Yale SCHOOL OF MANAGEMENT
Program on Financial Stability

Lessons Learned Oral History Project Interview

Interviewee Name and Crisis Position	Claudia Sahm[1] Principal Economist and Section Chief, Consumer and Community Research and Statistics, Federal Reserve Board
Interviewer Name	Mercedes Cardona (Contractor) Yale Program on Financial Stability
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Introduction:

The Yale Program on Financial Stability (YPFS) contacted Claudia Sahm by email to request an interview regarding her time at the Federal Reserve Board as a Principal Economist in the Division of Research and Statistics.[2] Sahm joined the Fed in 2007, where her work focused on macro forecasting; she also researched household behavior and responses to fiscal stimulus.

While at the Fed, Sahm proposed the Sahm Rule, a gauge to call the start of recession, based on an average of the unemployment rate. The rule is part of Sahm's work on the use of automatic stabilizers to improve fiscal policy response in times of economic crisis.

Sahm became section chief for the Consumer & Community Development section in the Division of Consumer and Community Affairs at the Federal Reserve Board in 2017. In 2019, Sahm left the Fed and advised Congress on fiscal policy. In 2021, she became a senior fellow at the Jain Family Institute, where she now serves as director of macroeconomic research.

This transcript of a telephone interview has been edited for accuracy and clarity.

Transcript:

YPFS: **We will be recording this. If you have any sort of caveats or disclaimers you want to make, this would be a good time.**

Sahm: I have no one I have to disavow my words from. This is a benefit of being self-employed now.

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[1] The opinions expressed during this interview are those of Ms. Sahm, and not those any of the institutions for which the interview subject is affiliated.

[2] A stylized summary of the key observations and insights gleamed from this interview with Ms. Sahm is available in the Yale Program on Financial Stability's *Journal of Financial Crises*.

YPFS: **Since this is an oral history, why don't we start with a little bit of narrative? You had joined the Fed in 2007, just as the crisis was brewing. Can you tell us about what you were doing then and what you were seeing? What were the economic forecasts showing?**

Sahm: I started at the Board of Governors in July 2007. Those first months were just a matter of settling in. Towards the end of the year, I began to train to be on the staff's macro forecast. This is a forecast that is put together before every Federal Open Market Committee meeting. It explains what we view as current macroeconomic conditions, and then where we think the economy's headed over the next quarters, over the next few years. That is one of many inputs into the monetary policy decision making process.

By the end of 2007, it was clear that there were stresses. Certainly, it was noted there were stresses even into the summer, in the subprime mortgage space. Now, the big question was, "Is this contained?"—as Chairman Ben Bernanke said in an infamous speech—or is it something that is more like a canary in a coal mine, that's telling us there's much broader problems brewing in the mortgage markets?

The latter was the correct interpretation to take. Subprime distress was a sign of much greater distress that was brewing in the markets. That was not where most economists, and certainly not the consensus of Federal Reserve officials, were at the end of the year.

I remember a briefing in the boardroom. I believe it was in either late November, early December. I was just there as a trainee. My focus was on consumer spending, household behavior. One of the things that we track—and I certainly used this throughout an entire career as a macro forecaster—is what's called the Survey of Consumers out of the University of Michigan. It's when we go straight to households and ask them, "How are you feeling about the economy?" What was happening towards the end of the year is, they were becoming more and more pessimistic; whereas, the macroeconomic data—the GDP, the business income, the more objective data—they weren't looking so bad. So, there was this disconnect.

I remember being in the board room, and having one of the governors basically ask: "What's wrong with these people?" It got turned into a joke about: "There's only 500 of them. Why don't we just call them up and see what's wrong?" but in kind of a snickering way. Like, "these people don't really understand."

Sometimes the survey can be hard to parse because you're going to people and asking them. I was kind of horrified sitting there because I do a lot of research with surveys. That's what my dissertation used. Those 500 people are a very special, selected group. They're representative of the US population. So, to write them off as if they were just some 500 random people that are feeling kind of down about the economy struck me as outrageous.

It was kind of one of those funny moments. If you're not laughing, you're crying a lot of times. I don't think it was meant to be as disrespectful as it sounded to me, but it was just one example of us explaining away some of the warning signs that we were getting.

My first forecast as the lead for consumer spending was January 2008. That was the forecast where we put in the tax rebates from the federal government, the 2008 tax rebates. It was my job to figure out what these were going to do to consumer spending. That kicked off research that I do to this day, using household surveys, on spending effects from fiscal policy.

Then, my second forecast in March 2008 is when we put the recession call in. It was that the forecast went from being just "GDP, blah, blah, blah," to: "We're in a recession." That's a fundamentally different kind of macroeconomic dynamic. No macro model is going to give you a recession. They just look different in terms of a break in growth and a climb in unemployment.

But the outside world had not gotten there. It was clear things were not so great. I remember our forecast meetings. These are internal staff meetings. We were told not to say the "R-word"—recession—in the building. Our forecast meetings became invite-only. So, only the people on the forecast were supposed to go. Whereas, normally, they would bring in people like me, who are new, to listen to the meeting, to have there for the learning. But they said, "No R-word in the building, invite-only." They didn't want it to get out and spook the world.

In April, our division director, Dave Stockton, who is an amazing forecaster, took the recession call out because things looked a little better in the data. It came back in with the June meeting, and then it stayed in for the duration. Our projection of what the forecast—the Great Recession, the financial crisis—was going to look like. It got worse and worse over the year, in terms of being the big one. . . until now in 2020.

