufficient return from holding the remaining safe assets they can find. Average savers have little recourse to the stock market since even those with 401(k)s or other investment portfolios do not derive our wealth from these investments. For most Americans, once home ownership spurred middle-class wealth, but the great financial crisis took care of that. Now the only engine of wealth accumulation for those who don't have large stock portfolios is savings, but that engine is in reverse.

Starting also in 2007, $10,000 in a bank deposit earning the usual compounded interest rate of 0.50 percent would have only $10,615 or six percent return to show for it after twelve years. Add in a two percent inflation rate – again about right given the high costs of post-crisis consumption – and our thrifty saver has only $8,522 – i.e., in real terms, a loss of fourteen percent. This isn't the saver's fault – it's the Fed's for allowing rates to fall so low that average households can't save for the future no matter how hard they try.

The To-Do List

After initial success calming the crisis, U.S. monetary policy since 2010 has demonstrably boosted equity prices, not output.[11]At the same time, U.S. interest rates have hovered just about zero in real terms and could soon join other nations in a race below what now seems quaintly called the zero lower bound. All this has made wealth management an earnings bonanza, but yield-chasing, the lack of structural corporate investment, and weak loan demand have all wreaked havoc with large- and regional-bank franchise values.

Each of your banks is a good deal safer now than it was in 2007, but market capitalization remains highly problematic even as Big Tech platform companies are cherry-picking what were once core intermediation and infrastructure activities. Bankers thus share a common interest with low-and-moderate income households: they will also do better if the Fed normalizes its portfolio and restores rates to levels at which net interest margins are meaningful.

But bankers have something LMI households lack: a voice to which the Fed listens and advocacy through ABASA with which to ensure you are heard.

The first to-do, then, is to step back from day-to-day regulatory rewrites also to consider the post-crisis construct and take an active role also in changing policies that increase inequality in ways that damage your bank's prospects and financial stability as a whole. I don't have time now to discuss the repo-market crisis, but this epitomizes the collision of post-crisis monetary policy, the new regulatory framework, and the switch of financial markets from intermediation to complex, leveraged products with no equality impact.

Another to-do is to determine the extent to which your bank can support ESG investment as a core business activity, not just a do-good corner for asset-management clients. You all know the pressure now to focus on green bonds and other environmental activities. Let me bring to your attention another ESG opportunity: developing new financial instruments to speed the treatment and cure first of blindness and then of other diseases and disabilities. My husband and I have been working on this for several years, with legislation now pending in Congress (H.R. 2620) to make this a reality. We need your help.

Finally, let's think through the concept of equitable capitalism. Stakeholder capitalism would make your banks more responsive to communities other than institutional shareholders, but which communities and how?

I've worked hard to think through new charters for what I'll call an "Equality Bank." But all I can do is design one – you could build it either alone or as an industry initiative.

All of these ideas align profit and purpose to what I think would be considerable equality effect. Each of your companies does what it can in the communities you serve, but charity won't cut it anymore. We need to align equality-focused activities with core strategic objectives first by redesigning the post-crisis policy framework and secondly by standing up to institutional responsibility.

There's a lot of talk these days about innovation as a way to advance financial inclusion. This should mean more than a new app on a mobile phone. New charters, new products, and a new goal – equitable capitalism – will make far more of the difference we need now. The electorate is very angry and a good deal of that is aimed at large banks. If we don't build out an equitable capitalism vision, I fear we'll face prescriptive socialism.

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[1] FRB Gov. Lael Brainard, "Is the Middle Class within Reach for Middle-Income Families?," (speech, Washington, D.C., May 10, 2019), available at https://www.federalreserve.gov/newsevents/speech/brainard20190510a.htm#fn16.

[2] Carlotta Balestra and Richard Tonkin, "Inequalities in household wealth across OECD countries: Evidence from the OECD Wealth Distribution Database," *Organization for Economic Co-operation and Development (OECD) Working Paper No. 88*, 14-15 (June 20, 2018), available at http://www.oecd.org/officialdocuments/publicdisplaydocumentpdf/?cote=SDD/DOC(2018)1&docLanguage=En.

[3] OECD, *Under Pressure: The Squeezed Middle Class*, April 10, 2019, available at https://www.oecd.org/els/soc/OECD-middle-class-2019-main-findings.pdf.

[4] Alissa Quart, *Squeezed: Why Our Families Can't Afford America*, New York: HarperCollins, 2018.

[5] Kuhn, Schularick, and Steins, "Income and Wealth Inequality in American, 1949-2016," *op. cit.*

[6] U.S. Census Bureau, "American Community Survey Provides New State and Local Income, Poverty and Health Insruance Statistics," *U.S. Census Bureau Press Release Number CB19-152*, (September 26, 2019), available at https://www.census.gov/newsroom/press-releases/2019/acs-1year.html.

[7] Board of Governors of the Federal Reserve System (FRB), "Distribution of Household Wealth in the U.S. since 1989: Wealth," *FRB Distributional Financial Accounts*, (2019:Q2), accessed October 7, 2019, available at https://www.federalreserve.gov/releases/z1/dataviz/dfa/distribute/table/.

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[9] FRB, *Report on the Economic Well-Being of U.S. Households in 2018*, *op. cit.* at 21.

[10] David C. Radley, Sara R. Collins, and Susan L. Hayes, *2019 Scorecard on State Health System Performance*, The Commonwealth Fund, 4 (June, 2019), available at https://scorecard.commonwealthfund.org/files/Radley_State_Scorecard_2019.pdf.

[11] Dietrich Domanski, Michela Scatigna and Anna Zabai, "Wealth Inequality and Monetary Policy," (March 6, 2016), available at http://www.bis.org/publ/qtrpdf/r_qt1603f.htm.