U.S. DEPARTMENT OF THE TREASURY

# Remarks by Secretary of the Treasury Janet L. Yellen on Economic Lessons and Principles in Relief and Recovery

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WASHINGTON - Secretary of the Treasury Janet L. Yellen delivered remarks at the Brooking's Hamilton and Hutchins Center event Recession Remedies: Lessons Learned from the US Economic Policy Response to COVID-19.

*As Prepared for Delivery*

I'd like to thank the Hamilton Project and the Hutchins Center for hosting this important conference. I am especially honored to participate in today's event with former Treasury Secretary Bob Rubin. And I congratulate the authors of the volume on recession remedies for assembling a thoughtful collection of essays. This book is a useful guide for policymakers preparing to address future economic challenges.

Like many of the scholars engaged in this two-day event, I am no stranger to business cycles. My career has spanned three years at the Council of Economic Advisers and almost two decades at the Federal Reserve. Over this period, the U.S. has experienced seven recessions—varying in origin from a financial crisis to the bursting of the tech bubble to a global pandemic.

Beginning in the mid-1980s, economists observed what they called the "Great Moderation." Many hypothesized that a combination of structural economic changes coupled with monetary policy innovations had permanently dampened the business cycle. Unfortunately, the financial crisis of 2008 and the ensuing Great Recession dashed that hope. Economies remain vulnerable to major shocks. Most recently, the global pandemic, and now Russia's invasion of Ukraine, underscore the likelihood of large economic shocks and disruptions that must be addressed. Downturns are likely to continue to challenge the economy.

Recessions exact heavy tolls. For example, the average output loss during the last seven recessions is roughly 3.2% of GDP. Excess unemployment—unemployment in excess of the estimated natural rate—during the ensuing recoveries averaged about 4.5 percentage points. Moreover, deep and long-lasting recessions appear to permanently lower the path of potential output. Thus, entirely appropriately, policymakers typically seek to mitigate these costs by implementing policies designed to ignite a quick and strong recovery. That is one of the most important responsibilities of policymakers and has been a central focus of the Biden Administration since the outset.

Accordingly, my remarks today will focus on the current recovery. And I will highlight some "lessons learned" for recovering from future recessions.

A first observation is that, conditional on the inevitability of large negative shocks, countries will fare better if their economies are more resilient and less fragile. Research that improves our understanding of the transmission channels of disruptive shocks can improve our resilience. Improved understanding of breaks in supply chains, increases in commodity prices, bursting of asset bubbles, and labor and productivity shocks can help policymakers implement reforms that bolster our economic resilience.

To take one example, a wealth of research preceding the financial crisis of 2008, but not sufficiently appreciated at that time, has now given policymakers a much better understanding of the linkages between financial markets and the real economy. It explains how risks to financial stability emerge and how policymakers can monitor the economy to detect growing threats in real time. Importantly, it explores financial regulations that are needed to diminish financial stability risks. In the aftermath of the 2008 financial crisis, the Dodd-Frank Act mandated new regulations intended to diminish financial sector fragility. Far more stringent capital and liquidity standards were imposed on America's largest and most systemic banks.

The effectiveness of these measures was tested during the pandemic. They enabled America's banks to weather the pandemic shock while meeting the credit needs of a recovering economy. But the crisis also revealed that significant vulnerabilities in the nonbank financial sector had not been addressed, and, consequently, the Financial Stability Oversight Council and the Biden Administration are working to mitigate these remaining threats.

In recent weeks, energy price movements have been another significant source of global economic shocks. The Biden Administration's proposed energy agenda is designed to diminish our reliance on fossil fuels and help achieve greater energy independence. These shifts will mitigate our future vulnerability to oil price shocks. At the same time, they will abet the transition to cleaner energy sources which will, in due course, lessen the risks tied to natural disasters and climate change. Over the long run, such measures will reduce volatility while also lessening the depth of future recessions.

