THE BROOKINGS INSTITUTION

WEBINAR: COVID-19 AND THE ECONOMY

WHAT WASHINGTON HAS DONE AND THE CHALLENGES TO STATE AND LOCAL GOVERNMENTS

Washington, D.C.

Monday, March 30, 2020

PARTICIPANTS:

DAVID WESSEL, Moderator
Senior Fellow and Director, The Hutchins Center on Fiscal and Monetary Policy
The Brookings Institution

AMY LIU
Vice President and Director, Metropolitan Policy Program
The Brookings Institution

ADAM LOONEY
Joseph A. Pechman Senior Fellow, Economic Studies
Urban-Brookings Tax Policy Center

LOUISE SHEINER
Robert S. Kerr Senior Fellow, Economic Studies
Policy Director, The Hutchins Center on Fiscal and Monetary Policy
The Brookings Institution

JANET L. YELLEN
Distinguished Fellow in Residence, Economic Studies, The Hutchins Center on Fiscal and Monetary Policy, The Brookings Institution

* * * * *

P R O C E E D I N G S

MR. WESSEL: Good afternoon. I'm David Wessel; I'm director of the Hutchins Center on Fiscal and Monetary Policy at the Brookings Institution. I want to welcome you to our experiment in communicating via webinar about what is perhaps the most unusual experience economically that I've encountered in my career.

We invite you to join us by asking questions with #COVID19Economy on Twitter. I also invite you to look at the COVID-19 page on the Brookings website which has a wealth of information, things that we've posted, more than 100 pieces by my colleagues from Brookings. And I also want to call your attention to later this week we have an event on Wednesday on unemployment insurance, on Thursday on the effect of COVID-19 on marginalized communities, and on Friday, experiences and lessons from the front lines in Asia.

Today I'm very pleased to be joined by a number of my colleagues, Janet Yellen, of course the former Federal Reserve chairman, Louise Sheiner, my colleague at the Hutchins Center, and Adam Looney, who is one of our colleagues from Brooking whom, we hope, temporarily lent to the University of Utah Business School, and Amy Liu, who is Vice President for Metropolitan Policy at Brookings.

We're going to focus today on the economics of COVID-19. It's not because the public health isn't important, it's just that if you wanted to talk about public health this is not the group of people you'd get together.

We're going to start with Janet Yellen, and I'm going to ask each of my colleagues to comment and then we'll turn to your questions, or some of my own.

So, with that, Janet, let's start with you. I wondered if you could kick us off by talking about how deep a recession you expect and on what the depth and duration of the recession will depend.

MS. YELLEN: Thanks, David. Well, the downturn has been rapid and sharp and it's different than any we've ever experienced in America. Frankly, it's impossible to know at this point how deep the recession will be. It depends critically on how long the period of social distancing lasts. The hope is that lockdown can be lifted in May and activity will be begin to normalize in the early summer, but a longer period of confinement certainly seems possible. There could be a second wave of infections after activity resumes. Every indication so far suggests there will be a huge plunge in output in the second quarter. The decline will be reported at an annual rate and could easily be 20 percent or higher.

I expect a very large rise in unemployment. The 3.3 million initial unemployment claims that were reported last Thursday suggest that the unemployment rate may already have spiked to 5.5 percent or so. That would be a two percentage point increase from February. Now, we will see that in Friday's employment report because it's based on earlier data, but unemployment will surely rise a lot. Hopefully, the fiscal package will soon begin to kick in and help limit the increase in joblessness.

The depth of the recession I think will partly depend on what happens to overall financial conditions. The virus has caused a significant financial tightening. The Fed is doing everything they can to keep financial markets functioning and credit available to households and firms. Still, private borrowing rates are significantly higher now, naturally because lenders are fearful about losses and defaults. State and local governments also face higher rates, but the Fed actions have brought about some improvement from their March peaks. U.S. high grade credit spreads were about 60 basis points tighter, U.S. 30 years mortgage rates have declined 40 basis points, and municipal bond yields were down over 100 basis points.

An important question is whether the recession will be V shaped or U shaped, or yet a worse shape, such as an L. If lockdown ends reasonably soon and the monetary and fiscal supports that are now in place enable households and businesses to resume activity when the confinement ends, we'll likely see a V with positive growth by the fourth quarter of the year. But that's a best-case scenario. And I'm worried that damage may occur that could lead to a prolonged recession.

One concern is that firms will end up severing their relations with their workers. The fiscal package is designed to prevent that, but it is already happening to a significant extent. That will make it harder for workers to get new jobs and for businesses to start up again smoothly. In addition, firms will experience losses. There may well be bankruptcies and there could be a prolonged period in which firms scale back investment and hiring to deal with debt burdens.

There have also been disruptions in supply chains worldwide. Our recovery will be smoother if it's accompanied by global progress.

