1 Feature Article

Central Banking and Inequality: The Current State of the Conversation

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HIGHLIGHTS

- **Monetary policy has a short-run and possibly medium-run impact on inequality. In the long run, the distributional impact is not clear.**
- **Incorporating inequality into policy deliberations may help achieve a more effective monetary policy.**

Introduction

For a long period, "benign neglect" characterised the attitude that central bankers displayed towards inequality (Monnin, 2014). Traditionally, the mandates of central banks and inequality are considered to be independent of each other.

However, since 2011, frequent statements have been made that seem to suggest that a rethinking of monetary stance on inequality may be needed (Monnin, 2014)[1]. For example, in October 2014, Yves Mersch, a member of the European Central Bank (ECB) Executive Board, asserted that "all economic policy-makers have some distributional impact as a result of the measures they introduce – yet until recently, such consequences have been largely ignored in the theory and practice of monetary policy." Figure 1 provides a timeline of milestones that may explain the recent popularity of inequality among central bankers.

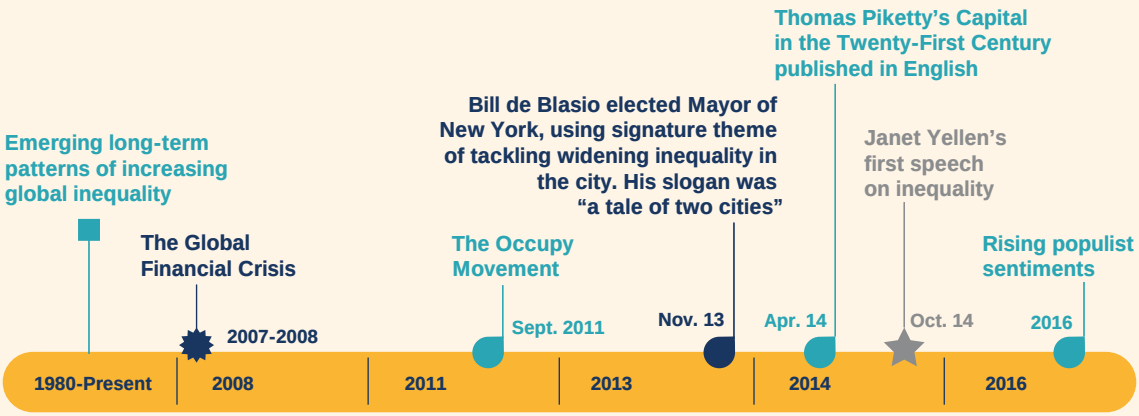
Building on the work by Monnin (2014), this article reviews selected studies and statements by officials of three major central banks – the Fed, the Bank of England (BOE) and the ECB – on the interaction between central banks and inequality. The findings can be summarised into the following three questions[2]:

- Does monetary policy influence inequality?
- Should central bankers consider inequality in their monetary policy deliberations?
- How can a central bank address inequality?

[1] Ibid. Note: Among major central banks, statements about inequality are especially more frequent after Janet Yellen, at a conference organised by the Boston Fed in October 2014, spoke about inequality. It marked her first speech as chairwoman focused exclusively on inequality. Nevertheless, she did not make any links between this issue and monetary policy.

[2] These questions are adapted from ones discussed in Monnin (2014).

Figure 1: Factors contributing to the rising popularity of inequality



1) Most central bankers acknowledge that monetary policy has a short-run and possibly medium-run impact on inequality. The long-run effect, however, is subject to debate.

The mechanism in which monetary policy affects inequality depends on several factors; namely the current distribution of assets between the rich and the poor; and the responsiveness of households and firms towards changes in the monetary policy stance.

In an environment of loose monetary policy and rising inflation, a low interest rate environment will benefit net borrowers while reducing the rate of returns on savings. As such, the short term impact could be to widen the income gap if the rich are net borrowers while the poor are net savers. Furthermore, if loose monetary policy fuels asset prices, the rich who tend to own more assets than the poor and middle classes, would also disproportionately gain from higher asset prices. Over the medium-term, however, an accommodative stance will lead to a reduction in unemployment. If labour market outcomes (wages and employment prospects) become relatively more favourable for the poor, then income inequality may narrow.

