It is wonderful to be in Ohio today. I spent six of the most formative years of my life here. I went to junior high and high school in Canton. But my father was transferred right after I graduated and I haven’t had a chance to come back in many years. So this is a trip down memory lane for me. Indeed, I am driving to Canton tonight and visiting my high school tomorrow.

Ohio is not only relevant to my past; it is a central concern of my present. States like Ohio, Michigan, and my current home state of California have been ground zero for the fallout from the financial crisis. The Great Recession has taken its most devastating toll in these and similar states. Ohio alone has lost more than 400,000 jobs since the recession began, and its unemployment rate has reached 11 percent. I wanted to come here both to talk about the Administration’s policies and goals, and to hear for myself what is happening in the local economy.

In my remarks this morning, I want to discuss the actions that have been taken to end the recession and my sense of how the economy is doing. I want to discuss both the very real progress that has been made and what more we need to do to spur recovery.

I also want to talk about the importance of financial regulatory reform for states like
Ohio. Congress is in the middle of writing sensible new rules of the road for our financial system. I want to discuss the key elements of reform and why it matters so much to every single one of us.

**Treating the Recession**

President Obama came into office during the worst recession since the Great Depression. I remember vividly the end of my first week of the transition. It was Friday, December 5th, 2008, and I was pulled out of a meeting to brief the President-Elect by phone on the November employment numbers. It was clear that what might have been an ordinary recession a few months earlier was taking on ominous proportions. That day we learned that we had lost more than half a million jobs in November. I found myself saying, “Mr. President-Elect, I am so sorry, the numbers are just horrible.” He replied, “It’s not your fault—yet.”

Over January and February of last year, other countries also began to report staggering declines in output and employment. Any hope that growth in the rest of the world might help to cushion the decline in the United States was dashed. We were clearly facing a worldwide contraction unlike any we had seen for more than a generation. In the United States, we lost almost 3 million jobs between November and March.

The key source of the recession was clearly the popping of the housing bubble and the ensuing financial crisis. In a matter of months, trillions of dollars of household wealth were destroyed, setting off a rapid decline in consumer spending. The collapse of Lehman Brothers and the runs on money market mutual funds and other financial institutions caused credit spreads to skyrocket and key sources of credit to dry up. Swift action by the Federal Reserve and the Treasury in the fall of 2008 had helped to avert an all-out panic, but throughout the following
winter, stock prices continued to fall and credit standards steadily tightened. The entire financial system was in a state of anxiety and paralysis.

President Obama understood that this was an all-out crisis that required an all-out policy response. Working with Congress, the Administration took several major actions within its first few months.

Most obviously, we passed the American Recovery and Reinvestment Act. The Recovery Act was the boldest countercyclical fiscal stimulus in American history. It included $787 billion of tax cuts and spending, with the total split roughly one-third tax cuts, one-third government investments, and one-third aid to the people most directly harmed by the recession and to troubled state and local governments. Already, American families have received more than $200 billion in tax cuts and in relief payments such as unemployment insurance. Thousands of investment projects are already underway, including everything from roads and bridges to a smarter electrical grid and clean energy manufacturing.

The Administration worked with the Federal Reserve and the FDIC to help repair the financial system. Perhaps the most important action was the stress test that gave a comprehensive evaluation of the health of the 19 largest financial institutions. This careful scrubbing of the books, together with the government’s pledge to fill any identified capital shortfalls that the institutions couldn’t fill by raising private capital, helped to restore confidence in the financial system. It also led to a spurt of private capital-raising that put our financial institutions on a much more secure footing. Credit spreads decreased substantially and stock prices recovered greatly.

The Administration also worked to stabilize the housing market and stem the rising tide of foreclosures. The Treasury worked with the Federal Reserve to help reduce mortgage interest
rates, resulting in lower payments for the millions of Americans who refinanced their homes. We also set up a program that helped responsible homeowners facing foreclosure get more manageable mortgage payments. Already more than a million homeowners have gotten trial modifications, and we are working to improve the program so that more troubled homeowners qualify and that more of the trial modifications turn into permanent ones.

These policy actions complemented the Federal Reserve’s actions. Monetary policymakers quickly reduced the policy interest rate to nearly zero. They also undertook large-scale purchases of government bonds and mortgage-backed securities to further reduce longer-term interest rates. And, they created programs that successfully restarted some of the securitized lending that had evaporated following the crisis.