Households and firms have been somewhat protected by the fiscal package, but nevertheless they may emerge with significantly worsened balance sheets with higher debts and lower assets. And that may lead them to tighten their belts and restrain spending, even after health concerns abate.

So, if the lockdown lasts a long time, I would also expect banks to come under pressure.

I will be watching carefully high frequency data, such as confidence surveys, credit market developments, weekly unemployment insurance claims, travel and shopping data, and I'm even beginning to watch one of Alan Greenspan's favorite statistics, freight car loadings.

MR. WESSEL: (Laughing) Why, that's an inside joke for those of us who have read FOMC transcripts. Well, Janet, do you think, given what we've known so far that the totality of the monetary fiscal response is sufficient, or is there more we're going to have to do?

MS. YELLEN: So let me start with monetary policy. The Fed has done almost everything possible to ease financial conditions in support of the economy. The traditional policy tool is the level of short-term interest rates. They quickly lowered their target range for those to 0 to 25 basis points, effectively as low as short rates can go without the Fed moving to negative rates, and they're extremely reluctant and unlikely to do that.

There were two so-called unconventional -- but now they're becoming conventional -- tools that the Fed used after the 2008 crash, forward guidance and asset purchases, and they've also been deployed. The Fed has stated that rates will remain 0 until the economy is back on track and inflation moving back up to 2 percent. And that has led most observers to anticipate rates near zero for many years to come. And on the basis partly of that, Treasury rates have fallen to -- long-term Treasury rates have fallen to unprecedented lows.

The Fed has also resumed asset purchases and without a cap, to an unlimited extent. Purchases of Treasuries and mortgage backed securities have started off at a very rapid pace. The Fed's balance sheet over the last couple of weeks, because of this and other programs I'll mention, has risen almost $1 trillion.

Many private borrowing rates are linked to Treasury rates and mortgage backed securities rates. So these actions do help households and firms and lower mortgage rates will enable a lot of households to refinance their mortgages. Overall, still financial conditions have tightened a great deal.

The onset of the pandemic led to a serious breakdown in the functioning of financial markets. Investors have been fleeing from every conceivable risky asset into the safety of cash, and that's threatened the drying up of funding for main street households and firms. So the Fed has taken a huge range of additional actions to ease strains in short-term money markets, and also now in corporate and municipal bond markets. Importantly, the Fed has restarted most of the emergency lending facilities that they put in place in 2008 and they've invented some new ones to deal with problems that weren't so important back then.

These facilities require Treasury authorization and in most cases a Treasury fiscal backstop because they could result in losses. The Fed is allowed to lend to anyone in an emergency, but the loan has to be backed by collateral. The Fed isn't allowed to give grants or to take credit risk. That's a job for Congress and the Administration. The CARES Act, the big fiscal package that was passed last week, contains about $450 billion of backing for these programs, so it will permit a huge scaling up of the Fed's lending programs in coming months, probably to the order of $4.5 trillion.

The initial focus of the Fed's emergency lending was the market for commercial paper. That's a very crucial source of funding for a wide range of companies. Last week the Fed extended the focus to a wide range of corporate bonds and loans. And they've also promised to start up a main street lending program that would be focused on small and medium-sized businesses as well. The details haven't been spelled out yet, but the Fed's lending program is intended to compliment the work of the Small Business Administration.

And, finally, I'd mention that the Fed has expanded its network of so-called swap lines. It's working with foreign simple banks to provide dollar funding to foreign banks. Those banks do a great deal of dollar business, including providing loans to American households and businesses and they're experiencing a great deal of funding pressure.

Okay, so the monetary policy response has been rapid and enormous. On the fiscal front, the CARES package that Congress passed I would consider to be very significant. And I think it will provide a great deal of support to households and businesses in the coming months. It allocates $300 billion to households for tax rebates and $250 billion for expanded unemployment insurance. There's $150 billion of aid to state and local governments, $150 billion for public health, $375 billion, or thereabouts, for SBA loans, and those loans can be forgiven if the firm retains employees. I mentioned the $450 billion that bill has for Fed facilities. There is industry specific aid, tax delays, and modifications for firms.

I think it's easy to pinpoint areas where one could easily argue that more was needed and there are questions about implementation. How fast will the money get to people who need it, will the conditions that have been imposed on firms, limiting layoffs and stock buyback and dividend restrictions, will they limit participation in the programs. So those are important questions.

Since many of the measures are temporary, Congress will certainly have to do more if the shutdown is prolonged. Many economists wanted the legislation to include automatic triggers that would provide additional aid if the lockdown is prolonged without requiring new legislation, but that didn't occur.

In terms of size, the fiscal stimulus exceeds what was done after the global financial crisis. The three measures that have been passed by Congress amount to about $2.8 trillion, or 13 percent of GDP. So they are very substantial.