YPFS: **Why were the experts, as you said, explaining away these symptoms? What were the conversations going on? Was it concern about creating a panic? Or was it concern about being wrong with the call and the possible effects it would have in the greater economy? Why is the conventional wisdom so often so tortured?**

Sahm: These are questions that I really grappled with, even years after the recession. I had a very hard time in the recovery because we seemed to be missing something, maybe we were being overly optimistic. I kind of sat back and wondered, "What is going on?" Because the staff, and not just the economists at the Board, but the staff across the Federal Reserve System, are well trained.

They are dedicated, and they are willing to put the time in. So, I wondered: What is going on, that we're missing something? Because it's not for a lack of trying or caring. It's just our tools, or the way we read the data, was not clicking.

I think I'd point to three things. The first thing, and this very much affirms the perspective you had: They didn't listen to people sounding the alarm inside the Fed. There is a group largely ignored at the Board, and I worked in this group, called the Division of Consumer and Community Affairs, my last two years. This is a group that has many functions. One of them is to oversee the community development function across the entire country, through the Reserve Banks. It has very few economists. I was managing a team of eight economists and research assistants. The thread that tied them together is a focus on low- and moderate-income families and communities.

They have boots on the ground. They were seeing, in 2005 and 2006 that subprime mortgages were creating a lot of hardship for people, particularly in these lower income communities, communities of color. The writing was on the wall. There were products that were getting sold to people that ranged everywhere from, not what those people needed and could afford, to outright fraud, to feed a mortgage securitization machine that was running out of control.

The Division of Consumer and Community Affairs group at the Board tried to get attention. The Fed governor, [Ned] Gramlich, who was the oversight governor for that division, was listening. He is pointed out as the governor that got it and went nose-to-nose with [Alan] Greenspan. Talking years later with some of the very senior staff in that division who were there at the time and are now retired, they said, "Even Gramlich was dragging his heels."

There were things they could have done in the regulatory space to really clamp down on banks that were doing some of these outrageous things. Greenspan was an absolute acolyte of markets, but it went across the board. The economists argued: "Well, the market can't be that wrong. They can't, there's no way these banks are making trillions of dollars of bad bets on the economy." Now, in hindsight, that's exactly what happened. Even Greenspan rewrote the foreword to his memoir to say, "I was wrong." That is so rare, to hear a macro-man say he's wrong. He was.

So, one piece is: the knowledge was there. They just weren't listening to it, because it didn't come packaged in the six-panel charts and the GDP. There are things they're used to looking at as indicators, and that's not where the news was coming from. So, they ignored what they had.

Now, the second piece was: How did they explain it away? Because it was percolating up. One of the things that I learned is that, when the staff thinks about current economic conditions—where they go in the real economy, in the financial economy—it has to look backward. Because that's the relationship. That's what our macro models are estimated with, relationships in the past.

I remember there was a very senior officer, in the middle of my time with the Fed, who said: "I need to have lunch with you. I keep hearing about you. I need to meet you." I'm like, "Okay. That should be an interesting conversation." I'm always a little worried about these, but he was someone who was very much on point in the financial crisis in the housing space.

We had lunch. I asked him: "These no-documentation, no-income-required, low down payment loans; how are those not bad loans? Why is it okay for banks to give them to people that they're not verifying that they could actually pay these loans back?" He said: "Some of these particular loan products, the “NINJAs,” the no-income-requirement, these used to be products that were used for older individuals who were retired but had a lot of wealth. They didn't need to document that they have great income sources because they had all these assets." But he said it was a segment of the market. I said: "But we could tell that wasn't the segment of the market that was buying these now."

That's just an example of this product that existed for a long time. It didn't cause any problems. So, why would it cause problems now? Knowing other non-economists who worked with this individual before the crisis, and other people like him who were economists, it was shocking how they had this sense of theory, and relationships, and big data aggregates, but they weren't connected to the real world. That disconnect really caught us and catches us every time the world changes very rapidly. So, that's the second thing.

I think the third thing that has spurred a lot of crusades of mine in recent years is the fact that we just have such a narrow focus. In terms of expertise, the economists listen to themselves. In terms of lived experience, we don't have a lot of people coming from low-income backgrounds. I worked with only three Black economists in my 12 years at the Fed. Recently, there was one Black economist at the Fed in the economics groups that inform the staff forecast, and she just retired among the 400 economists. So, it's just hard when you have such a closed, homogenous system to really get it when things are happening out in the world.

I think it's all three of those things. I will say, at the time I was at the Fed, there began an introspection. The Fed, I think, realized well before a lot of the economic profession—and frankly, I think some of them still haven't—that the system, the culture, the institution of how we did our analysis wasn't serving the policy makers as well as it should.

Now, fixing that is really, really tough, but I give them a lot of credit. I enjoyed being part of that process, to try and pull it apart, and put it back together in a better way.

YPFS: **Well, let's unpack that a little bit. You mentioned the forecast meetings being limited to staff, and the need for a reality check so to speak, from the real world to the economists. What was the state of communications between all the various organizations—the Fed, the New York Fed, the Treasury, the White House—before? How did it evolve during the crisis? Does it still need to evolve some more?**

Sahm: The point about the invite-only staff meeting was that it was during a very rare period of time. I will say that within the Board, not everyone who's a Federal Reserve employee has clearance and access for the forecast, but there are hundreds of economists who do. The hundreds of people at the Board who work on the forecast are in the conversation and can access nearly anything going on in the conversation—if you want to pick up a memo and that kind of stuff. Then, in the Federal Reserve System [the Board plus the 12 district banks and other operations], you add hundreds more economists who have access to that information, and there's a dialogue. They're part of the Federal Market Committee. The economist staff will come, and they exchange ideas, so that's a very open communication. But it's a closed system. That means whoever has been invited into that group are the only persons who will get to participate.

