***Beyond “Unprecedented”: The Post-Pandemic Economy***

**Episode 2: “Can the Fed Rescue Us?”**

[00:00:02] **Kathryn Judge:** The Federal Reserve is our nation’s central bank.

[00:00:05] **Peter Conti-Brown:** The Federal Reserve is exercising our power. This is a subject of deep relevance to what we do.

[00:00:12] **Judge:** Throughout the COVID crisis, the Fed has acted very aggressively.

[00:00:15] **Conti-Brown:** I do not think that they are on their back foot anymore.

[00:00:21] **[Media clips of journalists saying “unprecedented”]:** The coronavirus pandemic has tanked the global economy with unprecedented speed. The steepness of the decline here is unprecedented. This is a crisis that is unprecedented. It is unprecedented. And we just don’t know.

[00:00:35] **Eric Talley:** This is *Beyond “Unprecedented”: The Post-Pandemic Economy* from Columbia Law School and the Millstein Center for Global Markets and Corporate Ownership. I’m your host, Eric Talley, the Sulzbacher Professor at Columbia Law School and co-director of the Millstein Center.

[00:00:55] **Talley:** There’s one person in Washington who, simply by stepping up to the microphone, is all but guaranteed to move markets. And no, it’s not the guy you’re probably thinking of. Rather, the person I have in mind is a lawyer and an investment banker. And since 2018, he’s been the chair of the Federal Reserve Board. When Jerome Powell assumed that job two years ago, the U.S. economy was humming. Unemployment and inflation were at historic lows. And markets were surging. And then this winter, in the matter of just a few days, everything changed.

We rely on the Federal Reserve, or the Fed, to guide monetary policy and to regulate financial institutions, most especially in moments of crisis. And many of the levers it has to pull—stabilizing interest rates, buying up financial securities, shoring up banks—got pulled in the 2008 financial crisis. But beyond these tools, is there anything left in the Fed’s arsenal to address our current crisis? And how well will any of these tools work in an environment where traditionally apolitical institutions are increasingly becoming politicized? What role can smart and creative financial regulation play in digging us out of this crisis?

My two guests today, Professors Kathryn Judge and Peter Conti-Brown will help us sort through these and other issues as we explore a question about a national institution that plays an often hidden but all-important role in our economic well-being: Can the Fed rescue us?

[00:02:30] **Talley:** I want to introduce my guests. Kate Judge is the Harvey J. Goldschmid Professor of Law at Columbia Law School and an expert in finance and banking. She’s a regular contributor to *Forbes* magazine and has written extensively about financial regulation, regulatory design, and the Federal Reserve. Peter Conti-Brown is Pritzker-Pucker Family Visiting Associate Professor of Law at Columbia, an assistant professor at Wharton, and a non-resident fellow at the Brookings Institution. He’s the author of *The Power and Independence of the Federal Reserve*, and he’s an expert in central banking, financial regulation, and public finance. Welcome, Kate and Peter.

[00:03:08] **Conti-Brown:** Thanks so much.

[00:03:09] **Judge:** Good to be here.

[00:03:10] **Talley:** Kate, let me start with you. What exactly is the Federal Reserve?

[00:03:14] **Judge:** So the Federal Reserve is our nation’s central bank. It is the actor through which we get monetary policy. It plays a critical role overseeing banks and implementing bank regulation. It also plays a critical role during periods of systemic distress. And it is increasingly playing additional roles to facilitate the flow of credit to minimize the impact of shocks on the health of the real economy and the functioning of the financial system.

[00:03:43] **Talley:** One of the things that the Fed is generally identified as is being the key monetary policy agent in the United States. What’s the difference again between monetary policy and fiscal policy?

[00:03:56] **Judge:** So the general idea is that when you’re engaging in monetary policy, you’re not directing where money goes. What you are doing is affecting overall the cost of credit. So the way the Federal Reserve likes to put it is their role is trying to make it so either the tides come in or the tides go out and they affect all boats equally. Whereas fiscal policy is usually Congress coming in and saying it looks like states and municipalities really need some extra help. So we’re gonna direct money to those entities that we think are in need of particular financial support.