MR. WESSEL: Thanks. And, finally, thinking not so much about the public health side of this, where there are other people far more expert than the people on this call, I'm curious what vulnerabilities you think this episode has exposed, particularly in the financial system where you had already expressed some concerns about what was going on.

MS. YELLEN: Well, thanks for that.

Well, importantly, the economy and financial system were generally in good shape prior to the crisis. And the banks had lots of capital and liquidity and are holding up well. But non financial corporations entered this crisis with enormous debt loads, and that is a vulnerability. They had borrowed excessively in my view through issuing corporate bonds and leveraged loans, many with weak loan confidence and poor underwriting. And much of that borrowing wasn't to finance investment spending, but rather for stock buybacks and to pay dividends. Arguably, this was a borrowing binge that was incented by the long period we had of low interest rates. Investors were also engage in a search for yield, so this debt was attractive to pension funds, insurance companies, and investors generally looking for high yield opportunities.

The truth is that regulators had few, if any, tools to contain this borrowing spree. Leverage lending by banks can only be reined in by bank supervisors if it is deemed to create a safety and soundness issue for the banks themselves. And that wasn't the problem with is borrowing, the problem is that it creates risks to the economy. And I'm afraid we'll see that in spades in the coming months because it may trigger a wave of corporate defaults. Even where a company avoids default, highly indebted firms usually cut back a lot on investment and hiring. And that will make the recovery more difficult.

The rating agencies are now downgrading leverage loans and bond funds, particularly high yield funds, are seeing substantial outflows. Issuance is dried up and refinancing will be hard.

I finally mention another vulnerability, which pertains to the repo market and the money market funds. After the crisis, new regulations were put in place to strengthen the repo market and to avoid runs on money market funds that would end up curtailing lending to households and businesses. But those reforms seem not to have worked. The Fed quickly had to rush in with emergency lending facilities. So I think we'll need to revisit these matters when the pandemic has subsided.

MR. WESSEL: Thank you very much. I want to turn to my other colleagues and we'll come back to Janet Yellen.

Louise, as Janet mentioned, state and local governments get a dollop of aid from the CARES Act, but there is substantial worry that it won't be sufficient to compensate them for the sharp declines in revenues and the increases in spending. So, can you put that in perspective for us?

MS. SHEINER: Yes. So I think the first thing to think about is the state and local governments are obviously on the forefront of this public health crisis and they are spending a lot of money on building capacity and testing and just a huge array of public health activities and other activities related to the crisis. So, the fiscal package, the CARES Act, that was passed had $150 billion, which is a lot of money, but that was dedicated to helping states and localities, actually with the public health spending related to the pandemic. It wasn't to be used for general revenues or anything like that.

So, when we think about the state and local sector, we know that their revenues are very sensitive to changes in GDP and they're likely to suffer large losses in revenues, sales taxes, income taxes, and also increased demands on them. So as the economy weakens more people are obviously eligible for unemployment insurance, more people are eligible for Medicaid, which the states pay part of. So they're likely to have huge budgetary stresses that the fiscal package did not address. And what's particularly important is to know that state and local budgets do not have the capacity that the federal government does to borrow. They are by and large subject to balanced budget requirements, which means that they have to cut spending or raise other taxes -- most likely cut spending -- in response to declining tax revenues. So tax revenues declined $120 billion during the Great Recession and so with -- as Janet said, we really don't know what the economic impact of this pandemic is going to be, and whatever that is translates directly into the impact on states and localities. But even with the more optimistic scenarios, it's going to be a big stressor for the state and local government.

And the other important point is that if we want to get that V shaped recovery that everybody wants to have, it's important that state and local governments get some aid, because otherwise they will be one factor, as they were past the Great Recession, holding back the recovery. If they're cutting spending over the next year or two, they're an important part of the economy and that will make it harder for the economy to recover. State and local employment is 13 percent of total employment, for example. So I think when people are talking about what else needs to be done, the package passed so far was very helpful, but I think one of the biggest missing pieces was general aid to state and local government for the declines in revenue and increases in spending that are anticipated.

Another thing that did happen before the CARES package was the government did raise the Federal share of Medicaid. That you can think of kind of as general aid to states. That's worth maybe about $40 billion if it lasts all year. So that's helpful, but not nearly enough for what the likely stresses on their budgets are going to be.

MR. WESSEL: Thank you.

Amy, you and I talked a little bit about your concern that we already have fairly wide gaps between winners and losers in our economy, and that an episode like this tends to widen the inequality and it may make it more long-lasting. So, could you talk a little bit about why that's on your mind?

MS. LIU: Sure. I'm glad you raised that. And, by the way, I endorse everything that Louise mentioned, which is the fact that right now, states and localities, including counties and their county hospitals, are bearing the brunt of this pandemic. Every day they are incurring the financial costs of execution to manage this public health crisis and an economic crisis simultaneously in their communities.