The interactions with other policy makers, I'd say probably the closest interaction that the Fed has in a technical sense, would be with other central banks. I can remember being on calls with the European Central Bank and the Bank of England. We're not sharing forecast details like, "We think it's 2% next quarter." It's more frameworks and basic thinking about risk factors in the economy, but there's a technical dialogue.

In terms of other policy makers in DC, the one that gets the biggest picture of the macro analysis would be the White House. Before every FOMC meeting, the Fed staff puts together a forecast document, both economic conditions, financial conditions, and then also monetary policy analysis: "If they chose this, this is the likely scenario, etc."

Fed staff put this document together before each of the meetings of the Fed officials. That document also goes to the White House. So, with every meeting, they can see what the Fed thinks of as the state of the economy. That document does not go public until six years after, along with all the meeting transcripts.

I can remember when I started at the Fed. I was having lunch with my section, and my section chief, David Lebow, was there. I had watched this process a little bit. This might have even been before the recession. This might have been in 2007. I said, "We have hundreds of economists. We pull all this data in from everywhere. It's so smart. We do all this analysis, and then we keep it to ourselves. We don't share it with the world. We don't get feedback from the world on that." All the color drained out of his face because I'm, "Why don't we publish it to the world?" He's like, "Oh, goodness no that would cause problems," which was a bit like, "We gotta keep an eye on her."

But what I realized once we were into the recession is, if we had been publishing those forecasts in real-time, we would have spooked the markets. At least this is what I thought. I'm less confident now. The world needed more information. We had it. Now, if we were wrong about the economy, about a recession, and things weren't going south, you could be self-fulfilling. Frankly, by the time the Fed, or the economists figure out we have a problem, we're already into the problem. So, the chances that we're going to front-run something that's not actually happening are pretty rare.

But the reality is, the Fed doesn't share until six years later. It does go to the White House. When I worked at the White House, I would read this document just to see what the Fed is up to, but that's one little piece of all the analysis at the Fed. Most people at the White House don't know how to read it. It can be subtle.

The Fed will interact with other agencies, to the extent it's information they need. They might work with the Federal Housing Authority, to understand some mortgage piece, or something like that. So, there's that. The thing that I think has improved to some extent, but is still the weakest link, is bringing in people from the outside to have an exchange of ideas. And give us critical feedback.

At the Federal Reserve, this has been tricky, because we don't want to give private information out to a select group of people. There have been cases where a select group of people have gotten information and then they do insider trading on it. Very bad.

The Fed generally gets very scared when it tries to talk to people. Because if it says the wrong thing, it can create a market kerfuffle. But if it doesn't talk in a way that people can understand, it becomes the center of all these conspiracy theories and real negativity. Then I think they miss out on actually serving the people because they're not in a dialogue with them.

They've tried various things to open this up. They have some Community Advisory Committees, but it's still a very stilted, highly-choreographed exchange. I think that could be better. But if you don't have a diverse staff of economists, then you have to find a way to bring ideas and feedback from outsiders into the dialogue. You have to listen to non-economists at the Board.

YPFS: **You were speaking about spooking the markets. First we had Bear Stearns in early 2008, then the big one, Lehman, and the AIG crisis. How**

did the thinking around the financial system evolve as we saw these institutions showing signs of stress?

Sahm: I'll be really clear. I was very new at the Fed in 2008, just coming straight out of academia. So, I was not prepared at all for what I was walking into, nor were many economists. I worked on economics, like the GDP, the consumer spending. So, I was not an expert on the financial side.

Now, I can remember more than once going over to go up the elevator to the cafeteria and seeing people like Nellie Liang, and asking, "Okay, what blew up now?" Because every week, there was some product that did. This was something relatively new: The problems were so widespread and were showing up in parts of the market like mortgage-backed securities. They were impacting very specific pieces of that market that had grown a lot before the crisis.

I do think that some of our financial sector colleagues were playing catch-up. It's like putting out fires instead of getting ahead of the fires, because it was moving so fast, it was in so many pieces of the market, and it showed up in places that were unexpected. Thinking of the hedge funds, like Bear Stearns, Lehman, they might have gotten ahead of their skis.

But AIG, that was a risk that the Fed did not really understand until it was too late. I hope you talk to Ben Bernanke, too. But one of the things that's really striking in both his memoir and in his speeches after the crisis is: AIG is his regret. In the sense that that company did not deserve to be bailed out, at least not the part of it that really put the economy in harm's way, but he and the Fed had no choice.

I believe that. I think Bear Stearns was their lesson. They probably shouldn't have let that one go. That really did cause disruptions. Lehman, they were kind of learning as they were going. Lehman was very messy, but AIG was the one that could have cost the Fed. Because that was a bailout. Even within the Fed, it was like: "We've got to do this," but it's: "Ugh. Hold your nose and jump."

If they had brought someone in who had just left AIG a year or two before, they might have seen it coming. They didn't.

I will say now things are changed a lot. But in their regulatory space, I know they didn't have regulatory authority over some of these nonbank entities then as they do now. But they could have used their bully pulpit to raise alarm bells, and they didn't. They missed that opportunity in 2005, 2006.

That's unfortunate, but Nellie, who I quizzed in the elevator, went on to stand up the Division of Financial Stability at the Fed, and I do think that's an area where they have better tools. It's still going to be hard, but they've thought a lot more about where these systemic risks are, and try and monitor where they could be, and try to get ahead of them.

