EconoFact Chats: Recovering from Economic Crises

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Michael Klein:

Hello, everyone. Welcome to EconoFact Chats. I'm Michael Klein, Executive Editor of EconoFact, a nonpartisan web-based publication of The Fletcher School at Tufts University. At EconoFact, we bring key facts and incisive analysis to the national debate on economic and social policies, publishing work from leading economists across the country. You can learn more about us and see our work at www.econofact.org.

Michael Klein:

We're recording this on the last Friday of May 2020. Yesterday, the new data for initial unemployment claims came in, and the economy has lost 40 million jobs in the last 10 weeks. How do we resolve this? Well, today, we're very excited to kick off this inaugural episode of EconoFact Chats with Dan Sichel. Dan is a Professor of Economics at Wellesley College. Before joining Wellesley in 2012, Dan worked for more than 20 years at the Federal Reserve Board, and he served on the senior management team during the economic and the financial crisis that began in 2008. Welcome, Dan.

Dan Sichel:

Thanks. Good to be with you, Michael.

Michael Klein:

Good to have you. So, Dan, I'd like to draw on your policy experience and your research, and also the memos that you've written for EconoFact, to talk about the economics of the current COVID-19 crisis, and especially the resolution of the crisis. As you know, recently, the Chairman of the Federal Reserve, Jay Powell, said that the scope and the speed of this downturn are without modern precedent. And there's a famous saying, sometimes attributed to Mark Twain, that history doesn't repeat, but it rhymes. So, does 2020 rhyme with 2008, Dan?

Dan Sichel:

It does rhyme with 2008. In both cases, there was a very sudden drop in economic activity, big run up in the unemployment rate. This time around a little faster, actually a lot faster and sharper, but it definitely rhymes of an economic crisis.

Michael Klein:

So, in 2008, there was a pretty clear marked point when the crisis began, which was, for 10 points, Dan?

Dan Sichel:

That would be Lehman Brothers.

Michael Klein:

Right, right. In the Great Depression, for another 10 points.

Dan Sichel:

That would be the stock market crash in 1929, followed by a banking crisis. I hope I got bonus points for that one.

Michael Klein:

Yeah, sure. Okay. That's fine. But then, for 50 points, this crisis. It's not so easy is it?

Dan Sichel:

It's not so easy. It developed a bit more slowly. I think in terms of economic crisis and the financial hit, think the pivot point is really mid-March. That was the point when states started shutting things down, when businesses started shutting down. And on March 15th, the Federal Reserve had a very important meeting, they had a meeting scheduled for a few days later, they pulled it forward, made it virtual, did some really dramatic things. Definitely got the attention of Main Street and Wall Street.

Michael Klein:

The meeting they were supposed to have was their every six week Open Market Committee meeting, right?

Dan Sichel:

Yeah, that's right.

Michael Klein:

How unusual is it to actually change the date of that or to move it just a few days in advance?

Dan Sichel:

So, in normal times they wouldn't do it, but in times of crisis or rapidly evolving events, there's plenty of precedent for it. They did that many times in the period around the financial crisis.

Michael Klein:

They had these special meetings, because events became particularly acute. Of course, there are these financial moments that were well-defined and you could look at bond prices or stock prices. Here, it was a little less clear, wasn't it?

Dan Sichel:

Yeah. Although, certainly, since the economic shutdown got underway, the stock market fell very dramatically. There are a lot of stresses and disturbances in credit markets as well, some of that has been reversed.

Michael Klein:

Right. But the stock market is not the economy, as we're told time and again.

Dan Sichel:

And that would be a correct thing to say.

Michael Klein:

Right. So, continuing with the rhyming theme, are there any lessons from how we got out of the Great Depression of the 30s or the Great Recession that began in 2008 that we might be able to draw on for today?

Dan Sichel:

Yeah, I think there are. I would say there are two things that are important for getting past the acute phase of a crisis. One is solving the underlying problem. Banking crisis in 1929, financial crisis in 2008, this time around the health crisis.

Michael Klein:

So, the health crisis, I mean, that's really different though, right? Because, I mean, the Federal Reserve can't send out vaccines, but it can try to fix the financial system.

Dan Sichel:

Absolutely. That just highlights the degree of uncertainty around this episode or how important it is to fix the health crisis. In the Great Depression, stock market crash of 1929, the issues around the banking system weren't resolved until 1933, so it took a long time because they didn't resolve the underlying crisis. So, we're really going to have to get to a point where the health crisis gets resolved before we're going to solve the economic crisis.

Michael Klein:

So, Roosevelt comes in after the election, the inaugurations are actually later at that time in our history, he comes in and says, "The only thing we have to fear is fear itself." Now we have more to fear, don't we?