This all-out policy response has made a huge difference. Last Friday, we learned that real GDP, a measure of the total quantity of goods and services we produce, grew solidly for the third quarter in a row. Growth at an annual rate of 3.2 percent in the first quarter of 2010 is a dramatic turnaround from the decline of 6.4 percent that we had in the first quarter of last year. Likewise, in March we started adding jobs again. Employment rose by 160,000, and given the other data, we are hopeful that Friday’s April employment report will yield another positive reading.

Now, we all know that the economy still has a very long way to go. The loss of output and jobs in the recession has been so severe that it will take a number of quarters of robust growth and job creation to restore the economy to full health and full employment. But, we are unquestionably on the right trajectory. And the policy response is a big part of the reason that we are on the road to recovery.

I want to talk particularly about the effects of the Recovery Act. The Council of
Economic Advisers was charged by Congress with reporting each quarter on the economic impact of the Recovery Act. It is a responsibility that we take very seriously. Over the past year we have analyzed the impact of various components of the Act—including the state fiscal relief, the clean energy provisions, and the tax cuts and income-support payments. Each in-depth analysis has shown strong impacts on growth and jobs.

Our most recent report estimated that the Recovery Act has saved or created roughly 2½ million jobs. That means 2½ million people are employed today who wouldn’t have been without the Act. Our estimates are based on two different approaches and are similar to those of private forecasters and the nonpartisan Congressional Budget Office. They are also consistent with the direct recipient reporting data. Recipients of about 15 percent of Recovery Act funds file a form each quarter about the number of jobs funded by the Act. The newest reports for this small subset of Recovery Act funding identified almost 700,000 directly funded jobs.

But perhaps the best way to see the impact of the Recovery Act is not in our overall jobs estimates or even the aggregate economic statistics. It is to take stock of what it is doing on the ground, in states like Ohio.

The Act has provided over $2 billion in state fiscal relief to Ohio. This funding has saved thousands of teacher jobs and allowed the state to deal with the devastating impact of the recession on its budget without significant tax increases. The Act is also supporting more than 400 transportation projects in Ohio and over 2000 loans to Ohio small businesses. This is spurring job creation and long-term public and private investments that are turning the Ohio economy around and will make it even stronger in the future.

Equally important, the Act has provided $2½ billion of tax relief to 4½ million working families in Ohio, another $2½ billion of aid to almost a million unemployed workers and others
in the front lines of the recession here, and half a billion dollars of one-time payments to 2 million Ohio seniors and veterans. This tax relief and income support is not only helping families get through hard times. By putting money in people’s pockets, it is supporting demand, and so making the recession less severe and the recovery stronger than they otherwise would be.

Where Are We Now and What More Needs to Be Done?

Because of the actions we have taken, the economy is decidedly better—the treatment is working. But we need to be realistic about the substantial challenges that remain. With an overall unemployment rate of 9.7 percent, it is clear that while the economy may be recovering, it has not yet recovered.

Fundamentally, the economy is still suffering from a deficiency of demand. Recessions occur when, for reasons such as a financial crisis or a decline in wealth, consumers and firms stop buying. Producers respond to this falloff in demand by producing less and laying off workers. The resulting unemployment further reduces demand.

Recoveries happen when spending begins to rebound. And that is exactly what has been happening. Last Friday’s GDP report showed that consumer spending was up strongly and firms were doing more investment in equipment and software.

But, even though demand is growing again, its level is below where it was when the recession started, and far below where it would be if we had grown normally over the past two years. The Congressional Budget Office estimates that demand (and hence output) is at least 6 percent below its trend path.

Friday’s GDP report made it clear where some of the deficiency in demand is coming from. For example, while business investment in equipment and software is growing again, it is
starting from a painfully low level, and so is still low in an absolute sense. And business investment in structures—that is, the building of factories, office buildings, and shopping malls—is continuing to fall. Likewise, consumers are spending more, but housing construction remains low and actually fell again in the first quarter. So an important traditional source of demand and employment remains in the doldrums.