But let me answer your question, David, which is as states and cities are frontloading their spending to both deal with the health crisis and the economic stabilization, there's another issue that is on a lot of people's minds. They are grappling with how to ensure that the $2 trillion of taxpayer spending, or potentially $4 trillion if we anticipate future stimulus bills, how do we ensure that those trillions of dollars do not reinforce or deepen existing inequalities.

As I have learned from my own work on Hurricane Katrina, disasters expose a lot of the structural challenges that existed before a crisis. And, further, vulnerable populations and vulnerable communities have the hardest time bouncing back. So the question is, you know, should trillions of dollars of emergency and recovery aid be used to recreate the status quo. And I know that many state and local leaders prior to COVID-19 were working on how to make sure the economy worked for more people in more places, closing disparities by race, by income, and geography. And those goals simply don't go away in this crisis. In fact, they're even more pressing today.

So let me just give you a couple of examples. For instance, prior to the disaster, 90 percent of the Nation's job growth in innovation sectors took place in just 5 metropolitan areas, mostly on the coast, while midsized metros in the nation's interior barely kept pace or were falling behind, which was accentuating the nation's geographic divides. Well, analysis by Tim Bartik and others found that economically distressed places often take a decade to rebound from a recession. Think places like Detroit, Cleveland, New Orleans. These are places that are currently the epicenters of their state's COVID-19 outbreaks. I don't anticipate a V curve recovery for them. Meanwhile, other hot spots, like Seattle, New York, Bay Area, now, they might be okay weathering this crisis.

So the question is how do we structure aid that isn't just population based, but helps these more distressed places recover better so we don't emerge from this crisis even more geographically polarized than before.

I'm getting a lot of other questions from local officials about what we've learned about the impact on women and minority owned businesses and entrepreneurs in prior recession given the enormous number of efforts right now to close the racial wealth gap. There are questions about how do we use this moment to truly close the digital divide for workers who are working at home, who can work from home, or for the young students. And what about the sizeable share of low wage workers -- 44 percent who prior to this crisis could barely make ends meet. Many of those low wage workers were sole earners in their households with children at home. Those workers are now considered essential workers today, whether in home health aides, nursing assistants, grocery store workers. I think there are a lot of questions now about do they now after the crisis return to a secondary, low wage, no benefit status going forward.

So I think there's -- what I'm witnessing among state and local leaders is this constant balancing act between managing the public health, managing economic stabilization, the tradeoffs, and how to respond to the immediate relief, but also thinking about the longer-term recovery questions. And the way we help these leaders manage those issues, the better it's going to shape our Nation's fortunes.

MR. WESSEL: Yes, thank you for that.

And I want to particularly underscore your point. I think that too often low wage workers have been undervalued in our society and we're now seeing how important it is the home health aides who are dealing with the elderly, the people who are delivering food to people who are high risk. And I agree with you and I hope that what we see today will remind us of their importance. And it is interesting to see that a number of employers of those people are raising wages and providing hazard pay to people who we didn't use to think of as having hazardous jobs.

Adam, you were involved in Washington during the Great Recession working in the Treasury, and now you're in Salt Lake City. And I wonder if you can give us a sense of what it feels like there and how the community there is responding, and particularly what pressures this is putting on the local governments in Salt Lake and the state government in Utah.

MR. LOONEY: Sure. And thank you for that question. And excuse me for a second because there is a garbage truck picking up a trash can across the street.

MR. WESSEL: Well, I'm glad to see essential public services are still functioning.

MR. LOONEY: So it does remind me a lot of 2008 and 2009. At that time I was -- enacted the new TARP bill. They had established the new office of financial stability and I was dispatched to that office to help initiate some of these billion dollar lending and equity investment programs. And I remember on that first day I walked into an office that didn't -- not only didn't have people, but also didn't have desks or chairs, didn't have paper and pencils. We would have to borrow paper from -- steal paper out of copy machines. We didn't have conference call lines, so we used something like conferencecall.com and we'd have to dial in early to listen to the advertising before the Treasury Secretary got on the line.

And I mention that episode because Congress writes a new piece of legislation that enacts these trillions of dollars of new spending programs or tax programs, but at the end of the day, getting those resources to people is often a very mundane practice. It requires people to operate like a startup, where you're creating these programs sometimes from scratch. It's a high pressure environment. A lot of the activities are new and novel. I think we see that very clearly in the newspapers about the public health response, where people are trying to ramp up testing and acquire protective equipment. And just the scaling up of that important activity is a difficult task. It's going to take some time.

And so I feel like the same thing is true on these economic programs where there are millions of people applying for unemployment insurance and I think local offices are working very hard to process those and understand what the (inaudible) used in the legislation mean for their beneficiaries. I think these new lending programs are going to be very important for businesses, but right now they and their lenders and Federal regulators are thinking about how to implement those, when the money will start flowing, what steps need to be taken in order to establish those. And so it's a tremendous amount of I think difficult work that is getting underway.