In the long run, things are less clear. Would the above distributional effects cancel each other out, such that there is no long-run distributional impact of monetary policy? Or, would they reinforce each other, in which case, monetary policy is responsible for the rising long-term trend in inequality. Below are selected statements made by representatives of major central banks and the IMF on this issue:

Bank of England (2014 and 2016)

- Over the shorter term, central bank policies can affect inequality; for example through extraordinary monetary accommodation which has boosted asset prices and exacerbated inequality.
- However, the tools at the disposal of central banks; i.e. interest rates, money supply, regulations cannot reshape the long-term structural trends in the economy.

ECB (2016)

- Over the medium-term, monetary policy reduces unemployment, which benefits poorer households the most. A faster return to full employment should, in turn, contribute to lower future inequality.

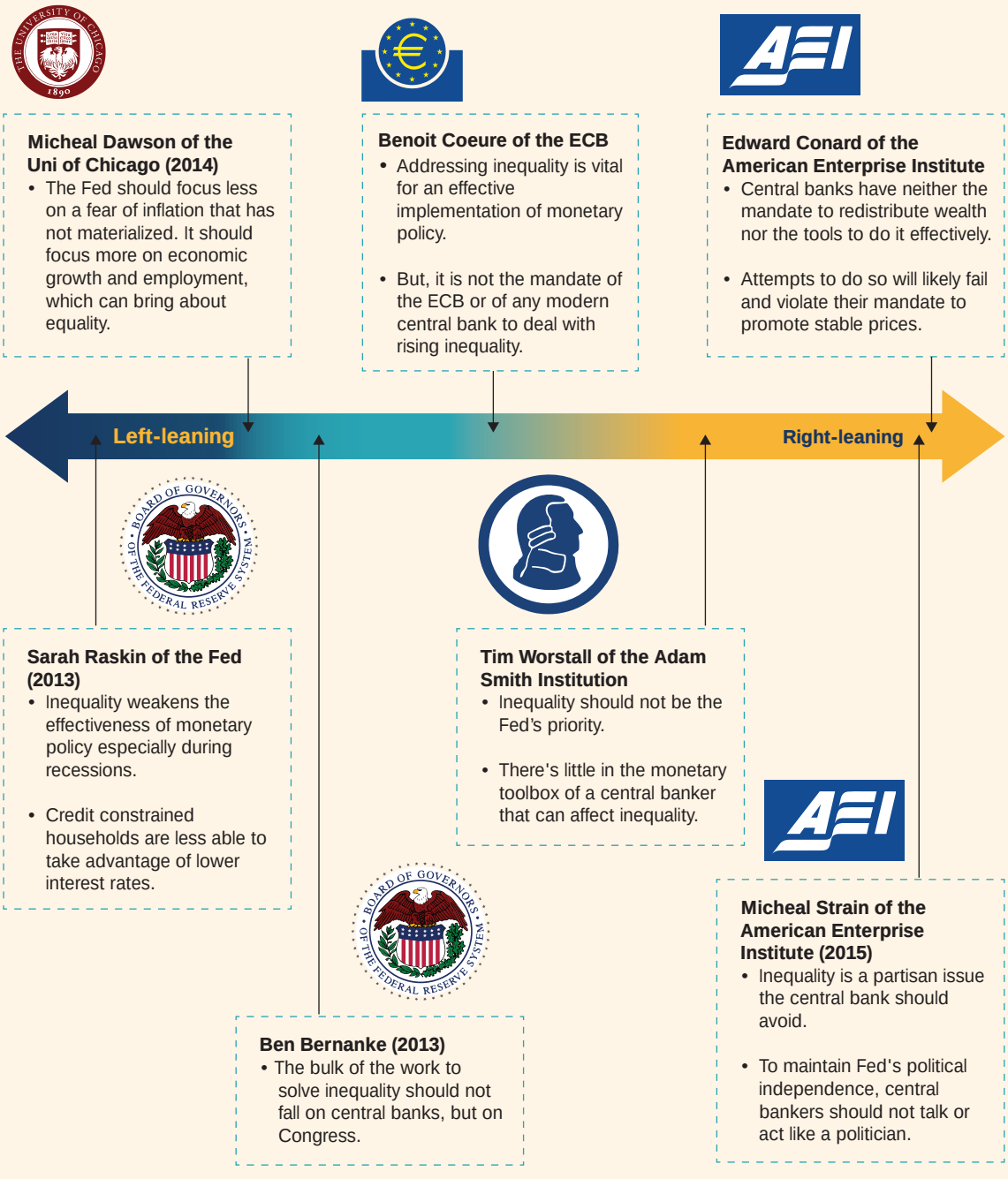
The IMF (2012)

- Monetary policy shocks play a significant role in cyclical fluctuations in inequality, but cannot account for the increasing trend in income inequality.