This March [2020], I give a lot of credit to the Fed. There was an immense amount of disruption in financial markets. The Fed stepped in; they had to keep doing more, but by the end of March, they had it under control. If March 2020 had happened in September 2008, I think given the tools and mindset that the Fed didn't have then, it could have been worse. September 2008 was really bad, but I think they would have been overwhelmed then. This time, they were ready.

YPFS: **The [GFC] crisis came to a head just at the peak of an election campaign where there was going to be a new administration. How much of that was a factor in the discussions on how do you attack the crisis, as it became clear that this wasn't just your average economic cycle?**

Sahm: First I'll say, anyone at the Federal Reserve who tells you the Federal Reserve is not at all involved in politics is wrong. Full stop. For many staff economists, and staff in general, their work is independent from politics. But at the top of the house, there is no institution in DC that is not touched by politic. The Fed is no different.

I do believe they try hard to make their decisions independent. Congress doesn't tell them what to do. It created the Fed and can take it away. But in a big sense, Congress hasn't gotten into micromanaging. So, the Fed doesn't listen to the President, even if he's tweeting at them. They're going to do what they think is the right thing. But Fed officials do understand that there are political ramifications to what they do.

There are times, like in 2008, in September. I can remember sitting at my desk, refreshing on the *New York Times* and the *Wall Street Journal*, just watching the stock market in freefall, and Congress voted down the relief package. It was a bailout-type package. I sat there and I was like, "How? How is Congress not doing it?" Financial markets are teetering on the edge, and Congress was like, "Mm-mm [negative], not doing a bailout."

So, that was a political decision. They're elected officials. I'm not; Fed officials are not. But then, not too long after that, the Federal Reserve stepped up and said, "We have emergency lending powers, Section 13(3). We are using those now." So, they took a step that Congress didn't, and they knew that they were putting it all on the line. They had the legal authority. No one on the Hill—or very, very few people—knew that authority existed. If they knew it existed, they probably never dreamed that the Fed, which is known for not being bold and flashy, would use it, and the Fed used it.

That was very important. I truly believe that was the thing we needed to stabilize financial markets. It was also extremely unpopular with many elected officials on the Hill, and the Fed knew it. They had to know that backlash was going to happen. Later in Dodd-Frank, they lost the ability to do that independently. Congress said the Fed would have to have approval from Treasury to do that emergency lending.

Over a weekend in late November 2020, [during] the mini-crisis with the relief package, there was language added in, in a draft by Senator [Pat] Toomey, that would have restricted the Fed's Section 13(3) authority even more. It was very ambiguous, the way it was written, that the Fed would actually have to go to Congress to get authority for emergency lending. That would be a massive problem, because the Fed and Treasury can move a lot faster than Congress. In March 2020, they moved really fast, and they had to. If they had to wait on Congress, and wait on the politics, it's a little bit of a crapshoot as to whether the political powers will step in.

I do think there is a myth, and it's maybe in a protective sense, that the Fed likes to tell about: "We're not in politics." They may not be political, but they are absolutely tied into this dance of politics.

YPFS: **You were talking about how the regulatory response has evolved. There was this sense coming out of the crisis that the public felt that the banks, the auto industry, and big businesses were bailed out, while people were left to foreclosure and bankruptcy. So, what's the lesson there, in terms of regulatory preventive regulation, and regulatory relief once the crisis blows up?**

Sahm: I think this is an area where the Fed still has to do better. It's better, but they still need to do better in terms of their tools. I think they've come a long way since 2008 in terms of the tools they need to assess systemic problems in the financial industry that go beyond the banks that they normally regulate and oversee. So, they have many more tools. There are many more institutions that are not just the Fed. The Fed's part of FSOC, so there's a lot more infrastructure to think about financial risk.

I think because they think about systemic risk, that means they have to do a lot more work on bank-specific risk, like the stress tests. And then the Fed, the biggest division at the Board, is the one that regulates banks for safety and soundness. Most employees at the Board work on making sure the banks are doing things that will not take them under. We don't like runs on banks.

So, all of this oversight of the systemic risks, which included the stress tests, monitoring the individual banks, etc., that sets the Fed up in a better position to catch problems at banks that the Fed was always been responsible for understanding. Whether it's bank risk procedures or just supervision of programs and products the bank does. I think all of that puts us in a much better place. Yay, Fed.

Now, where they continue to have lots of struggles is in being able to communicate to Main Street. In addition to communicating to Main Street, figuring out how to serve Main Street. The communication issue will not be solved by economists. I try so hard. I write, now, an opinion column for the *New York Times* on the Federal Reserve, and try and put the Fed into people words, to pull back the curtain, so to speak, to say— "There are real people there. They care. They are not the Wizard of Oz." But it feels like that because the Fed is so bad at talking to people.

There's a communication aspect that they absolutely have to work on because they're not good at this. The average person can't rely on explanations like, "By helping Wall Street, we indirectly help you on Main Street, because now you can go to your bank. If we didn't help the banks, then you couldn't go to the bank." Okay, fine. This is true. But the reverse logic would also work. If the Fed just directly helped Main Street, if they actually did their job and kept us at full employment—guess what? —it would indirectly help Wall Street.

This idea that they only go in one direction is ludicrous. In the CARES Act, they were instructed by Congress to set up emergency lending facilities that were going to go to middle-sized businesses and municipalities. I was over the moon. This is the Fed directly helping Main Street. These facilities, they kind of worked, but they really didn't work. They certainly didn't work the way Democrats had envisioned them. They were an overreach, relative to what Republicans wanted.