And so what I can see from my position here is I see that there is a lot of that work that is being undertaken. Here in Utah the governor has a plan that tackles not just these public health issues, but these economic issues. My sense is that the state and local governments here are really working hard to understand those programs, to get the aid that is available through them and through other sources up and running. There is kind of an unprecedented mobilization of both public and I would say private sector resources to help address the crisis.

And so all those things I think are going to take some time and will flow in over weeks and maybe months. I'm optimistic that help is flowing and it's on its way and that assistance will do a lot to address the near-term health and the economic consequences of this pandemic.

MR. WESSEL: Thank you.

Janet, let me pose a couple of questions to you and then we'll go to the other panelists. There's a lot of concern that we're borrowing a lot of money -- the federal government is borrowing a lot of money. We already had a debt that relative to the size of the economy was much larger than we'd seen in the past. Is this going to be a threat to economic growth in the future if we borrow a lot of money now?

MS. YELLEN: Well, I think it's appropriate to borrow a lot of money now to deal with what is an absolutely unprecedented situation. It's true that the U.S. debt has risen a lot since before the global financial crisis in 2008. Before this crisis it had actually doubled. The federal debt is about 80 percent of GDP and it was about 40 percent before the crisis. And you might think that that would have been a huge problem, but the truth is one way to think about the burden of that debt on the economy is how large are the interest payments required to service it. And interest rates had been drifting down for many, many years even before the financial crisis, and they've continued to drift down. And many economists before this pandemic thought interest rates would stay low for decades to come. So even before this pandemic we had seen no increase in the share of interest as a share of GDP in spite of it doubling of the ratio of debt to GDP.

So, yes, this is going to be cause an increase in the ratio of debt to GDP, but I think we're still in a world of very low interest rates as far as the eye can see. And so I don't think there's going to be an unmanageable additional debt burden and interest burden because of the spending that we're doing now. And the spending is preventing even more of an economic collapse and the more the economy shrinks the more tax revenues decline. So a dollar of spending now doesn't really add a dollar to the U.S. debt.

MR. WESSEL: And what about inflation? Is an increase in inflation inevitable given all the demand we're putting into the economy and all the easing that the Fed has done?

MS. YELLEN: So I don't think an increase in inflation is necessary or even likely. The problem the Fed and other advanced countries' central banks have faced for a very long time is inflation too low, below their targets and not too high. And it is true that there has been a supply shock to the U.S. economy. We need people to stay home for public health reasons and not be out producing goods and services and having people buy them. So that is a decrease in supply. But I think there's been a larger decrease in demand because of the layoffs, the losses, the loss in asset income, in equity values. And so really we're in a situation where demand has fallen more than supply. So I don't that's inflationary either. And even as we recover and supply increases and demand begins to be restored, for the reasons I mentioned earlier, I am worried that we're going to see households and businesses tighten their belt, and that's going to require low interest rates and result in low inflation for a long time to come.

MR. WESSEL: And one of the people on the line wondered about the capacity of the Fed and its staff to manage a lending program that, as you point out, could be $4.5 trillion. That's quite a bit bigger than the lending programs that the Fed ran during the Great Recession. Do you have any concerns about that?

MS. YELLEN: Well, this is an incredible burden on the Fed, and I know that there is staff throughout the Fed who are working 24/7 to pull all of this together. It's going to be a huge task to run this.

To some extent -- well, to a great extent, the Fed, when it comes to actual lending decisions, especially in this main street program, will have to rely on banks that do business regularly with small and medium sized business. They'll have to rely on them to make judgments. The secondary corporate lending program, it's already been announced that the Fed has hired Black Rock to help manage that program. So the Fed may look for outside expertise to add to its own, but it's in a way fortunate that the Fed has been able, at least to a great extent, to rely on work that was done after the financial crisis in developing some of these programs. It has some off the shelf programs it's been able to put in place quickly. But there are a lot of new ones and it is a huge burden.

MR. WESSEL: And somebody picked up on the point you made about risk that companies potentially lose the connection with workers when they're laid off. And the questioner asked whether you're seeing that now, or is it just something rather that you have to anticipate will happen based on your past experience in labor markets.

MS. YELLEN: Well, it's more that I'm anticipating that that will happen, but we have seen a surge in unemployment insurance claims. And often people who are applying for unemployment insurance have lost their jobs and severed their relationships with their employers.

So there are aspects of these programs, the lending programs to businesses, that are designed to provide support so that firms can keep on their workers. But it's unclear how successful that will be. And the unemployment insurance, at least short-term, is quite generous, and so the firms may decide that that's a better way to go.

MR. WESSEL: Louise, you've done a lot of work lately on state and local pensions, and one questioner asks whether this won't make a big problem an even bigger problem because state and local pension funds tend to be invested in the stock market and the bond market, and both of those have gone down quite a bit.