2) Incorporating inequality into policy deliberations is generally agreed to help achieve a more effective monetary policy. Incorporating inequality into a central bank's mandate however, is perceived as radical.

Figure 2 shows the views of select policy-makers and scholars along their partisan lines. Left-leaning policy-makers and scholars have advocated for greater scrutiny of inequality in monetary policy deliberations. Those on the right have preferred for central banks to focus on its traditional mandates. There is a general agreement that inequality dampens the transmission of monetary policy. Despite this, there is a broad sense of reluctance for the existing mandates of central banks to be revised to include an additional goal of curbing inequality.

Figure 2: Statements on whether inequality should be considered in monetary policy deliberations across political spectrum



3) Central banks have limited tools (e.g. regulatory policies) which are at best indirect, incidental and transient in redistributing wealth. But, as long as achieving their traditional mandates is not compromised, they could consider the distributive effects of their policies.



Janet Yellen (2017)

- Monetary policy cannot boost real GDP growth over the longer run or address the root causes of income inequality.
- But, the Fed still has a vital role to play in addressing issues around economic opportunity and inclusive growth.

BROOKINGS

Brookings Institution (2015)

- Monetary policy is blunt and its distributive effects are not clear. But this should not prevent the Fed from pursuing its mandate to achieve maximum employment and price stability, thereby providing broad benefits to the economy.



Joseph Stiglitz (2014)

- Central banks should be bolder in their regulatory role to help tackle inequality. For example, they can work towards preventing abusive credit card practices, usurious interest rates, and predatory and discriminatory lending, which are especially costly to the poor.



Fontan et al (2016)

- Central banks could address inequality in two ways:
  - o Using distributive concerns as tie-breakers. If a central bank can choose between two policies that perform equally well with respect to its mandates, it should choose the more equitable policy.
  - o Revising the existing mandates of central banks to include a permanent objective of curbing inequality.

Bank Negara Malaysia has been mindful of the implications of policy on inequality and its distributional consequences on various segments of the economy. In this regard, the Bank has ensured that the mandate on financial inclusion remains on track. In addition, the Bank has carried out specific research on affordable housing and the impact of debt on inequality to get a better grasp of the issues faced by the households. Granular data analysis, for example on the distribution of wealth by age groups and income groups, is used extensively to deepen understanding on the distributional impact of monetary policy.

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2 Feature Article

The Sharing Economy – Harnessing the Value of Idle Assets

Author: Ang Jian Wei

HIGHLIGHTS

- The 'sharing economy' is a system that reduces asset or resource underutilisation for monetary or non-monetary benefits.
- Malaysia ought to embrace the sharing economy but with appropriate safeguards.
- Clear and coherent policy stance is important for a vibrant sharing economy industry.

Introduction

The sharing economy has disrupted many traditional means of doing business and will grow further in prominence. Its rapid development has drawn both sharp critics and strong supporters alike. By 2015, there were already 17 sharing economy firms globally with valuations of more than USD1 billion. This is impressive since many of these companies were only formed during the Global Financial Crisis[1]. The sharing economy's global revenue is projected to grow from USD15 billion in 2015 to USD335 billion in 2025[2]. If harnessed correctly, the use of technology to better unlock the value of idle assets can improve economic efficiency and provide other means for households to increase their income.

What is the sharing economy?

The 'sharing economy' is a system that reduces asset or resource underutilisation for monetary or non-monetary benefits with three major characteristics. Firstly, it is usually driven by digital platforms that match both demand and suppliers of goods and services. Secondly, it promotes access rather than a change in ownership. Thirdly, it provides other means for households and businesses to monetise their underutilised assets and resources (Figure 1). The sharing economy typically spans the transportation (e.g. ride-sharing), space (e.g. accommodation), goods and the intangibles (e.g. skills, time) industries (Figure 2).

New Frontier with Benefits to the Economy

Technology has helped reduce transaction costs, thus making the sharing of assets much easier, cheaper and larger in scale. This has led to new job opportunities, more efficient ways of using resources and more innovative means of doing business.