But it also just showed that the Fed didn't know what they were doing serving medium sized businesses and municipalities, many of which don't have the sophistication in terms of understanding that a big, huge hedge fund on Wall Street has. The Fed just really has to go back to the drawing board and understand, "In the next crisis, or next year, how would they do that better?"

They've got to learn lessons from this year so they can serve Main Street better. They took the first baby step, but the baby step was so much smaller than in 2008 for Wall Street bailouts because they haven't been as connected with Main Street. It's messier, and it does get into politics. The Fed never wants to pick winners and losers. It wants to do this big stuff. You can do that with big financial markets, but at the end of the day, businesses and communities are not big. I think the Fed can do better there.

YPFS: **You say the Fed doesn't like to pick winners and losers. But isn't there also, when dealing with these relief programs, a certain amount of value judgment like there was during the recession? Do we bail out house flippers along with just plain old homeowners who got in over their heads?**

Sahm: Central bankers are very concerned about Dodd-Frank, in that the one piece of Dodd-Frank limits the emergency lending facility of the Fed by requiring the administration and the Treasury to agree before they can use these powers. I personally think that that step is good for the Fed.

Now, there is a downside risk, where the administration is just out to lunch and they don't pass it. But usually the Secretary of the Treasury is in touch enough with financial markets that they're not going to let them go under. Though, they are often more connected with Wall Street than with Main Street.

In the CARES Act, they did this too. Congress told the Fed and the Treasury to go off and figure out the details. The CARES Act told them to stand up, create these two lending facilities: middle-sized businesses, municipalities. So, they had to agree in tandem about eligibility, and which loans would get approved, etc.

Now, there were disagreements. The administration wanted to be more restrictive in some of these loans because some of them were more risky loans than lending off into the Treasury market. That was frustrating. I'm frustrated. I thought they could do more.

But Treasury is connected to an elected official. The Federal Reserve, when it starts using extraordinary powers, they are not elected officials. They have oversight by Congress, but it's not the same as the American people can vote them in or out. So, the administration, Congress, the American people have put them there knowing full well they're going to pick winners and losers. They can't do everything.

So, I think for the Fed to have the administration say, "We're going to tell you how to set this up. We're going to decide this eligibility. Hey, Fed. You all are real smart. Go off and make it happen." See, that takes a lot of the politics out. Whereas, in 2008, because they were going it alone without Congress, they were making big decisions that had a lot of ramifications. Frankly, they really bordered on, if not stepped over, the line of democratic institutions, because they don't have the accountability to voters. Now, the Fed was doing it in good faith, but they're not perfect. And again, they're not accountable.

What Dodd-Frank did with the emergency lending facilities is good for accountability. There's a lot of people who are experts in monetary policy that would firmly disagree. But I think in this nexus of the political decisions that have to be made, it's better to have those made by political actors, and then give off to the technocrats to make it happen than leave it to the technocrats who, frankly, aren't always qualified. They are not just not accountable, they're not always qualified because of the closed system at the Fed.

If you get too far into politics and you have Congress, which is a massive body that is not known for getting its act together quickly, in charge, I do think that would be a bad step further. As long as Treasury's doing it, Treasury's attached to the President, the President's elected. To me, that's enough of a buffer. But it doesn't always have to work out well. There is definite foot-dragging by [Treasury] Secretary [Steven] Mnuchin, which I would not expect under Secretary [Janet] Yellen. But that's politics.

YPFS: **That leads us to a discussion of the Sahm Rule, and the issue of creating some kind of a structure for early warning system and direct stimulus triggers. Is this a means of speeding up that decision of stimulus, reduce the political arguments that we were just talking about, take those value judgements out of the debate? Or does this sort out that entire situation by having some kind of hard line and automatic trigger?**

Sahm: I work on proposals for automatic stabilizers, and that's just a fancy word for fiscal policy relief that Congress puts out in recessions, on autopilot. I think of that as guard rails. I wouldn't put all policies on autopilot. Congress has a job to do.

But there are certain programs, certain relief programs that happen in basically every recession. Recession after recession, we have sent direct payments out to families, a lot of families. We do enhancements of the unemployment insurance system: a little extra in weekly benefits, extending the durations. This time, we saw more people made eligible. We'll often bump up the food stamp amounts. We'll often increase some of the funding to state and local governments. So, there's a core group of policies. Congress could agree or disagree on exactly which these are. Is it three? Is it four or five? Whatever. We do those every time, so let's put those on autopilot, so then Congress can deal with the current [situation], what is different about this recession. It'll clear up bandwidth.

After the Great Recession, Congress could think about good policy to deal with the overhang in mortgage debt and underwater borrowers. At that time, Congress had to address both usual stimulus and new mortgage policies. In 2009, they were trying to figure out this huge relief package with unemployment insurance and other issues. And they were trying to figure out how to help borrowers that were in distress—mortgage borrowers.

This time, we have a pandemic. It would have been great if Congress had a lot more time to think about keeping people safe and public health response. But again, they were trying to do the usual economic relief at the same time. So, in terms of the policymaking burdens in the moment, already having put some policies on autopilot will give you some space to do focused, thoughtful deliberations.

The other thing is, if we know we're going to do these policies anyway, let's build the administrative systems to do them right. So, it's not this kludgy, in-the-moment, slapping-it-together solution. If some policy change happens now, state agencies can't implement it. Just don't do that. In a quiet moment before the crisis, agree on the best basic policies, build the infrastructure, and then they're ready to go.