MS. SHEINER: Yes, exactly. So state and local pension plans are about 50 percent in equities and a varying of other things, bond markets and some more exotic stuff. So there's no question that the decline in the stock market means that plans that were not fully funded are less funded now. Their obligations haven't changed but their assets have changed. And maybe if interest rates have continued to fall, then it's even harder to get income on their assets going forward.

But the work I have done was really about whether or not plans need to be fully funded. And it's very reminiscent of this question about whether or not debt is costly. When state and local pension plans aren't fully funded, it means that they're basically carrying implicit debt and that's just simply not that costly. And I think this is a perfect example of something that could happen that would be a bad thing to happen, which is state and local governments might say, oh, look, we've gotten less funded, that's a bad thing. We'd better really pull in our belts and spend all this money refunding our pension plans and therefore not rehire teachers and cut spending. And that would be a bad thing for the recovery.

So just as the federal government should be borrowing more in order to make sure that we have a decent economic recovery, it wouldn't be a great thing if state and local governments decided because of long-term problems in their pension that they needed to immediately address them and, as a result, cut spending.

MR. WESSEL: Amy, there's an interesting question from somebody who observes that the more densely populated an area, the more the spread of COVID-19 has been a problem. New York City is an obvious example. We've been talking a lot about the virtues of density, you've talked a lot about the vitality of metro areas, were building a lot around public transit systems in order to be more climate friendly. Do you think this episode will lead people to rethink the advantages of density?

MS. LIU: I think that history has shown us that cities have weathered all kinds of disasters and catastrophes and pandemics and continued to grow and prosper and increase their share of the national economy. And what we've also seen in this pandemic is that rural areas are similarly vulnerable right now. I don't think that a low density or a high-density place is immune from this pandemic.

That said, I do think that we need to watch for structural shifts in the form of our communities going forward. Are we going to see much more open spaces to allow people to spread out more, more sidewalks that allow for people to get out and exercise? I think we're even seeing whether or not we're going to see rise in telework in cities around the country, and does that change the future of office space development and that kind of density, if the way people work is a lot more flexible.

So I do think we need to watch overall what some of the long-term structural implications are from this, but overall I think cities are going to continue to be strong.

MR. WESSEL: Adam, do you see yet any signs of how this is affecting state and local budgets in Utah, or are you not close enough to that?

MR. LOONEY: I mean my sense is that it's -- I mean I think it's having an important impact. So obviously just the decline in economic activity is going to impact the state and local budget and the taxes that people pay, for instance. They're also spending a lot more money I think on ramping up public health efforts.

In Utah they've already enacted -- and I think blown through -- tens of millions of dollars of spending to procure medical equipment, medical supplies, and things like that. And so I think that they will continue to enact that. I think in this state, Utah is in a good place. They have a large surplus and an emergency rainy day fund that has been built up, so I think that this state is prepared to make those types of investments, but I don't know if that's true more broadly.

MR. WESSEL: Janet, usually when we think of a recession we think about a period in which there's a depressed economic activity and then things get better. This is what's implied by all these V and U shape things.

Do you think that there's a possibility that this will permanently put the economy on a lower track? And, if so, what are the things we need to do now to prevent that from happening?

MS. YELLEN: Well, I guess that is a possibility, that something that we've seen after many financial crises, including the 2008 crisis, where it seemed as though GDP on the economy's output remained on a lower track -- never really got back to the old path. And it can be because of damage that occurs during the downturn that has long lived effects. If firms are very damaged and really cut back their investment spending or spending on R&D dramatically, or workers become deskilled or lose connections, productive connections to firms, those things can have long-lasting effects.

And, you know, also global supply chains, when they've worked I think they have certainly succeeded in raising business productivity, but given the disruption that we're seeing that comes from -- you know, first we had trade disruptions and now we're going to have I think a broad based rethink of some of the dangers of relying on global supply chains. That could lead to changes over time that have long-term impacts on the economy.

MR. WESSEL: What can we do to minimize that risk?

MS. YELLEN: Well, I think everything that we can do -- I mean some of that I think is inevitable and does reflect a rethinking of the risks that were present in the global economy in the arrangements that we had that ought to be rethought. But much of the damage would come from not responding fast enough or strongly enough with policy to deal with this downturn. So the fact that we are seeing the strong monetary and fiscal policy response in the U.S. and many other countries, this is good news in terms of being able to avoid that damage.

MR. WESSEL: The Federal Reserve, as you know, has been engaged in a deep rethink of its whole monetary policy framework, preparing for an era in which interest rates are low for a long time. How does this episode affect that work do you think? Does it reinforce its importance, or lead them to just put it off and fight this fire and we'll deal with that one later, or what?

MS. YELLEN: Well, they are in the middle of a fire, but I think the underlying situation that they were worried about, which is that inflation seemed to have become endemically low, interest rates had drifted down to low levels, even in economies like the U.S. was, operating at its potential, the Fed was worried that its normal policy space would be very much restricted and that it would have to find new tools to use.