[00:04:35] **Talley:** And financial markets are sort of like that: It flows like water or at least it’s supposed to in theory. Peter, let me turn to you. So the Fed has all kinds of tools at its disposal. Kate’s talked about a few of those. But first, let me understand a little bit what it’s trying to do with those tools. What sorts of outcomes does the Fed traditionally attempt to accomplish or to meet?

[00:04:56] **Conti-Brown:** In a word, peace. Stability. The lines get blurry in a crisis, and that’s inevitable, but doesn’t mean the lines are obliterated in a crisis. The Fed has been doing credit policy for many, many decades. And since 2008, it’s doing something like credit policy more and more. And I think that this is probably inevitable. But I think it’s still desirable to say the sharpest tool we have for it is fiscal policy, and that’s to be done by Congress, the president, and the Treasury. The Fed is trying by affecting the availability of credit and the supervision of banks and the regulation of banks and, even in crises, the provision of emergency lending to institutions that it doesn’t normally work with. It just wants to keep the peace.

[00:05:44] **Talley:** And I guess the stability that the Fed is mainly interested in are things like inflation, interest rates, stable growth and the economy, stable growth in the money supply. Did I miss anything?

[00:05:55] **Conti-Brown:** Yeah. The biggest thing that the Fed is pivoting toward, and that is the availability of jobs. Generically, not hiring people for specific tasks, but just labor market conditions so that people who want work can find it because it’s available, given the general economic climate that the Fed influences.

[00:06:17] **Talley:** Interesting, well let’s talk about that economic climate right now. If you were forced to put our current crisis on a scale between one and 10, with 10 being the most extreme, where would you rank it in terms of its intensity, its likely duration, and downstream consequences, and why? Kate, let me start with you.

[00:06:35] **Judge:** I would say right now it looks like a six or seven, but it’s really going to depend on whether or not Congress provides additional support in addition to how the Fed continues to fulfill its dual mandate. And as Peter just alluded to, throughout the COVID crisis, the Fed has acted very aggressively with all of the tools available to it. And most of those interventions have been explained by their efforts to support labor markets. So we have seen time and again Chairman Jay Powell referred to the fact that the Fed has a specific obligation to try to ensure that the people who want jobs are able to find them. And one of the most horrific effects of the crisis thus far has been the massive spike in unemployment and the particular spike among those who are making the least. So I think we have a real concern with trying to make sure that there’s employment opportunities for those who are traditionally are closer to the margin.

[00:07:40] **Talley:** What about you, Peter? Would you rank this somewhere around between a five and a seven or above or below, or do we just not know?

[00:07:47] **Conti-Brown:** I think a five and a seven sounds right with a very high standard deviation. From a historical perspective, we’ve had several acute crises in unemployment. The worst since the Great Depression was the recession from 1980 to ’82. And then we had the 2008 crisis. And in March and April, it looked like we were doubling those peaks. But unemployment has come down an awful lot in the months since then. But we don’t know what tomorrow will bring. We do know that the Fed is nearing the end of its ability to experiment innovatively at places where that unemployment is feeling most acute. At least the Fed certainly thinks that, and most people agree. And so what tomorrow may bring could be a much more dramatic display of fiscal force, an epidemiological resolution to the current crisis, or it could be an exacerbation on both fronts, in which case this would once again take its dismal place as one of the worst crises that the republic or even the world has ever encountered.

[00:08:50] **Talley:** Certainly seems to me appropriate that the COVID crisis have an epidemiological solution. One of the things that I’m sort of interested in, because you both lived through and have written extensively about the financial crisis in 2008 to 2012, you know, in some ways that was almost a textbook financial crisis. It first hit financing securitization and insurance markets, and it spread from there. And the thing that’s kind of interesting about that crisis is that it was right in the Fed’s wheelhouse. I want to flash forward to today, though. How well equipped is the Fed to deal with today’s crisis?

