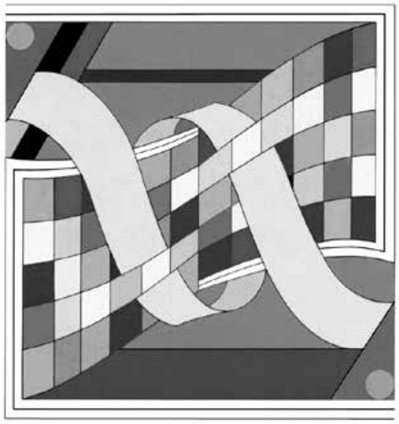

The Yellen Era

By Lawrence B. Lindsey

A review of
Empathy Economics: Janet Yellen's Remarkable Rise to Power and Her Drive to Spread Prosperity to All by **Owen Ullmann,** PublicAffairs, 2022.

There are few individuals with a more illustrious career in public policymaking than Janet Yellen. She is the only individual in American history to have served as Chair of the President's Council of Economic Advisers, Chair of the Federal Reserve, and Secretary of the Treasury. That speaks well of both her scholarly intellect and her talent in navigating Washington's political currents. As the title *Empathy Economics* indicates, Yellen did all this while maintaining a good deal of the original idealism with which she embarked on a career in government. That makes her story even more unique.

Owen Ullmann sketches out the path Yellen followed in a way only a man of his long years covering the Washington policymaking scene could. Ullmann can take somewhat arcane economic points and describe them in a way the lay reader not only understands but finds interesting.

In the interest of full disclosure, I have known both Yellen and Ullmann for at least three decades and my name pops up several times in his biography of her. Even stranger for Washington, we have always been on good terms despite being on opposite sides of the political aisle and, in Ullmann's case, on opposite sides of that chasm between officials and journalists! Despite these apparent conflicts, the editors of *The International Economy* apparently had faith that none of that would stand in the way of my candor.

Yellen's career in Washington spans the decades that the economics profession rather immodestly came to call the "Great Moderation." In many ways, her career epitomizes the *zeitgeist* of the period that runs from the fall of the Berlin Wall to the present. During that time, inflation fell to a low and stable rate that developed into the Fed's 2 percent target. There were recessions, but jobs were generally quite abundant. Whereas only 55–56 percent of the working-age population was employed before the Great Moderation, it was more typically 62–63 percent during most of it.

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The economics profession had achieved an outstanding result: low inflation and high employment! This celebrated success contributed to a political moderation within the profession, sometimes called the "neoclassical synthesis," in which all could claim credit. The previously

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THE INTERNATIONAL ECONOMY
THE MAGAZINE OF INTERNATIONAL ECONOMIC POLICY
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Washington, D.C. 20002
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right-of-center view highlighting advantages for economic optimization through markets was fused with the previously left-of-center view emphasizing the advantages of activist macroeconomic management by government. Surely that very sensible fusion produced the much-celebrated result.

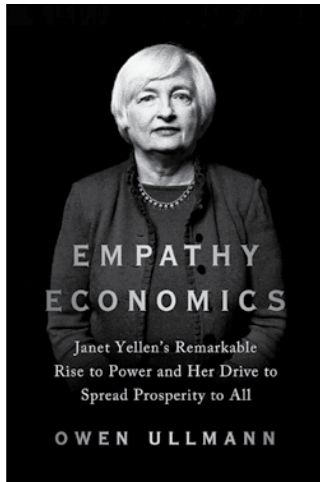
A skeptic might argue that the good times did not result from the extraordinary talents of the economics profession but instead flowed from our victory in the Cold War. That geopolitical win freed up about 2.5 percent of GDP annually—a cumulative $18 trillion in today's dollars—to use for other purposes. More importantly, it brought tens of millions of new workers into the global trading system, which imparted a huge disinflationary shock to global prices. The Fed was therefore able to run an easier-than-normal monetary policy with more employment and smoother business cycles as globalization took care of the inflation that might otherwise have been present.

Ullmann notes that the jury is still out on Yellen's career.

Expansion of the money supply went into asset prices. When the dot.com bubble of the late 1990s burst, the Fed cut rates to just 1 percent and then increased them very slowly. This led to a housing bubble, which burst in 2007 and produced structural damage in the financial system. The solution was an even easier monetary policy, with rates cut to zero and the Fed purchasing government debt in a move called quantitative easing. The Fed's balance sheet mushroomed from less than $1 trillion in 2007 to nearly $9 trillion in 2022. A massive bubble developed in bond prices, which move the opposite of bond yields. The ten-year Treasury yielded less than 0.75 percent during much of 2020.

These record-low rates offered very cheap financing for major fiscal stimulative efforts. By the time Congress passed the March 2021 stimulus bill, the economy had already recovered 98 percent of what it had lost under Covid. The additional borrowing pressures coupled with the stimulated household spending initiated a major acceleration of inflation. This ultimately forced the Federal Open Market Committee to tighten monetary conditions and pop the bond bubble. The ten-year bond now yields more than five times what it did just two years ago.

All of this suggests that the Great Moderation might not end so moderately. Ullmann notes that the jury is still out on Yellen's career because we don't yet know whether deflating the bond bubble will occur relatively painlessly or be very disruptive to the global financial system.



Janet Yellen did not cause these events, but she was an integral part of the policy choices that led us here. As Fed chair, she was a major proponent of easier policy and quantitative easing. When she tried reversing the policy and found the consequences too painful, she reversed course. As Treasury secretary, she was a leading proponent of the idea that the rising inflation of 2021 was transitory. To her credit she has admitted getting that wrong.

Easing of monetary policy has long been thought of as an "empathic" approach. Easier money is associated with job creation. Job creation is key to expanding the economy's benefits to those out of luck. It is here that the ironies of an empathic policy become most acute. There were rapid increases in employment during all three of the presidential administrations in which Yellen served. But the Gini coefficient, a key measure of income inequality, increased more under Clinton (.029 points) than under Reagan (.023 points) and more under Obama (.018 points) than under Bush (.004 points). There are measurement issues involving how to account for tax credits in the various stimulus packages, so the jury is still out on income distribution changes under Biden. Easy monetary policy seems to benefit those who can access the money and profitably deploy it, not those who don't have it.

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Empathy Economics is a great biography of a highly successful woman who climbed to the very pinnacle of economic policymaking. She did so at a time when the profession was far more male-dominated than it is today, breaking glass ceilings as Fed chair and as Treasury secretary. Even better, she did so with charm and thoughtfulness in a political environment where both traits were rapidly disappearing. But Ullmann's biography is also a lesson that even if one does everything according to plan, things may not turn out quite as expected. ◆