Finally, at the same time that Federal government spending is increasing demand, state and local governments are retrenching. The recession has had a devastating impact on state and local revenues, and governments are being forced to cut back on essential services. Projected budget shortfalls for state and local governments are roughly $300 billion over the next two fiscal years. If these shortfalls are closed by tax increases, the negative impact on consumer spending could be substantial. If they are closed by laying off teachers and first responders, as many reports suggest is likely to happen, the impact on education and public safety could be terrible.

Today’s painfully high unemployment rate is a direct consequence of the shortfall of demand. Unemployment is not high because of structural changes or because workers aren’t trying to find jobs. It is high because we are not producing at anywhere near a normal level.

What all of this means is that it is essential that policymakers continue to take steps to help generate private demand and growth. It is not enough that output and employment are growing. We need to spur robust growth that will speed the return of output and employment to normal. That is why the President has been working with Congress to pass a small business jobs bill. One key piece of this package is a lending fund that will help small businesses get the credit they need to grow. Another piece eliminates capital gains taxes for people who invest in small businesses.
The President is also continuing to work with Congress to further jump-start the transformation to clean energy. One program in the Recovery Act, the clean energy manufacturing tax credit, has been very successful in helping American firms establish themselves as producers of clean energy products such as wind turbines and solar panels. This program was greatly oversubscribed. Further investments in this area would be good for job creation and the long-run health of the economy.

More aid to state and local governments would also be incredibly helpful. The dire condition of state and local budgets is one of the most difficult headwinds the U.S. economy faces on the road to recovery. Finding the funds to keep teachers in the classroom and to maintain essential services is one of the most effective things we could do to support families, communities, and local businesses.

The additional actions we are talking about are very well targeted. We have looked for programs with the very highest bang for the buck. We are all very aware of our large long-run fiscal challenges and the need to begin to take steps to get our fiscal house in order. The President is absolutely committed to dealing with the budget deficit as the economy recovers.

But, it would be penny-wise and pound-foolish to try to deal with our long-run problem by tightening fiscal policy immediately or foregoing additional emergency spending to reduce unemployment. Immediate fiscal contraction would inevitably nip the nascent economic recovery in the bud—just as fiscal and monetary contraction in 1936 and 1937 led to a second severe recession before the recovery from the Great Depression was complete. And nothing would be more damaging to our fiscal future than a protracted recession that eventually led to permanently higher unemployment. Responsible, targeted actions today that help the private sector come back more strongly is the right policy both for people and for the long-term health of
Preventing Future Crises through Financial Regulatory Reform

In addition to doing more on jobs, the President has another key item on the legislative agenda: financial regulatory reform. Compared with steps to deal with our immediate jobs problem, financial reform may seem to be something that matters only inside the beltway and on Wall Street. Nothing could be further from the truth. It was an inadequate financial regulatory and monetary framework that led to the stock market crash of 1929 and to the catastrophic waves of bank failures starting in 1930, and so to the Great Depression. And it was the failure to update our regulatory system in response to decades of financial innovation that led to the excesses of the early part of the past decade and to the disastrous near-meltdown of the financial system in 2008 and 2009, and so to the Great Recession. Thus, putting in place sensible new rules of the road that will help prevent the next crisis is important to all Americans.

This is something that should not wait. Memories are short and already we see some willing to put off necessary reforms. An earlier generation put in place a regulatory framework that kept their children and grandchildren safe from financial panics for 75 years. We need to follow their example and take the challenges of the moment and channel them into modernizing that regulatory framework to ensure that our children and grandchildren remain safe for at least another 75 years.

Let me discuss some of the main features of the Administration’s proposals and the bills that are now working their way through Congress. How will the new rules help to prevent financial crises?

Improving Regulation. A central feature of the legislation is more thorough regulation
and appropriate capital requirements. One thing that we learned from the crisis is that some very important financial institutions whose failure could threaten the entire system had managed to slip through the regulatory cracks. That can’t happen again. In the proposals, any financial institution that is large enough or interconnected enough with other institutions that its failure would threaten the whole system is regulated by the Federal Reserve. It doesn’t matter whether the institution calls itself a bank, a hedge fund, or an insurance conglomerate like AIG. This way, one regulator will be in charge and will be held accountable for thorough monitoring of these institutions.

We are also going to improve that monitoring. For the first time, key regulators will be required to consider not only the safety and soundness of the particular institution, but the stability of the entire system. A council of regulators will be on the lookout for new risks developing, and individual regulatory agencies will ensure that they are adjusting standards to protect the system.