[00:09:26] **Judge:** I think it is very easy, with the benefit of hindsight, to look at the last crisis and say that was exactly in the Fed’s wheelhouse. They knew what they were doing. It was bad to the system, which is this term of art that gets used in central banking that effectively says we want central banks to step up and provide liquidity whenever the private markets are failing to provide adequate liquidity. Traditionally, the Fed has played a role trying to support financial market functioning by supporting banks, many of which it oversees. Whereas the last crisis really erupted in a market-based system of intermediation. And the reason I think it’s so important to emphasize that is, what we really saw over the course of the last crisis was incredible creativity by the Fed. But it took them a long time to get there. The crisis was more than a year in the making before Lehman exploded. And it was a long time after that before we really got the economy on track. And so we saw this ongoing experimentation in innovation by the Fed. And so we think we very likely will see something similar this time. It’s a very different crisis because, as you said, it was a shock to the real economy having spillover effects into the financial system. But what we are seeing is the Fed is already starting to get a little more creative in the types of tools that it’s willing to use. Monetary policy alone won’t be the solution. But whether they’re willing or able to create additional tools, that we’re still going to wait and see.

[00:11:04] **Talley:** Interesting. Let me actually pick up that thread and weave it in with something that Peter mentioned earlier. Peter, as you noted, the Fed has been notably active in recent months, and in the spring and summer it was almost on a buying spree, not just of government bonds, but even corporate debt and various other sorts of financial assets. And in fact, the numbers really revealed it’s between mid-March and mid-June that the Fed’s portfolio of securities that was just holding onto that it had purchased increased from under $4 trillion to over $6 trillion. First, how unprecedented is that? And second, is the Fed close to out of bullets to use here? Or does it have some extra mojo, some extra tricks up its sleeve that it might be able to deploy?

[00:11:51] **Conti-Brown:** So in terms of the just absolute value signs of the Fed’s balance sheet, we have never seen anything like what we are seeing. In terms of the relative change to its baseline, if we take its baseline right before this crisis and then extrapolate forward, then we did see a much larger increase in the balance sheet in 2008. As Kate said, and I think that this is a really important point for understanding the history of 2008, what seems natural in hindsight was in fact quite controversial in the moment. And right now, I feel up to my eyebrows in controversy as I look at what the Fed is doing. And 10 years from now, we might say, oh, yeah, no, it’s no big deal. They’ll just open up a small business lending facility, it’ll be no problem. Right? And so what will the Fed do? I do not think that they are on their back foot anymore. I think the central bankers at the Federal Reserve still regard peace and stability as the thing that they are trying to secure. And I think they are willing to push their legal authority to the limits. They’re willing to push markets and insert themselves in markets to the limits. My biggest fear right now, and we can talk about this in more detail, isn’t, in fact, what the Fed might do, but the politics around what the Fed might do and how Congress might react to the Fed’s experimentation. That, to me, is a bigger concern

[00:13:19] **Talley:** Even from a simple economic perspective, the tools the Fed has to use aren’t necessarily cheap. It requires the Fed to spend hundreds of billions, even trillions of dollars buying up government bonds or other sorts of securities. And this task gets even harder when the government is running historic deficits. And in addition to the Fed’s balance sheet, the U.S. government’s balance sheet is very much lopsided right now. The deficit for next year, or this year, I guess, is projected to be just under
$4 trillion, which represents 20% of our gross domestic product. And that’s just an astronomical number by historical context, you know, four or five times as high as we have seen ever historically. And financing that is going to require the Treasury to issue a bunch of government IOUs that the Fed’s going to have to fumble to keep up. That usually—at least the textbook account of this, Kate—suggests that this is a recipe for an inflationary Zimbabwe-like explosion. Do you think it’s gonna happen?