That situation continues to prevail. We're now at the bounds, pretty close to the bounds, of what the Fed can do in thinking about are there ways -- by rethinking their strategy, their monetary policy strategy, can they find more room for monetary policy to be successful and to help the economy that remains an important piece of work for the Fed.

But, of course, the other thing that most economists concluded was that given the constraints on the Fed that come from a world of low interest rates, you know, what you want to -- the Fed should do everything to maximize what it can contribute to fighting downturns. We need to understand that fiscal policy sometimes has to play a role too. And that conclusion that sometimes monetary policy can't do it all and fiscal policy must step in and help, I think this episode reinforces that conclusion too.

MR. WESSEL: Amy, the deputy mayor of a city in the Midwest asks the question, what's the smartest investment a mid-sized city can make to lay the foundation for the economy that will emerge after the pandemic?

MS. LIU: Well, I think the thing that's on everyone's mind, whether it's a mid-sized city or a larger city is small business recovery. And one of the things we've also seen whenever there is a recession or a downturn, when recovery begins we've seen a spike in entrepreneurship or self-employment. And so what I think a mid-sized community could do right now is really begin to rationalize to what extent the current federal aid package really can support the full array of entrepreneurs, startups, small businesses, women and minority owned firms are going to be impacted by this freeze on the economy and shore them up enough that they can rebound.

Some of the analysis our team has done has shown that obviously the younger the firm is, the smaller the firm is, the more vulnerable they are to an economic shock and maybe even more vulnerable to bankruptcies. Yet, they're also nimble enough to restart if once an economy begins. And so, you know, one of the things that we're seeing quickly in a lot of cities right now and states is surveys out to every single business, no matter their size and no matter whether they're a startup, to understand what their challenges are and the extent to which existing aid really meets their needs. Right now I think there's a lot of -- and based on that, really customizing the array of grants or no interest loans to help them.

I think what we're hearing from a lot of our allies on the ground is the fact that the current CARES Act, as generous as it is for small businesses through the SBA, it still misses a whole proportion of our small business community, particularly small minority owned business in our low income neighborhoods or urban neighborhoods that are often served by CDFIs versus being served by traditional banks. And so how do we make sure that in the absence of that partnership, how can states and localities step in.

I also know there are a lot of cities that have really focused on their entrepreneurship ecosystem. And a lot of the entrepreneurs or startups don't have demonstrated revenue or full bank relationships. And so this about venture capital and seed funding, and so there might be a different kind of response for them.

So what I would say right now for a mid-sized city is really thinking hard about whether we have the continuum of tools that really can help this really large portion of your economy be prepared to bounce back when doors open up again.

MR. WESSEL: Thank you.

Janet, we're going to see extraordinary cooperation between the Treasury and the Federal Reserve. It's kind of remarkable to me that after many years of hearing people in Congress criticize the Fed for the role they played in the Great Recession, now Congress has decided, here, give you $450 billion and figure out how to leverage it. How does this affect the independence of the Fed to make monetary policy?

MS. YELLEN: Well, I don't see it as affecting the independence of the Fed to make monetary policy. This is a situation where it's necessary for -- in emergency situations, it's necessary for fiscal and monetary policy to cooperate, and especially when there's an incipient financial crisis or real problems in the financial system. Congress created an authority for the Fed to supply liquidity, saw the value of the broad based programs that the Fed put in place in 2008, allowed a situation where the Fed would be able to do these again. And I think Congress is getting a clear lesson on how valuable these programs are and how important the Fed intervention is.

Of course, they do require cooperation between Congress and the Administration and the Fed, but that's appropriate in the current situation.

With respect to monetary policy, if we're lucky enough that a year from now the economy is booming and I'm wrong about inflation and inflation is picking up and it looks like the Fed needs to tighten monetary policy, the Fed has the independence to be able to do that and hasn't lost in this situation.

MR. WESSEL: Adam, I'm wondering how you talk to people who are not economists when they say to you, look, the cure is worse than the disease. We can't all stay home forever. It's time to reopen the economy. When you hear that from people -- I've heard that from some non economists and non public health experts, what do you say to them? And I'm going to ask Louise and Janet how they'd respond to the same question.

MR. LOONEY: Well, so I think right now we're in this very critical phase of trying to stop the spread of the disease. And I think for right now it's clear that healthy policy is economic policy in the sense that the most important thing we can do to promote the wellbeing of our country, to resolve the uncertainty about how this is going to affect us, and to get on a path to be back to normal is to get the health crisis under control and to develop a strategy that moves to a system where we can get back to normal in the sense of being confident that either there are medical resources available to treat the disease in the future, or that there is a sufficiently big testing system so that we can confident going into society isn't a danger.