Now, this ready-to-go part is where the Sahm Rule comes in because, if you're going to kick off a multi-hundred billion dollar relief package, it probably ought to be in a recession. My motivation was to think about putting fiscal policy in recessions on autopilot. Specifically, I'd done a lot of research on direct payments to people. They are good for economic reasons, political reasons. You give people money, they're happy, and it supports spending. So, that was my proposal. But to make that proposal the kind of thing that somebody in Congress could pick off the shelf and do, I needed to have a way to know: "We're in a recession. Let's go."

So, the people at Fed already understood the basic principle of the Sahm Rule, but they didn't sit down and create a rule to say we're in a recession; I did, because the Fed has a little different objective. They want to get ahead of a recession, and they can have some false positives. A quarter-point down on federal funds rate isn't going to hurt much outside a recession, but I wanted an indicator that was very reliable, and it triggers only when we are in a recession—early in a recession.

What the Sahm Rule is: I look at the monthly unemployment rate. We get this very quickly, a couple weeks after the end of the month, and it's highly followed. Frankly, it's why we hate recessions. Millions of people lose their jobs. That is the pain and suffering in recessions.

What I do is, I take that monthly unemployment rate for the country as a whole, I average it over the past three months, because bumps and wiggles in data ought not to kick off massive relief packages. Then I take that current month's number and compare it to the lowest in that series over the prior 12 months. When there's been an increase of a half a percentage point or more, we are in a recession.

This has been a perfect indicator since the 1970s. I went all the way back in the data to the 1940s. Every once in a while, it will trigger ahead of recessions. Mind you, the data then are not comparable in quality to now, but it's pretty good. It's simple. It's easy to explain. It's about the unemployment rate.

So, that is what I had proposed as a trigger to start the policies. What I have been working on more in recent months is: What's the best trigger off? It's not the reverse Sahm Rule. That gets a little weird and hard to explain. But most triggers off for programs are some kind of the level of the unemployment rate. Whether that's just a level, or even better, it's a level relative to the level before the Sahm Rule turned on.

There's an intuition for it, but I haven't had a chance to do the same kind of in-depth thinking and research as I did on the Sahm Rule—the trigger on. The Great Recession showed that this is important, especially the trigger off, because Congress loses the will to keep spending money. It's absolutely been borne out true this year. They triggered it on. Actually, the Sahm Rule wasn't the reason they passed the CARES act, but it totally lined up. The Sahm Rule just went off the charts. It never was a half a percentage. It was five percentage points its first month. This is a very unusual recession. But not long after passing the CARES Act, Congress stepped away. We had to go into a big hole again last winter to get more relief passed. That would not have been an automatic stabilizer.

YPFS: **The debate this time around was complicated by talk of blue state bailouts, and individual payments versus state and local aid, versus tax and regulatory relief. Is there a case to be made for direct stimulus versus state and local, versus the regulatory?**

Sahm: This is where I think, in a quiet time, Congress should decide what they're comfortable with as policies that happen every recession. There is bipartisan support for the direct payments. They're a very good front line defense. We can discuss: Should they be annual? How should they go on during the recovery? Stimulus checks are good policy.

The support to unemployed workers, there's debates about it, especially as the recovery goes on, but they're going to do that too. Again, we can figure out in a quiet moment what's the right way to do it. I think food stamps is another one where, we should never be letting children starve.

So, then there's this thing about state and local governments; there are some new issues to consider. . . The Payroll Protection Program, which was supporting small businesses this time, that could definitely be something in the future, once we improve the way that's administered.

Congress gets to decide what's in that bucket of standard relief in every recession. Then take that bucket of policies—which will never be enough in a recession because every recession has its own special crisis—and put the standard policies on autopilot. Then, Congress can focus on discretionary relief packages that they need to do in the moment and answers questions specific to the moment at hand. In the current crisis, they could ask, what extra help is needed? Do state and local governments need more, different relief because they're handling the public health? With the public health, should we be changing regulations in terms of liability shields? There are all kinds of things that will come up in one recession that wouldn't in another. Automatic stabilizers would let Congress focus on the special help needed instead of hashing out details about the things that they've always done in a recession and that they'll just do a little differently. It adds complexity, and it drains the scarce resource of attention.

The case is there; the economic case is there. I'm an economist, not a politician. So, there could be good reasons why you need to keep that basic relief discretionary. Maybe it was the benefits to the unemployed workers, or the direct payments that got anything done with this new relief package. Maybe you have to have relief that Congress has to adjust up or down on to get the other stuff through. I don't know, but I think it's very risky, especially in the recovery, to let Congress, basically, holding Americans hostage with, "Are you going to get economic relief, or not?" This is one where the Fed can make loans and push interest rates around, but that is not really going to help people feed their children.

Congress has to do that work and get money out. I have just been trying to help give them tools to do it better. I certainly have had a lot of interest since I left the Fed in 2019 at the end of the year, and I left so I could advise Congress. You can't do this as a Fed economist. I worked with over 20 Hill offices. I worked with committees, talking about the idea, how would you do it. So, there's interest. It's just that interest alone doesn't pass a bill.

YPFS: **We talked about the recovery earlier. There's conventional wisdom that the recovery from the Great Recession was long and labored, and not entirely satisfactory to some segments of society, as we saw with the Occupy movement and some other protests. What do you expect this economic recovery to look like from the COVID recession? Are the programs that were put in place in the CARES act, going to be enough to protect the economy from some kind of prolonged recession?**

Sahm: This recession is very different than the 2008 recession. Now, it is true after 2008 we, and by we, I mean economists in the Federal Reserve specifically, underestimated the negative persistent effects from the disruption coming out of the mortgage lending crisis. Because homes are a big asset for households up and down the income distribution. So, that ended up being problematic. What caused the Great Recession was the kind of thing that we now know would cause lasting damage; it would just be really tough. Then Congress stepped away and even did austerity. So, there were just a lot of things that made the Great Recession too slow.