Dan Sichel:

Well, I think we have fear to fear. I think we also have a pandemic to fear, and, again, that just highlights the importance of, with a vaccine and other public health measures, getting that under control.

Michael Klein:

Right. But in both cases, I guess, it's people's feelings about the economy that are going to become really important for the path that the economy takes.

Dan Sichel:

Yeah. In 1933, in the Great Depression, people didn't put money back in banks until they gained confidence in banks, and I'd argued today, people aren't going to fully engage in economic activity until they feel that it's safe to be out and interacting with other people frequently.

Michael Klein:

Yeah. I've heard this period called the great lockdown, but I prefer to call it the great shutdown, because lockdown implies that people are doing it only because the government says, but what we've seen is even when places open up, it's not necessarily the case that people are going to go out and go to ballgames or movies or restaurants or shopping malls.

Dan Sichel:

Yeah. I think that's a really good distinction. I think it's easy to make the case that somehow state governments issuing stay-at-home orders is the cause of the economic slow down, it's really not, it's the virus. What the states are doing is just a response.

Michael Klein:

So, returning to the resolution, the Fed was famously blamed for deepening the Great Depression because of its policies, and then now many economists think that the Fed was really at the center of, even though it was a tepid recovery, the recovery from the financial collapse in the fall of 2008, which could have been much, much worse than it was. The Fed has sort of taken a central role today in the policy response to the crisis. Do you see any parallels between what it did in the financial crisis in the fall of 2008 and what it's doing today?

Dan Sichel:

Yeah. There are a lot of parallels. I think really the Fed is following the playbook that was developed in the financial crisis. One thing that's interesting is they've really added some chapters to the playbook, because they have gone further. In contrast to 2008 and 2009, they are now providing support for the corporate bond market, lending to state and local governments, and doing a set of other things that they didn't do in that earlier crisis.

Michael Klein:

So, then there's this complaint that the Fed was bailing out Wall Street instead of Main Street, but Bernanke, the Chairman of the Fed then, was saying that you have to do that to save the financial system to help Main Street. But now, they're not just bailing out Wall Street, are they?

Dan Sichel:

Yeah, that's right. As I mentioned, they are supporting lending to state and local governments, they're also supporting a lot of business lending, both to small and large businesses, with the idea of trying to help Main Street and support Main Street and regular people.

Michael Klein:

Right. So, the key difference, as you were saying, is that this isn't just a financial crisis, it's a health crisis as well. What do you think could happen if the health crisis is not resolved and opening up starts to occur?

Dan Sichel:

If the health crisis is not resolved?

Michael Klein:

Right.

Dan Sichel:

Yeah. So, I think if the health crisis is not resolved, I think we're going to have a very long, slow, painful recovery, because I think people are just not going to be willing to engage in full economic activity until then.

Michael Klein:

I'm sorry. When you were at the Fed in 2008, you were there during some of the darkest days of the Great Recession, in times when it really seemed we were on a knife edge, when things could've gone really south, really fast, what was it like then to be working at the Fed?

Dan Sichel:

So, in the time right after the Lehman Brothers bankruptcy in fall of 2008, it was a scary time, there was a sense in the building of waiting for the next shoe to drop. And as you said, it was knife edge as to whether the financial system was going to totally collapse. It was a scary time, people put their heads down, they got to work to do the work that needed to be done. But, boy, I was with the team that did the U.S. economic forecast, and that was tough given the uncertainty about the economic outlook at that time.

Michael Klein:

And, I mean, now it's probably even more uncertain. It's even harder to do a forecast, because it's a dual health crisis and financial crisis, right?

Dan Sichel:

Yeah. I think that's right. In economist lingo, the financial crisis was really a large negative demand shock. This time around, we're having a large negative demand shock and a large negative supply shock. The supply shock being the virus, the demand shock being the follow on reductions and spending and other economic activity.

Michael Klein:

So, the supply is like people can't go to work and you can't have workers out there, and so even if people wanted to spend money, it's not clear how you would do that, or certainly you couldn't do it in the same pattern that you did before.

Dan Sichel:

Yeah. Labor is a key input into production of all goods and services, so if people can't or won't work, that is a really, really big supply shock. But that, of course, means that people's incomes go way down and they have both less means to spend and less desire to spend, because this is probably not the time a lot of people want to go on a Caribbean cruise.

Michael Klein:

Well, that's certainly true. So, people also make a distinction between a lifeline and a stimulus. And a stimulus can only really work if people can go out and spend money, a lifeline is really vital when we have 40 million people who've filed unemployment claims, and people are really worried about making rent or paying their mortgages and so on. Do you see a similar thing going on now as compared to... Was there something like that in 2008, in the fall of 2008 as well, a lifeline rather than just a stimulus?

