Yale Talk: Conversations with Peter Salovey

Episode 6: Yale Economic Experts on the COVID-19 Pandemic

**Peter Salovey**: Hello everyone, I’m Peter Salovey and welcome to Yale Talk. As we near the third month of the COVID-19 pandemic in the United States we’re seeing the devastating effects of this public health crisis around the world. Some of us have lost loved ones or are taking care of those who are sick. We also know friends and family members who are out of work or worried about supporting their families. As medical and public health experts work on the front lines to save lives we must also turn to addressing other aspects of this pandemic that are threatening our way of life and our future.

The unemployment rate in the United States is about 15% and more than 33 million Americans have filed unemployment claims since mid-March. We’re afraid to spend money. We are hoarding our financial resources along with toilet paper and canned goods. We may have a fear of leaving our houses and so even when businesses reopen many of us may not want to eat in restaurants or to travel or to attend a live performance. And these are serious issues for our economy. To mitigate the economic damage and to recover as quickly as feasible, we need to make decisions based on empirical evidence and the guidance of experts.

Today I’m joined by three Yale experts for a discussion about the economic impact of the COVID-19 pandemic. Penny Goldberg, the Elihu Professor of Economics at Yale University served as the chief economist of the World Bank Group between November 2018 and March 2020. Andrew Metrick, the Janet L. Yellen Professor of Finance and Management at the Yale School of Management and Director of the Yale Program on Financial Stability is with us. And Bob Shiller, Sterling Professor of Economics, was awarded the Nobel Prize in Economics Science in 2013, joins us today. Penny, Bob, Andrew, thank you so much for taking the time during this crisis to participate in Yale Talk.

Penny, so much of your work intersects with history and other areas of the social sciences and humanities. I’m particularly interested in your take on global economic response to the pandemic. During times of stress, people become insular when resources are limited maybe it’s easier for people to become less caring about others. What are the risks and potential effects of countries adopting protectionist behaviors and how will international trade and migration be affected by this pandemic?

**Penny Goldberg**: Peter, I have a slightly more optimistic view of human behavior.

**Peter**: That’s good to hear.

**Penny**: During stress and during crisis, I would say that stress brings out both the best and the worst in people and in countries, as well. We already saw some of the best at the individual level. You already mentioned the health care workers who put their lives at risk. And we also saw the worst. People trying to profiteer from the sale of masks. And the same applies to countries.

I would say that in terms of the economic response, not the public health response, but the economic response, the early response back in March and early April was actually what it should be. It was very swift. It was massive. It was decisive, and it did what it was supposed to do. Here I’m thinking primarily of the United States and Europe. Parts of the world where there are countries have enough space to enact very aggressive policies. In the United States, we passed the Cares Act, which is truly unprecedented, both in terms of its size and also the speed with which it was passed. And it was passed with bipartisan support which is truly unique these days. And in Europe many countries enacted similar policies, very aggressive policies, sending out the message: We are here for you. We’re going to do whatever it takes. And we’ll make sure that the economy recovers as soon as possible.

At the global level there are many countries, many developing countries, that unfortunately do not have the space to enact equally aggressive policies. But there again the global community helped. At the beginning, many official creditors agreed at that standstill back in April, that reassured markets. The Fed in the United States provided liquidity to international markets. I would say that at that time, what the economic actors did was to send out a message of solidarity and support, and the markets reacted positively.

I think things are have started to change recently. At the global level, we are starting to see the worst, in the sense, and you already mentioned some of the problems. It’s very tempting during the crisis to find a scape goat and blame the crisis on the scape goat. And in this case, it is China. We see renewed attacks of China. Of course, the tense relationship between the US and China is nothing new, but now it’s taking new dimensions. In some sense, what this crisis has done is to intensify and accelerate some trends that were put in motion before the crisis. And one of these trends was de-globalization.

The backlash against globalization, the backlash against immigration; we see these trends now being intensified. There are new calls for closing the border and for stopping trade. There are attacks of global value chains. Most of these arguments do not hold water, and they do not do the facts justice. What’s the danger? The danger is in the short run, this is going to impede recovery. In the long run, I think it’s important to resist this tendency, this urge to close the border and become protectionist, become isolationist. Here we can draw on the lessons from the Great Depression, where the United States enacted tariffs. It became protectionist in an effort to protect its own businesses and its own people. But, in the end there is agreement among economic historians, that what this did is actually deepen the depression and slow down the recovery.

Economists agree that it’s not the tariffs, it’s not protectionism, that led to the Great Depression, but they also agree that the start of this protectionism made the recovery much slower. And, we should learn from that lesson and try not to repeat these mistakes. Again, drawing on the lessons from the Great Depression, there are also historians who believe that what happened during that period, the rise in protectionist sentiment, eventually led to a political climate, to an international political climate, that was conducive to World War II. And I’m not suggesting here that we’re going to face a world war again, but tense relationships among countries do not benefit anyone in anytime. They are particularly harmful during a period of recession.

**Peter**: Thank you, Penny. Let me turn to Andrew for a minute. You are the director, the founder really, of a program called the Yale Program on Financial Stability, that has been running since 2013. It creates, disseminates, and preserves knowledge about financial crises. It was funded in the wake of the 2008-2009 crisis. You know a lot about that 2008-2009 crisis. How is the current global economic downturn different from that one? And are there lessons from 2008-2009 that will help us recover from the current crisis? Andrew?