[00:14:23] **Judge:** I think most people think it’s quite unlikely at this point. That’s what many critics thought might happen given the expansion in the balance sheet after the last crisis. And we saw just the opposite. We saw unemployment falling and continuing to fall, reaching just 3½%. Inflation remained below the Fed’s 2% target. What we actually saw is not just in the United States, but across the world, at least in many developed economies—a challenge where the natural rate of interest just seemed to fall below what it had been historically. And so the Fed and other central banks have been grappling, even before the crisis hit, with trying to accommodate these new monetary realities. Inflation is never off the table, but right now it is certainly not the most pressing concern of the Federal Reserve, nor should it be.

[00:15:27] **Talley:** Well, let me then careen in the exact opposite direction. You know, on some level maybe there’s even a bigger threat of deflationary movement in the economy and current interest rates, as we know, are at astronomically and historically very low levels, and had even gone below a zero percent interest rate in certain other countries, such as Japan and Denmark, Sweden and Switzerland, maybe even in a short amount of time in the U.K. Is zero a limiting point, or is it just a point on a scale? And should we not be worried about deflationary pressures and negative interest rates? Let me start with you, Peter.

[00:16:08] **Conti-Brown:** Let me be a lawyer, then an economist, then a politician. So as a lawyer, it matters because we don’t have a good legal framework for understanding how the Fed can charge banks and other participants in the economy rather than pay them for the pleasure of holding on to money. So crossing zero lower bound represents some legal problems that have not been worked out. The economist answer is that zero is just a point on a continuum like any other. And the idea that we can get interest rates lower than zero—we have seen them even in the United States. Not the Fed’s policy rate, but market rates. And that just means that people are so eager to hold on to U.S. assets that they’re willing to pay a price to do so. And interest rates are relative and in very important respects, not absolute. So negative interest rates economically may in fact be the very thing that the economy is demanding. Politically, the level of toxicity associated with moving into a negative interest rate regime, as has been experimented within Asia and Europe, I think is hard to overstate. My guess is that negative interest rates as a policy matter are not in the near future in the United States. That’s certainly what the central bankers at the Fed have said. But there’s no economic reason why that would be.

[00:17:27] **Talley:** Well, let’s peel that back a little bit. The idea of the institutional structure, the Fed, is clearly a really important issue in thinking about how we might go forward. These days, at least, the popular sentiment seems to be breaking down, that it’s harder for the Fed to stay free of politics and possibly harder for politics to stay free of the Fed. You know, Peter, you wrote an entire book about some of these issues. But what do you think about this trend? Is it a real trend, or has it been going on forever?

[00:17:59] **Conti-Brown:** I regard the crisis of technocratic governance to be one of the headline stories of the 21st century. And I think that the Fed is not only not immune from that, it’s at the center of that story. It is remarkable that in over 100 years, the Fed’s overt actions on behalf of one party or another or the utter lack of corruption scandals in the Fed, these are remarkable events. But to say an institution is political, or that it’s engaging in value judgment, or that there is a boundary between where technocratic consensus ends and where action still continues is not to accuse the Fed of acting badly. It’s simply to accuse it and identify it as the political institution that it is. So this has always been going on. I think we’re in a moment where throughout the world a consensus about the value of technocratic governance is breaking down. And so the Fed has to do more to justify and defend its technical approach. And that will expose places where we’ll hear central banking’s bankers say more and more, “We actually don’t know the answer to this question, but we still have to move forward.” And I think those kinds of conversations are importantly political. And it is important that the Fed participate in them. But we can’t pretend that the Fed is this some sort of magical institution that is immune, unlike the rest of us, from having a world view, because that’s not the case.