In addition to improving the resilience of the economy to shocks, it is imperative to build and maintain an effective and efficient set of recession remedies—recovery policies that shorten the duration of recessions and mitigate economic pain. The construction of these recovery policies must be informed by lived experience and rigorous evaluation of prior approaches, including those employed to address the economic devastation of 2020 and the beginning of 2021—which is, of course, the central focus of this convening.

I will offer some reactions to the newly released volume. And I will suggest some further guiding principles for recovery policy. But let me first pause to reflect on the current recovery and the progress that has been made over the past year and a half.

From a historical perspective, it is important to emphasize that we have already witnessed a rapid recovery buoyed by a substantial government response—beginning with the CARES Act at the start of the pandemic, and continuing with the Consolidated Appropriations Act in late 2020, and the American Rescue Plan enacted in early 2021. These federal fiscal actions were complemented by an unprecedented response by the Federal Reserve along with relief instituted by national and subnational governments and central banks abroad.

These responses played major roles in igniting a robust recovery. Notably, the American Rescue Plan played a central role in driving strong growth throughout 2021, with the United States real GDP growth outpacing other advanced economies and our labor market recovering faster relative to historical experience. This has meant diminished scarring and less human suffering. Even through Delta and Omicron—and now a global supply shock due to Putin's unprovoked actions in Ukraine—the Rescue Plan has allowed our economy to face unknown risks from a position of strength.

As we retrospectively evaluate the merits of this approach, it is important to keep in mind two key factors that influenced the chosen response.

First, these policies were adopted under conditions of substantial uncertainty. Throughout 2020, and into 2021, the path of the pandemic, including its severity and the role of future viral strains could not be predicted. Given this uncertainty, the recovery packages sought to protect against tail risk. They were not just tailored to address the median outcome. Let me be clear: the tail risk in 2020 and 2021 was a downturn that could match the Great Depression.

It is fairly easy to evaluate policies ex post. But it is important to remember the dire economic projections prevailed throughout the early days of the pandemic. In a survey conducted in the spring of 2020, 37 percent of small business owners expected to be closed by year's end. Zillow's baseline scenario for the housing market was a 60 percent decline in sales with no price appreciation across 2020 and most of 2021. In mid-2020 the Congressional Budget Office projected that the unemployment rate would average 9.3 percent over 2021. And, even in early 2021, the labor market recovery had stalled and the Blue Chip consensus projected years of elevated unemployment. These were not worst-case scenarios, but rather baseline projections. Tail risk scenarios were much worse.

Second, the scars from the Great Recession were still quite fresh. Less than a decade earlier, the United States had lived through an extended, and oftentimes slow, economic recovery in which Americans became detached from the labor market, lost homes en masse, entered bankruptcy and debt collection at alarming rates, and endured scarring that would last a lifetime. Policymakers understood the imperative of exiting the downturn as quickly as possible and ensuring that support reached those workers and households at greatest risk of that scarring.

These factors influenced the design of the policies that were implemented. Moreover, as has occurred in times of crisis, it is evident that some policy approaches presented significant implementation challenges throughout the pandemic. These factors highlight the need for reform of our recovery infrastructure.

In this vein, the Hamilton and Hutchins volume seeks to learn from recent experience and identify key lessons for policymakers. It is an important effort, and there are many critical lessons to be gleaned from these studies. I'd like to highlight a handful of points that I consider particularly salient.

Ganong, Greig, Pascal, Sullivan, and Vavra argue that unemployment insurance modernization is critical. I strongly agree. In their words: "The trade-off between speed and accuracy does not have to exist." In that regard, recent actions taken by the Labor Department to modernize unemployment insurance by preventing fraud, improving access, and reducing backlogs represent meaningful progress and are key steps.

Gelman and Stephens helpfully explain that stimulus payments can be an effective mechanism for injecting cash into the economy quickly, but we must also continue to study the interplay between cash support and the social safety net. The authors note, for example, that with long delays in the receipt of unemployment insurance and significant earnings losses even for workers who retained employment, rapid receipt of cash assistance served as a partial offset. But better understanding of these interactions will help us pinpoint when and how cash assistance should be delivered.