Dan Sichel:

Well, so I think in 2008 there was a lifeline, I think a lifeline was thrown to financial sector to prevent the financial sector from collapsing. There was also a big economic stimulus designed to try to boost spending. And this time, I think, also stimulus, but as you said, the more important thing happening now is the lifeline and trying to prevent too many businesses from going bankrupt, preventing too many individuals from getting into financial difficulties, and trying to just keep everything going, so when the health crisis is over, we'll be able to get the economy back again, and we won't have lost too much in the meantime.

Michael Klein:

And as you mentioned, the precipitousness of the decline is incredibly striking now, whereas the fall of 2008, as bad as that was, it was over 19 months that we lost all those jobs. And now, in 10 weeks, one in four people in the workforce have filed for unemployment claims. Even the Great Depression, the depths of that were a few years after the stock market crash.

Dan Sichel:

Yeah, the speed is just remarkable. The unemployment rate, that before this all started, was around three and a half percent or three and a half percent of the labor force being unemployed. And that jumped to 15% in April, and is expected to jump quite a bit higher when the numbers for May come out. So, really, the speed of decline is unprecedented.

Michael Klein:

So, the highest unemployment rate during the Great Depression was?

Dan Sichel:

About 25%.

Michael Klein:

Right. We could exceed that, I guess, right?

Dan Sichel:

We could. I've seen forecasts of numbers around that. I think the speed of the decline reflects what's different about this episode, which is, again, to use the economist lingo, it's a supply shock too, and a supply shock can shut things down really fast.

Michael Klein:

When you were at the Fed in the wake of the 2008 crisis, when did you start to see the light at the end of the tunnel?

Dan Sichel:

So, I would say by early 2009 there was clarity that a recovery was coming. Actually, anybody can go look back at the Fed's internal documents, because they release them after five years, and so if you look at the January 2009 reports that the Fed was writing, they were correctly anticipating a second half of 2009 recovery. They saw that was coming. All the caveats about great uncertainty, downside risks, but they correctly saw that was coming. Though, interestingly, it was weaker than they thought.

Michael Klein:

Yeah, it was a very tepid recovery. So, that's like four, five months after it began, right? After the Lehman shock, they started to see what Bernanke then called green shoots, right?

Dan Sichel:

Yeah, that's right. The Lehman Brothers was really the acute phase, but the economic downturn and the financial stresses had really started sometime before that, but that's right in terms of the acute phase.

Michael Klein:

I mean, what do you think now? I mean, I don't imagine many people are talking about a V-shaped recovery at the Fed or places... We've heard about the Nike swoosh or even worse. Are there any lessons from the way it was resolved then that we can apply now, or is this just, as you say, fundamentally different because it's a pandemic at its source instead of a financial collapse?

Dan Sichel:

I think it is fundamentally different because we just... The key thing is how long until the health issue is resolved and we have a vaccine or effective treatment. The consensus view still is for a pretty rapid recovery on the second half of the year. I think that's premised on an assumption there's no second wave in the virus.

Michael Klein:

Right. So, I'd like to conclude, Dan, by just shifting the focus a little bit from what's going to happen over the next few months to what's going to happen over the longer term. You're well known in the economics profession for your research on long-run growth and technical change, do you see any big changes in the way we do things that have economic implications as a longer consequence of this crisis?

Dan Sichel:

Yeah. I think I want to avoid any breathless pronouncements about how the world will be and the economy will be completely different going forward, because I think in time will be a vaccine and time will put this behind us, and life and the economy will largely get back to where they were before. But that being said, I think this crisis, any crisis, accelerates changes that are already underway. So, there are a variety of companies that were already weak and in trouble that have gone bankrupt and have disappeared from the scene. Boy, a lot of people have learned how to use virtual platforms and that sure seems to suggest that people may do a lot more of that going forward.

Michael Klein:

Like us doing this, you in one city and me in another doing this interview.

Dan Sichel:

Yeah, absolutely. I mean, virtual stuff was a thing before, but it was kind of at the fringes, and now it's front and center.

Michael Klein:

And everybody's had to learn how to do it.

Dan Sichel:

Exactly.

Michael Klein:

They've overcome that learning cost, yeah.

Dan Sichel:

Exactly.

Michael Klein:

All right, Dan. Well, thank you very much for these insights, it's been a real pleasure speaking with you today.

Dan Sichel:

Yeah, this was fun. Delighted we got a chance to do it.

Michael Klein:

Thanks for listening. This has been EconoFact Chats. To learn more about EconoFact and see the work on our site, you can log into www.econofact.org. EconoFact is a publication of The Fletcher School at Tufts University. Have a good day.