Frankly, the consensus is, most of that real painful slog back came from the source of the crisis. Personally, I think Congress gets a lot of "credit" for how bad that was. But I think it's legitimate that a housing market crisis can be very damaging to households because it's in their assets and their wealth.

This COVID recession is different. February wasn't great for everybody, but it was pretty damn good. We had unemployment under 4% for over a year; it was 3.5 in February 2020. Things were so much better than they were in December 2007, right before we went into the Great Recession. But this pandemic, we'd never seen anything like this in lived experience. It set off an absolute freefall in the US economy.

Now, the CARES Act and legislation was written with the assumption that we'd shut down for a month, and then we'd get everything back on track in July. The virus would be under control. By July, we're all back at work. There were key provisions, like the extra money to the unemployed, that expired at the end of July. That just shows that the act was written for us to be out of the worst by then.

By July, the economy was recovering, and at a pretty good clip. We were out of the technical recession pretty fast because as soon as the economy starts getting back on track, you're in the recovery. But we weren't out of the woods. People were still working from home. Millions were unemployed. The virus was not under control.

Now [December 2020], we're in this massive surge in cases and deaths. Things are shutting down again. This is the worst-case scenario. You ought to prepare for the worst and hope for the best. Congress and the Trump administration repeatedly planned for the best. That's not what we got. The Fed planned for the worst, but they don't have the tools to get us to the best. It was a bad scenario. Which is a scenario that we saw after the Great Recession, but we have a different underlying cause.

We can have a recovery for most people, and the economy as a whole, that looks pretty robust next year, if the vaccine gets out. Before, it was: "Oh, is the legislation good to clean up the mortgage markets and help underwater borrowers?" That was what everything hinged on last time. This time, it depends on Big Pharma, and state and local governments making good public health decisions, vaccine distribution, people being willing to take the vaccine. That's what's going to determine if we have a slow recovery, or if we have a fast one. The vaccine will eventually get out there, but if it takes long enough, there will be permanent damage to families and businesses, then recovery for all could take much longer.

People will pontificate either way, but this CARES relief package and the one in December were good. Whether it is going to be good enough, we won't know until later in 2021. This will be it. Unless we have gone into an even deeper, more dismal place by March, which God-willing we aren't, and if Democrats don't have power in DC, there will be no more relief. Even so, this is not on autopilot. It is not tied to economic conditions; it's tied to Congress. Congress barely got it together in 2020, and it was only because we have more people dying every day than we did in 9/11. We have hospitals overwhelmed. Congress could not go home if they didn't do more. They couldn't look at themselves in the mirror if they didn't get something out. But we're not out of the woods.

You mentioned how this affects different people. We have not, for decades, been at full employment. This idea that everybody who wants a job has a job. I think in February, we were getting a lot closer: 3.5% unemployment. There were still parts, there are still groups of people—often people of color, those with less education, some rural areas, there's some geographic areas of distress, in persistent distress—where some workers were still on the sidelines in February.

We were seeing more and more of them come back to work before COVID, but that was after over a decade of expansion, very supportive monetary policy, and frankly, the tax cuts by Trump probably helped, too. Anything that would boost the economy and keep it running was helping people. We are a long way from February. If February's your goal, the $900 billion (in December 2020) that just passed is not going to do it. Or even the vaccine coming out in the spring.

My view is: Do more because what is the cost of getting us back to February fast? I'd rather we're there at the end of next year than three years from now. The Fed's forecast right now (and they had a policy meeting last week) doesn’t have us getting back close to February until 2023. I don't want to wait that long.

YPFS: **What were the lessons learned from the Great Recession that may apply today?**

Sahm: At a high level: Go big. Whatever you think you need to do, do at least twice as much. Go big; go fast. You must move as quickly as possible when you think there's a crisis, because that's your best chance of short-circuiting it. And you need to go broad as well. Don't think, "If I just take care of this one market, that will be enough." If you see distress, backstop five markets, not just one.

The Fed did all that in March—and so fast. Within the month of March, they opened eight emergency or credit facilities, eight. Sunday night press conferences: "Here's another one." So, they weren't messing around. The CARES Act is the same, too. For Congress to get that legislation out before the end of March, and it was huge. It was $2 trillion. This was Congress going big, going fast, and there was a lot in the CARES Act. It was helping lots of different groups that absolutely needed help—so beautiful. March was the moment where they showed that they learned all of the lessons from 2008 and 2009.

Now, we are in a different phase. We're in that early recovery phase, the 2010-2012 phase, except everything is so much more compressed right now. But that's the space we're in right now. There's a recovery, but is it good enough? The Fed I think has very credibly committed: "We will stay the course. We're not going to get all spooked that inflation might be coming, we've got to raise interest rates."

Jay Powell is so cute. In some of the press, he's like, "We are not even thinking about, thinking about, thinking about inflation (laughs). This is so far off." The Fed's done some changes to their framework to really say: "We're not going to get ahead of this. We're going to see sustained inflation before we raise rates."

That's the Fed. Right now, they're doing everything they can to support the economy. Which isn't enough, given their tools and the low interest rate environment, but they're like, "We're going to keep that support going until we're convinced that things are really back on track."