Willen, Gerardi, and Lambie-Hansen rightly assess that mortgage forbearance relief was a successful element of the relief effort and a promising approach in future recovery packages, although it was neither costless nor a panacea. Throughout the pandemic, the combination of forbearance relief and the support from Treasury's Homeownership Assistance Fund has provided an important tool to preserve housing stability for American homeowners at risk.

Following Goodman and Wachter, the crisis has exposed the need for a more permanent rental safety net. Housing stability is a foremost concern not just in downturns, but in recoveries as well. During this crisis, Treasury was at the forefront of establishing—for the first time—a national effort at scale for rental assistance. Emergency Rental Assistance has not only helped to keep evictions below their pre-pandemic levels, it has also enabled states and localities to build an infrastructure for rental assistance going forward.

Finally, Aizer and Persico surmise that the rapid and sizable policy response will have long-term payoffs in terms of childhood outcomes including nutrition, health, and academic achievement. Indeed, I predict that researchers will establish that the Biden Administration's expanded Child Tax Credit increased childhood wellbeing during this crisis.

The preceding lessons come from interventions associated with the 2020 recession. There are also general lessons from the pandemic experience and from past recessions.

First, it is imperative to address the specific source of crises. In 2008, recovery would have been impossible without recapitalizing and restoring confidence in the banking system. In 2020, in contrast, recovery was tied to the progress of the pandemic. Vaccine dissemination has been the most important element of the response. Other crises will have different origins. It will be critical to address their root cause.

Second, we must consider equity. Downturns are often most destructive for the most vulnerable neighborhoods and populations, and especially communities of color. The American Rescue Plan made sure that funds reached those communities with the most serious damage. That included, for example: flexible rental assistance programs that did not exclude the neediest renters because of overly stringent documentation requirements; targeted outreach in a range of languages; and state and local funds used for investments targeted to communities especially vulnerable to the pandemic.

Third, effective automatic stabilizers—called "workhorse antirecession programs" in the 2019 book Recession Ready—are perhaps the most important policy tool, which is why President Biden proposed them in his original Rescue Plan proposal. Every recession in recent decades has reinforced the need for a flexible, automatic response.  Well-designed automatic stabilizers are the best remedy.  Preparing for the next recession means not only improving existing stabilizers but expanding their reach to other forms of social support and building the “pipes” to distribute relief in a timely manner.

Fourth, it is necessary to preserve attachment to the labor force in an economic downturn.  As a hangover from the Great Recession, the long-term unemployed and those out of the labor force continue to suffer its scars.  While we need more work to best target our policy response, in recent years we’ve worked with multiple new policy levers to keep workers on payroll and off long-term unemployment.  And the strength of the American Rescue Plan has no doubt contributed to the record fall in long-term unemployment—a strong and positive contrast to the lingering high numbers of long-term unemployed that we saw after the Great Recession.

Fifth, policymakers must support basic human needs, including housing, health care, and nutrition.  Denial of access not only results in immediate suffering, but also has long-term consequences as well.  Programs like the Biden Administration’s expanded Child Tax Credit and Economic Impact Payments provided umbrella support for these needs, but more targeted in-kind relief can also be an effective tool.

Lastly, we need to invest in measurement, oversight, and accountability to improve impact.  Economists and other researchers need high-quality, high-frequency data to assess the depth of recession in real time and to adequately evaluate the success of policy interventions.  The rapid onset of the pandemic recession dramatically highlighted the need for better data.  And despite admirable creativity by researchers in 2020 to assess the state of the economy, we must invest now in better tools for monitoring.  Similarly, comprehensive oversight and accountability safeguards—designed in advance—are necessary to ensure that public resources are appropriately deployed.

In conclusion, I commend the Hamilton Project, the Hutchins Center, and the contributing authors for this important volume.  Legislation over the past two years, unprecedented in size and scope, was informed by a rich literature directed at improving recovery policies. The pandemic’s toll would have been much worse if not for policy response informed by careful study.  The research and insight presented in this volume will help guide America through future recessions.  On behalf of the millions of Americans whose lives will be affected, I thank you.

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