And I think some of this is directed at state and local governors and mayors who are the ones who are promoting these shutdowns. But I think at the end of the day there's just a widespread -- people are concerned about their health and concerned about the consequences of opening their businesses. I think that it's not as simple as the government closing it down. I think that the public health issues are having economic impacts in and of themselves that we have to be concerned about.

And so I think that the most important thing, again, is to allow the public health workers to ramp up their efforts and to make big investments there. And in the meantime, the other element of this is how to -- basically how to save businesses and how to save jobs. And at both a state level and now with a huge amount of fiscal support from the federal government, there are viable ways to do that, an enormous amount of resources.

And so I think for the near-term we can hunker down, we can take advantage, and we will be in a position in several weeks to be open again.

MR. WESSEL: I'm going to change my plan. We've got about five minutes left.

Louise, I want to ask you one question and then I want to turn to Janet.

So in our office, Louise, you are somewhat notorious for saying that the early forecast that this was going to be a minor downturn were wrong. So I'm curious, now that the rest of the world has caught up to you and we're talking about GDP shrinking to 20 percent annual rate in the second quarter, I'm wondering what you're looking at to determine -- when you think about how bad this is going to be and how long it's going to last.

MS. SHEINER: I mean the first thing that I was looking at to sort of think that the forecasts were really off was just sort of what share of the economy was in things like entertainment, restaurants, hotels, and saying that was four percent of GDP. So even if that went, even half gone, that would be an 8 percent annual decline in the second quarter, and that seemed just like the tip of the iceberg.

So now I think -- I mean 20 -- I mean I probably think it might be a little bit worse in the second quarter, but then the question is completely one of what the end game of this thing is. And so that's just something that we have a really hard time knowing. It's both about when we think it might be safe to sort of start sort of maybe slowly going back, but also how people feel about that. Do they think that this is -- do they believe it's safe, do think there's going to be another wave and so they're not going to reopen their business, they're not going to use any of their savings -- you know, all those things. And I think that it's really hard to tell. I am more on the pessimistic end of things, that these things will sort of have a life of their own. And I think relationships are going to be broken, and I think it's going to take time to get back.

And I think the thing to remember from a public perspective is with interest rates this low, if we make a mistake and we do too much stimulus, we raise our debt more than we otherwise would, but that's not very costly. If we err on the side of not doing enough in terms of making sure, you know, people have income, then we do risk making this a far worse thing.

And so I think when we think about that tradeoff it's really key that we want to sort of go with the pessimistic scenario when you think about doing fiscal stimulus. The triggers are obviously a great idea, but if that's not what you have, then, you now, just be -- err on the side of generosity.

MR. WESSEL: Janet, finally, there are a lot of people out there who are pretty nervous, people who have seen their retirement savings disappear, people whose jobs have evaporated, businesses that aren't sure they can survive this thing, parents who are struggling with kids who can't go to school, or wondering about older relatives and stuff.

So I wonder what you tell people about the capacity of our government, broadly defined, the Congress, the fiscal policy, the Fed, to manage this thing. Can you offer any reassurance?

MS. YELLEN: These are certainly scary times, but I feel encouraged by the response I've seen on the part of the government so far and the commitment to do all that's needed to get the economy and protect households and businesses so we can restart.

I've never seen a more rapid Fed response and they're giving it their absolute all. They're throwing everything they possibly can into responding quickly. And we are seeing bipartisan cooperation in Congress to quickly get out a package that is very meaningful. And in spite of the problems we've discussed today, really provides a lot of support to households and businesses that are affected by this. And we're seeing more cooperation around the world understanding that we have to work together to restore economic activity.

So I think people should feel reassured that policy makers are on this.

MR. WESSEL: Thank you very much.

I want to thank Janet, Louise, Amy, and Adam, and my colleagues at Brookings, Ed Burke, Andrea Risotto, Anna Dawson, who helped make this work, as far as I can tell, seamlessly.

We had a lot of questions we didn't get to and we're going to assemble them and, to the extent that we can answer them, if they're question that we're capable of answering, we'll try and figure out a way to post some Q&A on our website. And I encourage you all to keep an eye on the Brookings website, www.Brookings.edu, for more on the COVID crisis.

So thank you all.

MS. SHEINER: Thank you.

MR. LOONEY: Thank you.

MS. YELLEN: Thank you.

* * * * *

CERTIFICATE OF NOTARY PUBLIC

I, Carleton J. Anderson, III do hereby certify that the forgoing electronic file when originally transmitted was reduced to text at my direction; that said transcript is a true record of the proceedings therein referenced; that I am neither counsel for, related to, nor employed by any of the parties to the action in which these proceedings were taken; and, furthermore, that I am neither a relative or employee of any attorney or counsel employed by the parties hereto, nor financially or otherwise interested in the outcome of this action.

Carleton J. Anderson, III

(Signature and Seal on File)

Notary Public in and for the Commonwealth of Virginia

Commission No. 351998

Expires: November 30, 2020