Jobs in the sharing economy can be appealing to households as some may have lower barriers to entry and flexible hours that allow them to work around their commitments. This flexibility is well suited for groups like students, working professionals or seniors that have resources that can be monetised. For example, seniors can use property assets to earn additional income. Airbnb reported that seniors are its fastest-growing host demographic, with 10% of its hosts being over the age of 60[3]. These jobs can also provide crucial support especially in tough times. Around 26% to 42% of those surveyed in the US and five European countries are engaged in independent work out of necessity[3].

[1] Owyang & VB Profiles (2015), "The Sharing Economy has Created 17 billion-dollar Companies (and 10 unicorns)"
[2] PWC, 2016, "The Sharing Economy"
[3] McKinsey Global Institute (2016), "Independent Work: Choice, Necessity, and the Gig Economy"

Figure 1: Characteristics of the Sharing Economy

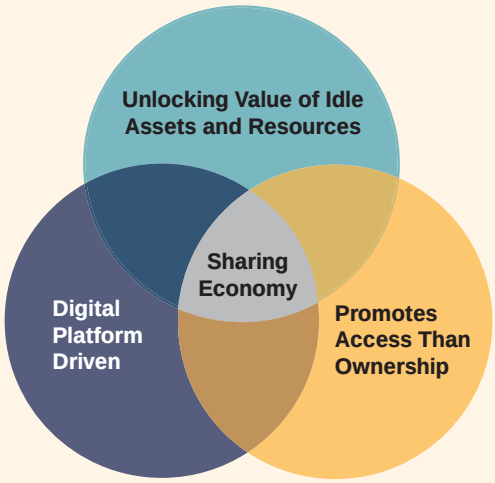
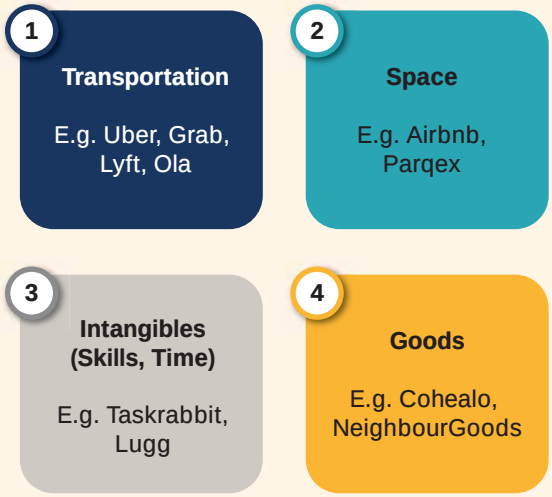


Figure 2: Main Industries Under Sharing Economy



The sharing economy can also help unlock the value of idle assets and improve economic efficiency. One example is the inefficiencies in mass private car ownership. Estimates suggest that cars, on average, are parked 95% of the time[4]. Increasing the usage of these private vehicles by integrating it with the current public transportation system (e.g. to address the last-mile challenge) can help households reduce their transportation-related spending. This concept can be further extended to other industries, be it underutilised space, time or skills.

Another positive spillover is the dynamism that sharing economy players bring to the economy through greater competition. Increasing competition from sharing economy firms has prompted many incumbents to relook into their existing business models and find more ways to bring value to their customers. Consumers also benefit from more options and lower prices. For example, Airbnb's rates are between 30 and 60 per cent cheaper than hotel rates around the world[5]. This helps drive tourism activity by appealing to budget travellers. Competition also leads to better quality services and more efficient allocation of resources.