[00:19:33] **Judge:** Two points to really draw forward. One, this is not specific to the Fed. I think there was a trend that actually did not persist throughout the last century, but took hold just really in recent decades of having greater faith in technocracy. And this is what enabled the Fed to operate without quite as much direct political scrutiny. But it is also what led to a lot of international organizations wielding increasing sway in policymaking that then had to be implemented across different jurisdictions. The other point to highlight is that there is a difference between saying the Fed is in or out of politics and trying to figure out, well, how are they in politics? As Peter alluded to, they’ve never been immune nor ought they be immune from the political system. The political system is how we achieve legitimacy. It’s how we garner accountability. It’s how the public buys into the policies that are governing them. On the other hand, it is particularly important for central banks to have some protections from direct accountability to politicians. So it’s really not, should they be enmeshed in politics or should they not, but how do we allow them to be just enmeshed enough that they don’t become enmeshed in the ways that could actually undermine their ability to do their jobs well?

[00:20:51] **Talley:** Let me transition a little bit to the institutional structure of the Fed. It’s a good topic for both of you, given, quite frankly, and don’t take offense by this, what strange birds both of you are. And here’s what I mean by this: Economics departments at business schools and policy schools, they have gobs of people who study the Fed. In law schools, where expertise really does concentrate on institutional details, traditionally, there are very, very few. What’s up with that? Why hasn’t this area historically attracted more attention from legally minded scholars and researchers?

[00:21:25] **Conti-Brown:** Although the Federal Reserve arguably is the most powerful agency of government, second to none, including the Supreme Court, it isn’t subject to judicial review in the places where it exercises that power. And lawyers, the conceit of legal science is predicting what courts will do and making analytical arguments about law in the shadow of judicial review. So you take that off the table and all the sudden lawyers and law professors are going to be a little bit less interested in understanding that decision-making process. Now, ironically, although economists are much more attuned to the power of the Federal Reserve, they don’t care much about process, and procedure, and institutional detail, and governance, and these kinds of things that lawyers and legal scholars tend to specialize in. And so it fell between two stools for many, many years. But I think the intellectual task here, for lawyers especially, is to recognize this is a subject of deep relevance to what we do. And so it is incumbent on us, given the privileges of a law license and certainly as legal scholars, but really lawyers everywhere, is to learn the jargon that is necessary and break down the jargon that is not so that we can participate in this conversation as peers with anyone else who might do so.

[00:22:48] **Judge:** I agree that Peter and I might seem like strange birds at this moment, but I will say our flock is growing. I think the 2008 financial crisis revealed that in order for the Federal Reserve to continue to do what it is doing and to do it well, it needs to not only have a technocratic component, but it needs to be able to continue to establish the legitimacy of the decisions that it’s making. And I think lawyers and legal academics have always been central to that process. So I think the importance of legal academics who can understand the Fed from the inside but also bring a wealth of knowledge about institutional structure is going to only become more pressing as we look forward.

[00:23:36] **Talley:** So that kind of picks up on another issue that I really want to push you guys on, which is that you’ve also sort of said, look, the Fed’s going to get more creative. Things that seem completely beyond the realm now might in 10 years be deemed to be something that, of course the Fed engages in that. And I want to invite you to think a little bit prospectively and creatively about what sort of out-of-the-box thing might the Fed be doing, possibly, you know, in conjunction with other branches of government that it isn’t doing enough right now.

[00:24:09] **Conti-Brown:** I’d love to see a renaissance of the Fed’s discount window.

[00:24:15] **Talley:** What’s that?

[00:24:16] **Conti-Brown:** The Fed discount window is the way time immemorial that it has lent to banks facing some kind of distress. And that distress might be their own, that’s the historical function, or it might be on behalf of their customers and clients. What I’d like to see are more of these kinds of discount window facilities, so engaging in what the Brits call funding for lending. So the Fed creates these facilities and says, “All right, banks, here is cheap or free financing to accomplish these ends. But you do the underwriting, you carry some of the risk, you have the relationships. We will regulate you, but we are not going to be in the position of picking winners and losers. And this is not going to be an emergency action.” So this could be really useful, for example, for what is probably a coming crisis of medium-sized bankruptcies: Not being able to stay alive because they can’t get access to mid-bankruptcy funding. I think the Fed could fix this by rejuvenating its discount window approach rather than simply going from zero, which is open-market operations, to a thousand miles an hour with our hair on fire, which is emergency lending in all its many forms. There’s an intermediate step, which is a very old tradition that could be innovated to accomplish some of these very same tasks.

