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Yale Program on Financial Stability
Lessons Learned

David Wilcox

By Mercedes Cardona

David Wilcox was the deputy director of the Division of Research and Statistics of the Federal Reserve Board of Governors during the Global Financial Crisis of 2007-09. He assisted in developing the Federal Reserve policy response that ultimately stabilized the economy by providing insight into the economic and financial outlook to the Federal Open Market Committee (FOMC) prior to each of its policy-setting meetings. Wilcox became director of the division in 2011 and served in that role through 2018, acting as the division's chief economist, manager, and the senior adviser to three Fed chairs. After leaving the Fed, he joined the Peterson Institute for International Economics as nonresident senior fellow. This "Lessons Learned" is based on an interview with Mr. Wilcox in September 2020.

The central bank can only do so much within its authority. Politicians have to find the will to act.

Dealing with the Global Financial Crisis in 2008, as well as coping with the fallout of the 2020 COVID-19 pandemic, the Federal Reserve's authority was and still is limited to monetary policy and lending. "In the new world," said Wilcox, "where interest rates look set to be low for the foreseeable future, many years into the future, it's clear that fiscal policy is going to have to step up its game." He continued,

> Simply because [the Fed is] a high-functioning, effective organization doesn't mean it's the right tool for addressing every situation. I think what we're learning here through two crises that have come only about a dozen years apart is that there needs to be a development of much more institutional capacity for dealing with various aspects of financial support that's clearly under the umbrella of fiscal policy.

From Wilcox's perspective, a central bank has to respect the statutory limits on its actions as set by Congress. But in a crisis, government needs to pull all the levers to preserve the economic and social safety net. In his opinion, focusing on small-business loans and temporary liquidity measures is not a comprehensive solution. In particular, Wilcox noted:

> We need a much more effective set of tools from Congress and the executive branch to reach individuals, to reach small businesses in ways that address […] situations of acute need where the issue is not one of liquidity. In other words, the situation won't be made better by extending an individual or small business a loan, but where a grant of some form, the gift of public resources, is what's required. Those are policy actions that need to be taken by the executive branch and the Congress, the elected representatives of the people. There's a good reason why those actions are outside the decision-making realm of a central bank. I think there needs to be much more institutional capacity-building there to provide that kind of assistance and a much

> more thorough effort to think through the circumstances under which assistance of that kind will be provided.

More detailed relief measures must come from the legislative and executive branches of government, Wilcox said, however, these groups do not always agree on how to act. He explained:

> There was, I think, some genuine apprehension at that time about cushioning individuals from bad decision-making. A constant part of the policy-making discussion was about precedent-setting with respect to future situations. Under what circumstances would the government provide assistance to an individual who had made a bad decision? A recognition there was at best an extremely imperfect ability of the government to separate the situation of an individual who was making extraordinary sacrifices to make their mortgage payments in a timely manner, or to make the rental payments on their apartments in a timely manner, from the situation of an individual who simply wasn't making the effort.
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> There was a very clear recognition [during the GFC] that millions of individuals were under tremendous economic pain, but there was also, from my perspective at the Federal Reserve, a recognition that these were decisions for the executive branch and the Congress to make, not the central bank. It's impossible. What these people needed—and there's some commonality, by the way, with the current COVID situation—in innumerable cases was not a loan. Because these individuals really were not suffering from a liquidity problem. What they were suffering from was, they were broke. They simply didn't have the financial resources to meet their obligations in a timely manner. In many millions of cases they were unemployed.
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> What would have been needed to address that was a massive commitment of public resources. That can only come from the Congress and the executive branch working together to create legislation to provide those resources. That can't come from a central bank that doesn't have the statutory authority to do that. My sense looking in from the outside was, there was some reluctance to provide that on a massive scale. What I think is impossible to say today is whether the individuals who were making those decisions would hold the same view now, knowing what they do today, as they made in the heat of the moment.

Don't rush to get out of crisis mode. Solutions should be broad and equitable.

Wilcox has argued in his post-crisis writings that the long, hard climb out of the Great Recession was not inevitable. Prematurely ending the relief programs in the early 2010s may have contributed to the growth of inequality, especially among minorities and other traditionally disadvantaged groups that didn't benefit equally from the recovery.