The best way for regulators to ensure that financial institutions don’t fail, and that they don’t gamble on the assumption that the government will save them if things go sour, is to require them to have serious skin in the game. That is why capital requirements will be a central tool of regulation. Capital provides the key buffer between bad outcomes and default for a financial institution. And, because it means that the institution’s own money is on the line, it provides incentives not to take unreasonable risks. By setting appropriate capital requirements, and by setting them higher for the largest, most interconnected institutions, we build stability into the system. That is what the legislation will require regulators to do.

**Eliminating Bailouts.** Another way to ensure that financial institutions are prudent and to protect taxpayers is to make it very clear that institutions will not be bailed out. One thing we
saw in the crisis is that under the current system, when a large financial institution is on the verge of default, policymakers are faced with a choice between two very bad options. They can let the institution go into conventional bankruptcy. But, as we saw with Lehman Brothers, the slowness and uncertainty of standard bankruptcy make it likely that one failure may trigger runs on other institutions, threatening to bring down the whole system and causing enormous damage to the economy. Or policymakers can hold their noses and bail the institution out. But, as we saw with AIG, this has the effect of putting taxpayer money on the line and softening the costs of the very behavior that caused the problem.

The way to prevent the need for bailouts is to create a third option. That is what resolution authority is all about. Resolution authority is a sensible mechanism to wind down a deeply troubled financial institution. In the proposed legislation, the shareholders are wiped out and the management is fired. The government then sets up a bridge to wind down the institution’s other obligations. If there are costs beyond those that can be covered by the sale of the institution’s assets in the orderly wind down, the legislation calls for a fee to be placed on all large financial institutions to ensure that there are no costs to the taxpayer. The legislation puts an end to bailouts. Shareholders and management are held responsible if their institution gets into trouble, and the system as a whole pays for any costs.

The existence of a sensible resolution regime means that we have a way to deal with a large troubled institution without generating a system-wide panic or bailing out shareholders. Indeed, at its best, the presence of a good resolution regime could mean that management and shareholders know they won’t be bailed out, and so they would have strong incentives to monitor risk and behave responsibly—with the result that the resolution authority wouldn’t have to be used.
I have mentioned that the new resolution regime would require financial institutions to bear the full cost of any orderly liquidation of a firm. You can get a sense for how this system might work from our proposed Financial Crisis Responsibility Fee. The most recent estimates from the Treasury show that of the original $700 billion authorized for stabilizing the financial system through the Troubled Asset Relief Program, all but about $117 billion will be repaid. The President has proposed that a fee, similar to that imposed by the FDIC, be placed on the liabilities of the largest financial institutions. This fee will completely cover the costs associated with TARP. Taxpayers will not be out a dime. Importantly, the way this fee is being structured has other benefits. By being based on liabilities, it raises more money from the bigger institutions. In this way, it helps to make large institutions feel the negative impact of their size on the rest of the system. It is gratifying to see that countries around the world are starting to express interest in imposing the same kind of fee.

**Regulating Derivatives.** Another essential part of the proposed reform is that it requires much more transparency for derivatives. These financial products whose payoffs are derived from other assets have a useful role in hedging risk. For example, farmers may want to protect themselves from the uncertainty about the prices they will receive for their crops, and firms that buy inputs from abroad may want to protect themselves against big swings in exchange rates. But what was once a minor sideshow to asset markets has grown to be a multi-trillion-dollar market of its own. An important source of trouble revealed during the crisis is that regulators and market participants had little knowledge of the risk exposure of key financial institutions.

The legislation brings derivatives out of the shadows. By requiring many derivatives to be traded on exchanges, the new rules of the road ensure that prices are set by market forces in a transparent way. Requiring many contracts to be put in clearinghouses allows the various
transactions to net out and ensures that margin payments are proportional to risk. This will prevent us from waking up again to the terrifying realization that a single firm such as AIG held billion of dollars of net exposure to derivatives, and that its failure would spiral through the system.

As with the other pieces of the proposed regulatory framework, the new rules on derivatives are designed to maintain what is good about the financial system while making it safer. A well-functioning financial system is essential to mobilizing savings into productive investment and to spreading risk. The rules we are proposing and Congress is working to pass are carefully designed to maintain efficiency while giving much stronger incentives for safety and stability.