[00:25:38] **Talley:** Now to push back a little bit on that. About 12 years ago, the Fed opened up its discount window—not as broadly as you’re saying, but that they opened it up for all sorts of banks to have what had then been unprecedented access. One of the problems that happened then, as I recall, is that a bunch of banks didn’t actually want to accept that money because doing so would be a publicly observable sign of their own weakness. Is that, would that be a danger under the proposal to open up the discount window more broadly?

[00:26:06] **Conti-Brown:** No. The discount window here, the model is not you’ve come to the discount window because you are in trouble. You’ve come to the discount window because your customers are in trouble. And so this is a bank-intermediated process that will allow the Fed as a supervisor and regulator to gain better access and to work more with banks in partnership. Now, a bigger risk is that banks will just say, “Yeah, sorry, Fed, that’s not what we want to do, we’re gonna go our own way.” And at that point, I think it’s appropriate to grab banks by the collar and say, “You are the beneficiaries of an extraordinary deposit of public trust to be in the business of banking. And that carries with it some obligations, not only obligations to be safe and sound so that you qualify for deposit insurance, but obligations to push funding to people who are good credit risks, who are facing a pandemic.” Right? And the shuttering of their small businesses.

[00:27:00] **Talley:** Kate, let’s get you looped in on this. If you were to be able to prescribe one out-of-the-box reform move or assertive policy move the Fed might make, what would it be, from your perspective?

[00:27:13] **Judge:** I think mine might actually be a variation on Peter’s, but it would be limited to periods of systemic distress. And that is being able to help companies through a bankruptcy process. I see that as really the ability to harness the strength of the bankruptcy system to make individualized determinations. Is this business going to be viable in the future? And if it is, we want to give it a fresh start. So let the bankruptcy system make those determinations over what entities have the potential to survive in the future. And once a bankruptcy system has made that determination, the Fed can play a critical role during the bankruptcy process of ensuring that the company has access to the funding it needs to go through that. What we want to protect is the footprint and the operations of that underlying business. Looking ahead, I fear that some of the greatest challenges the Fed is going to face are not the byproduct of the actions that it has taken or has failed to take in response to COVID, but are the byproduct of the fact we are facing some very, very daunting policy challenges. And when the country is facing difficult policy challenges that Congress doesn’t readily know how to solve, there has been a tendency to say, “Let’s see if the Fed can help us out here.” I think an area where we’re facing very difficult questions, where we don’t have great tools, have to do with inequality—wealth inequality, racial inequality. And so we are already seeing proposals and discussions about whether or not the Fed ought to be doing more to specifically help to reduce the disparities that exist for other reasons.

[00:28:54] **Conti-Brown:** The Federal Reserve is exercising the powers of sovereignty, and in the United States that sovereignty belongs to the people. It is not unhealthy for the Fed to be challenged. It is not unhealthy for citizens to develop views. If you sit around a Thanksgiving table in a month, and you talk about the Supreme Court, your debates about abortion or about affirmative action are gonna look a lot like what the judges end up debating as well. And I think it would be a better world if those same debates around the Thanksgiving table also started talking about, well, what’s the Fed’s role in helping small businesses? The Federal Reserve is exercising our power. And so developing views, even if those views are tenuous, about that power I think is a very healthy thing.

[00:29:40] **Talley:** Please pass the gravy and the securitized credit facility.

[00:29:48] **Talley:** My guests today were Professors Kathryn Judge and Peter Conti-Brown. Join me next time for another episode of *Beyond “Unprecedented”* and make sure to subscribe wherever you get your podcasts. Thanks so much for listening.

[00:30:01] **Talley:** *Beyond “Unprecedented”* is brought to you by Columbia Law School

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