"There was a very substantial initial injection of fiscal support, no question about it, a lot of people paid dearly in political terms for courageously supporting that," said Wilcox. "But too quickly… attention shifted to consolidating the fiscal position and underappreciating how much support the economy continued to require." Meanwhile, continued Wilcox, decisionmakers underestimated the scarring effects that long periods of unemployment and economic dislocation would have on the recovery in the longer term.

I think there were some decisions that in retrospect proved mistaken. There was prominently too quick a withdrawal of fiscal stimulus. For a period of time through the early part of the 2010s decade, fiscal policy was pulling in the wrong direction. Monetary policy continued to be expansionary with the fund rate held at zero and with the Fed continuing to undertake large-scale asset purchases. Too early in the recovery process, fiscal policy shifted from expansionary to contractionary. That did have the effect of slowing down the recovery.

In managing future crises, decisionmakers should pay close attention to designing policies that address the ill-effects of the downturn equitably, said Wilcox. He explained:

> It is incredibly important that policies be designed to reach all segments of the population without regard to race and ethnicity, without regard to level of income, without regard to political connectedness. It's critically important that we choose tools and methods of implementation that ensure effective support for all segments of society.
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> The horrifying aspect of the financial crisis of a decade or a dozen years ago, and of the COVID-related collapse, is that these kinds of events have enormously disproportionate adverse implications for individuals, for groups, for communities that historically have been relatively marginalized. It needs to be high on the list of priorities for policy makers in coming years to figure out more effective means of delivering financial and economic support in ways that reach those individuals and communities in a more equitable manner. The well-functioning of the economy is going to depend critically on that.

Wilcox noted that a different dynamic was at work in the response to the COVID-19 pandemic; the uncertainty over when an effective vaccine and treatment would be available added to the complexity of managing this economic crisis:

> We do know two things. One is it will be extremely difficult to achieve complete and durable economic recovery until the disease has conclusively been put in the rear-view mirror by one of those two means, either a treatment or a vaccine. Until that time, it'll be impossible to achieve a full economic recovery.
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> The flip side is that once that does happen and a very large portion of the population is immune to this disease, that will actually provide a clearer recovery signal than is available in the course of an ordinary economic recession. Usually in the course of an ordinary economic recession there's a gradual dawning that the labor market situation is getting better, but there's no all-clear whistle that sounds, that says, "Wow, the initial impetus for this collapse is now gone. Let's unequivocally get on with the task of rebuilding." Here I think in the midst of a very, very concerning [and] very, very dangerous situation, one reason for hope is that at some point in the future, (none of us knows when) there will be a more unequivocal all-clear signal that we can get on with the business of building a durable, and hopefully equitable, recovery.

Crisis decision-making is its own framework.

The crisis of 2008 spiraled so quickly; decision-makers didn't have the luxury to solve each emergency neatly before tackling the next. "The heat of the crisis is the time for action and later on is the time to build a more durable economic and financial regulatory structure," said Wilcox. Wilcox emphasized that it is more important to prevent collapse first, and then deal with the beliefs of decisionmakers about whether they will be bailed out for other bad decisions in the future. Those "remedial actions" can be handled later.

Wilcox also opined that in the lead-in to the crisis, economists should have felt more open to questioning why market participants were behaving in ways that contradict the fundamentals. Wilcox said:

> Economists need not be too polite or shy about questioning trends that look unsustainable ... I think it's important for economists, forecasters, and other analysts who spend most of their professional careers in normal economic and financial circumstances not to underestimate the potential of the financial system to destabilize the real economy in a time of financial crisis. In normal times, one can analyze the dynamics of the real economy—by which I mean things like GDP and the labor markets and inflation—mostly treating the financial system as a rather benign factor in the background. But in a time of crisis, the financial system suddenly becomes the first order importance, so the usual separation between the real system and the financial system utterly breaks down, and in that moment the financial system suddenly acquires tremendous potential for destabilizing the real economy.

In the heat of the moment, communication becomes a paramount concern, Wilcox explained.

> It's important not to underestimate the importance of clear communication, of explaining what you're doing: why you're doing it, the authority that you have for taking those actions, the objectives that you have, the basis for your decision making in the facts that you see around you, and what the effects are that you expect from your actions. Both in order not to over promise, but also to make clear about how much worse you think the world would be if you didn't take those actions. Oftentimes, if you can't explain what you're doing and why you're doing it clearly—in a way that is accessible to a non-technical, non-specialist audience—that's a signal that you need to go back and rethink the fundamentals of what you're doing.

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