Now Congress, since May onward, has been divided. Democrats have been much more: "Do more. Do more." Republicans: "Do less. Do less," or "Wait and see." That was the big excuse over the summer. Well, things are going. Let's see how it goes.

There were three lessons from the beginning of the Great Recession. The other lesson, to be taken from the recovery, is: Stay the course. The Fed is committed to stay the course. That's what I just explained. Congress is not staying the course. What they just did with the $900 billion (December 2020) is just barely hanging on to the edge of the course. We were veering off, and they just kind of, "We'll do a little bit here to keep us back on."

Nine hundred billion is not a little bit. It's just potentially too little relative to the crisis we're living. $900 billion is a big package, anyway, but it took them a long time, and we had to get in a bad place for them to be like, "Okay, we'll do more." I'm concerned. We've seen "party over people" for months. We have seen a lot of gridlock and arguing in Congress. There is absolutely no reason to expect the Biden administration to have the magic wand to get all these logjams moved out.

So, we're really banking on our scientists, our health professionals, pharmaceutical companies to save us right now. Because Congress is not going to save us next year, if we still have problems. It's really sad, because that was the lesson that they should have learned from the prior recovery, that there are real costs to stepping away. If you make Americans pick themselves up by their bootstraps, it'll take a long time, and a lot of people will be very hurt. Then the whole economy will be hurt because there's less productivity, there's less growth.

A slow recovery will come back and hit all of us, but it hits some people really hard and there is no reason for that to happen. The federal government can borrow money. They can help people, and they're just not doing it to the extent they could. Somehow, they didn't quite learn that from the GFC recovery, and

I'm not even sure they're going to learn it from this time because they're so tied up in the partisan warfare.

YPFS: **So, rounding things out, if you were to write a memo to your 2007 self before you joined the Fed about what you learned from this crisis to warn the younger Claudia, what would be your bullet points?**

Sahm: I think the one in bold at the top would be, "Hang in there." In 2008, I was straight out of my PhD program. Me and a lot of people in that position would have some kind of Imposter Syndrome. I absolutely had that. I came to understand later that basically every macroeconomist, at that time, should have had imposter syndrome because we were all so blindsided by what happened.

But, my first year at the Fed was really, really hard because I care a lot about people. I have an emotional response to macroeconomic data, which I think makes me a good macroeconomist, but it's also something of an occupational hazard. It makes it really hard on me.

So, hang in there. I tell a lot of people now, because this is not my first rodeo in an economic crisis. I work with a lot of people for whom this is their first crisis; they were in high school or college when the Great Recession happened. For a lot of them, I give them the "hang in there" advice.

But also, in terms of economic policy, in terms of the advice we give, the work we do, “it's a marathon and not a sprint,” is a very recent thing I would tell my prior self. The work I'm doing on automatic stabilizers, this grew out of work I did in 2008 as a brand new economist. I was doing all that research on nights and weekends. Sometimes it felt like, "Does this matter?" But it did matter. But it took well over a decade to figure out how to formulate my research to a broader policy audience. Eventually, I figured out things like the Sahm Rule, that were seeds planted in my 2008 work.

Working on automatic stabilizers and this policy, this is not happening overnight. This will probably not be in place before the next recession. Though, I want it to be. I believe in it, but it is a marathon. There were times where I think, early in my career at the Fed, I was sprinting too hard. I'm lucky I had a support network, but it would have been a real shame if I had sprinted off the course and stopped, because I was able to do some good stuff. It just took time.

I think the third and last thing is, it's okay to be different. There's a real push. I love my colleagues at the Fed. I love a lot of the people I work with at economic policy; not all of them, but most. But, it can be really hard to swim against the consensus. It can be really hard to stand up and say, "Those models you've been using for 20 years, they're not working."

The thing is, the time when you're able to see that most, and I was able to see it most, is when you just start out. In my first few years at the Fed, that's when I figured out where we had our problems. But in your first few years at the Fed, this is not an easy time to raise your hand and say, "Excuse me. I don't think this is right."

I did that a lot anyway. Some people rewarded that and wanted to hear it, and then some other people came down on me hard. I think there were times where I doubted like, "What's wrong with me?" I had people ask, "Why are you doing this? Why are you on Twitter? Why are you talking to people? What's wrong with you?" I'm like, "I like people. I need to talk to people."

So, I think it would have been good to say a few words of encouragement here, to say it's okay to be different, and it's okay to be that model for other people. I believe really, I do a lot of work now to create space in the economics profession for people who are different. Different than me, but sure as hell different from the “representative agent” economist. I think that's something I've learned. I really believe that's absolutely essential for better economic policy.

YPFS: **In talking to some of your colleagues, some of them have brought up the idea that, yes, we need to question the conventional economic wisdom more often.**

Sahm: Yes, it's hard.

YPFS: **On, the idea of automatic guardrails and stabilizers, Jason Furman, who was one of Obama's economic advisors is in that camp as well: "Go big or go home, do it early, and try to make it as automatic as possible, tied to some measure like unemployment."**

Sahm: Jason was the Chair at the Council of Economic Advisors when I was there as a senior economist, so I worked with Jason. He's great. Then, he was a contributor to the same volume that the Sahm Rule was born in, "Recession Ready." He had a proposal on the automatic funding to state and local governments. He has a big platform, so it's helpful.

On March 11, he and I briefed the House Democratic Caucus at their breakfast. We we’re both like: "Go big. Go big."

YPFS: **That seems to be the new conventional wisdom, because the last two recessions have been so violent and so sudden. Maybe they are learning something, after all.**

Sahm: Yeah, fingers crossed.

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