The Administration is also actively working to harmonize financial regulations across countries. It would be terrible if financial firms fled countries with responsible regulations for unregulated countries. The United States is playing a major leadership role in working toward better regulations, capital requirements, and resolution mechanisms worldwide. This is essential, because, as we learned in the crisis, our financial markets are intimately linked with others throughout the world. We are each safer when other countries are also imposing sensible rules.

**Protecting Consumers.** A final key feature of financial regulatory reform is the creation of a consumer financial protection agency with independent rule-making and enforcement authority. There needs to be a single agency whose only mandate is to watch out for the consumers of financial products. Too often in recent years, sophisticated financial institutions have taken advantage of consumers through financial products that were too complicated, deceptive, or flat-out fraudulent.

Often all that is needed is greater transparency—terms and conditions for products such
as mortgages and credit cards that are easy to read and easy for a lay person to understand. With greater clarity, American families and small business owners will have better information to help them make the financial decisions that work best for them. But sometimes what is needed is for regulators to identify and limit practices that are deceitful, harmful, or aim to take advantage of consumers.

A consumer financial protection agency will not only even the playing field between consumers and sophisticated financial experts, but also increase the stability of the system. Though many factors played a role in generating the bubble and bust in the housing market, questionable lending practices and unconventional mortgages that only made sense in an ever-rising market were contributing factors. Transparency and more focus on consumer understanding and fair dealing will surely help facilitate sounder behavior.

**Importance of Reform.** In making the case for the importance of regulatory reform to families, policymakers often focus on the consumer financial protection agency. And it is unquestionably important. But while capital requirements, resolution authority, and derivatives may sound far removed from everyday life, they are also essential. The central goal of regulatory reform is to prevent future crises and their attendant fallout on tens of millions of workers, homeowners, and businesses. Thus, *all* of regulatory reform is about protecting ordinary Americans.

Preventing future financial crises is something we owe to ourselves and future generations. If there is anything the last two years has taught us, it is that a well-functioning financial system is important to us all. When the financial system melts down, as it did in the fall of 2008, it is not just Wall Street bankers who feel the pain. Firms can’t get loans to buy materials or cover payroll. As a result, production grinds to a halt and workers are laid off.
Families can’t get credit to buy cars, houses, or a college education for their children. As a result, auto sales plummet, construction ceases, and dreams are put on hold. We have lost more than 8 million jobs largely because of the fallout from the financial crisis. None of us ever wants to live through this ever again.

To prevent it, we need sensible rules of the road that encourage responsible behavior, protect consumers, increase transparency, and build in mechanisms for keeping pace with financial innovation. That is what the President is working with Congress to craft.

As the Senate begins to debate financial regulatory reform, there will surely be many twists and turns in the legislative process. The Administration will work with lawmakers to hold the line on preventing loopholes and ensuring that the bill prevents both irresponsible practices and bailouts. The President will insist on genuine reform that holds financial firms accountable. He will also not hesitate to stand up against changes to the plan that may sound tough at first, but in fact leave the system even more vulnerable than it is now. He will take the heat, if it means we end up with a better bill. Because at the end of the day, what matters is that we create a new regulatory framework that makes the financial system safer.

**Conclusion**

I’ve used medical analogies a lot this past year. I suppose it’s only natural when the economy has been as sick as it has been. This time last year, I gave a speech on the diagnosis and treatment of our economic ills. Last fall, I gave a talk on just how close we came to the brink of disaster—I guess you could say I was describing our near-death experience.

This year, in describing the economy, I have the feeling of a doctor looking at a once-deadly-ill patient with a new sense of hope. The patient is weak to be sure—but clearly
recovering. The economy is going to make it. This means that our short-term focus can shift from crisis management to working to do all that we can to make the recovery as speedy as possible.

It also means that it’s time to start looking forward to prevention. Just as with a patient who is coming back from a heart attack, we need to not only do our best to hasten the recovery; we need to make important lifestyle changes that will keep us healthy in the future. The trauma of the past two years has shown us just how horrible the fallout from a financial crisis can be. We need to put in place good financial regulatory reform to safeguard us against a repeat. We must take what we have learned and channel it into a stronger and more secure financial system, and a better future for us all.