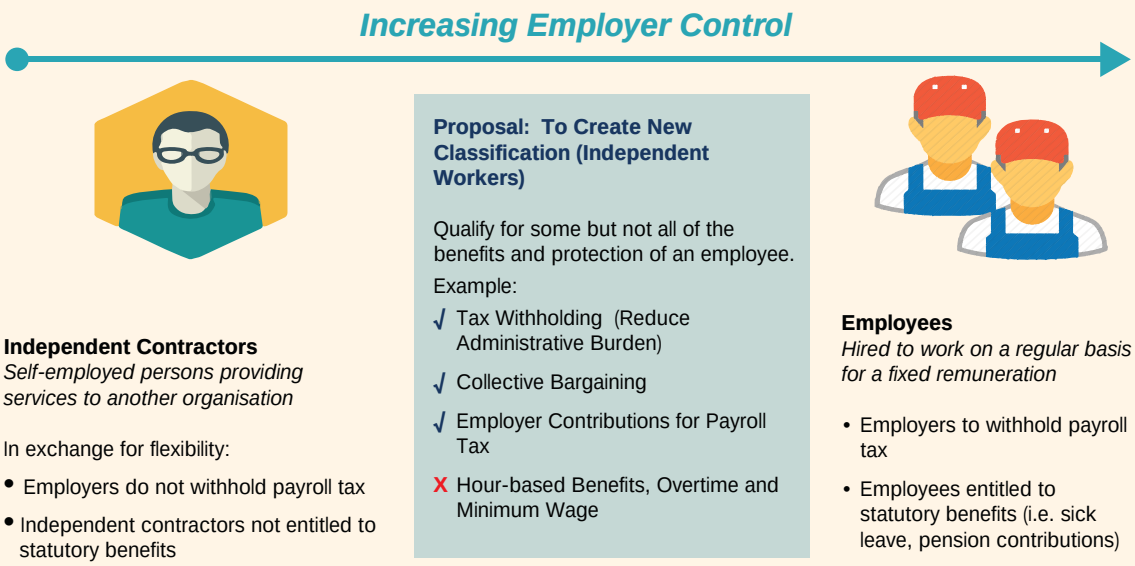
Embrace But With Appropriate Safeguards

Malaysia should embrace the sharing economy, but should be mindful of the risks that it poses.

The first risk is the dispute on the legal classification of service providers who participate in these platforms. Currently, a majority of sharing economy players are platforms matching supply and demand, with its service providers being classified as 'independent contractors' as opposed to 'employees'. Some platforms can use this as a means to shift liability responsibilities onto the providers and avoid the payment of statutory benefits[6] (e.g. paid sick leave, retirement contributions), while expecting a commitment no different than that of an employee. This has resulted in various litigations in the US and the UK. As a response, there are proposals for a new middle classification: 'independent workers'[7], where service providers will qualify for some, but not all of the benefits that employees receive (Figure 3).

[4] Barter, Paul (2013), "Cars Are Parked 95% of the Time. Let's Check!" This number originally refers to the United States, but the author did some cross country comparison and found that the numbers are also in that ballpark: Singapore (95%), UK (96.5%), Seoul (92.3%).
[5] Yaragi & Ravi (2016), "The Current and Future State of the Sharing Economy."
[6] Honor, Michelle (2016), "The Uncertainty of Worker Misclassification in the Sharing Economy"
[7] Harris & Krueger (2015), "A Proposal for Modernizing Labor Laws for Twenty-First-Century Work: The Independent Worker"

Figure 3: Classification of Workers



Another risk pertains to the welfare of both the consumers and providers of goods and services. Consumers need to have some confidence that the goods and services bought over these platforms are of a reasonable standard, and that safety will not be compromised. Likewise, providers should have some assurances that any assets shared will not be mishandled and that the payment is as agreed. In the event where expectations are not met, there should be well-established procedures for fair compensation. Timely reputational ratings will help reduce information asymmetry and have been used as a case for fewer regulations. However, they are also exposed to risks of collusion and reciprocity.

There is also a concern that there might be an erosion to the tax base and an unfair advantage against the incumbents should sharing economy players avoid paying their fair share of taxes. As a start, a clear taxation threshold should be set such that casual earners are not unduly penalised. This can then be complemented by raising awareness among the sharing economy participants on their tax obligations. The tax authorities in the US and Australia have taken the lead by launching a dedicated website to engage them. The sharing economy platforms should play a part in collecting tax on the Government's behalf, such as the arrangement between Amsterdam and Airbnb[8].

Policy Considerations

For the sharing economy to thrive in Malaysia, there will first need to be a clear and coherent policy stance. Positive signalling across the various industries, be it transportation or home sharing, will encourage both investments and participation by investors and the public, respectively. Given the wide-ranging issues, the Government will likely need to adopt a consolidated approach to work through the various concerns. The Government can also take this opportunity to engage sharing economy players in further enhancing the efficiency of public sector operations (e.g. running errands, survey collection). It can also explore other means to better utilise its idle assets (e.g. underutilised meeting rooms and car fleets) as adopted in the UK and Seoul.

[8] Airbnb (2014), "Airbnb to Collect Tourist Taxes in Amsterdam"

While the reaction of other policymakers towards the sharing economy remains mixed, there is a trend towards greater acceptance over time. It is a growing recognition that it is worthwhile to strike a balance such that the gains from the sharing economy are maximised, while the risks are managed accordingly. Malaysia too, should not shy away from the frontiers in the digital space. Rather, it should work towards building an edge in these new growth areas.

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