**Andrew Metrick**: Thank you that’s an excellent question. We don’t have to do any real deep study of it to see that these are very different crises, from an economic perspective, at least at the surface level. In 2007-2008, the crisis began in the financial sector and it was actually fears of solvency in the financial sector that drove the panic phases of that crisis. And then a very weakened financial sector that made it harder for us to recover. Here, obviously, the problem is different. We were going into the COVID-19 crisis pandemic with a very strong financial sector and, in fact, the hope is that the financial sector will remain strong enough to be able to aid in the recovery. Instead, the problem of course is as Penny said: people really don’t want to do a lot of the things that they did before, and economic activity is just been depressed for reasons that really can’t be immediately solved by policy. The economic crisis part of it is starting from preferences, from people’s desire and need to not be doing what they were doing before.

Nevertheless, I think there are some pretty important lessons. The first one is one that Penny mentioned in her talk which is really impressive, which is in the earliest stages of this crisis, there is a really strong reaction from central banks around the world, most notably from the Federal Reserve in the United States, that took tools out of our toolbox, that had been discovered and built in 2007-2008, and just applied them. It was basically the same form. We took out all these really powerful things. It was a really different looking crisis, and yet the liquidity tools that were used by the Federal Reserve were extremely effective in the early stages of the crisis and managed to calm financial markets down from their initial concerns. To me, a lesson from that was really the value of studying history. We are always told that we fight the last war, and when we study what’s happened in the past, it won’t tell us how to fight the next one. But, in this particular case it turned out that even though these are very different looking economic crises, the tools, at least at that first stage, were quite similar. I would say that’s the first, the first lesson.

The second one is that while this was a very effective first stage of reaction on the part of central banks, I am concerned that if this recession lasts as long as many people fear, the banks and the financial system more broadly, which is very well capitalized right now, will cease to be well capitalized. That some of the burden of helping to rescue the economy, which is falling on the banks, will lead them to end up quite undercapitalized sometime around the end of 2020. And if that happens, I don’t know whether we are prepared yet. I would say I’m concerned that right now were we to need to have more advanced technical emergency programs, that we haven’t yet really focused on it. And if, God forbid, we actually need capital for the banks, I just don’t know whether the political will for it will exist. And I fear that this would be a very bad phase of the crisis if it happens. Of course, it will probably happen at the worst possible time, right around Election Day. Just as the bad time happened in 2008, and also in the Great Depression in 1932-33.

So the final lesson is very much just purely on the fiscal side. Which is in 2009, I think that we declared victory a little too early on the fiscal recovery and we paid the price for that really over the subsequent decade. It was a long recovery, and it lasted quite some time. The job market got fantastic, but growth, and productivity growth stayed low for a very long time. I fear that the need for what will eventually be fiscal stimulus, right now it’s been just really rescue, but will eventually be stimulus, that we may really have fiscal spending fatigue by then. We are already seeing a little bit of this now in Washington, as people say, “Well, let’s wait and see.” I don’t think we really need to wait and see. I think we really are going to be in dire straits for quite some time, economically, and we need to we need to stay aggressive. I would say those would be my three main lessons, so far.

**Peter**:Great, thank you. Bob, let me ask you a question based on your book. Your current book is called *Narrative Economics: How Stories Go Viral and Drive Major Economic Events*. I’m curious to hear your views, I’m sure everyone is, about the current narratives underlying COVID-19 pandemic and the economic consequences of it. Then are there particular narratives that would be helpful and encouraging consumers and in general encouraging economic recovery as we move forward?

**Bob Shiller**: I wrote a book called *Narrative Economics*, but it’s really a research proposal and not a final statement. We’re getting better data and we can start to observe more and more through digitized text of what people are saying. I think it will be a new world for macroeconomics. But, I think some of the narratives that are really salient right now preceded the COVID-19 epidemic, and actually made it worse. I also emphasize in my book, that narratives often go way back into history. They are like viruses themselves; they reignite with new circumstances.

I go all the way back to 1916, with Professor William Graham Sumner. Remember him? He was a remarkable man. He wrote an essay in 1916. The title of it was *The Forgotten Man*. It was how our system tends to be clique-ish and it ignores people who follow the rules and are decent citizens, in favor of go-getters. That theme is still coming up among many people in this country. There is a fear of the deep state and of liberal bias. A mixture of these narratives then suddenly confronted the epidemic and the epidemic has amplified them and has left us in a difficult situation.

**Peter**: Bob, let me stay with you for just a minute. I know that you’ve written about the Great Depression and the narrative of fear that surrounded the Great Depression and that you’ve been looking at media coverage of the 1918 flu pandemic. What can we learn from the narratives that surrounded those periods in history?

**Bob**: I think the narrative space is a largely unrecorded and unknown to most economists because we didn’t have ability to search text. We didn’t have all of the different digital media that we now have. We couldn’t see what’s going on. It’s like, we only had things like GDP or CPI. We couldn’t see what was actually going on in people’s minds. But we’re getting there.

The 1918 pandemic was interesting because it didn’t produce an immediate stock market drop. I searched newspapers from around the influenza pandemic and you could see a huge surge in articles in October 1918. That’s when it became clear. We are in deep trouble with this epidemic. But what did the stock market do? It rose. It didn’t cause a depression until 1920. 1920-1921 was what they call “The Post War Depression.” They didn’t see a connection to the pandemic, because it was you know a couple of years. It was during the second wave of the pandemic. They thought it was separate, most people. But I think, there was a connection. That the pandemic augmented the nightmare of World War I, with an even bigger and more deadly pandemic. We developed a depression. It only lasted 18 months, the depression of 1920-21. Why did it go away? Nobody knows. Our James Grant in his book called *The Forgotten Depression*,thinks it had something to do with labor intransigence, which softened. The narrative changed and they started accepting pay cuts.

Now, the Great Depression is another example, which I think is in some ways similar to today. When Roosevelt ran in 1932 against Hoover, it was a very divisive moment. The country was polarized much as we are now. It was called, some people call it, “The Age of American Communism.” I think President Roosevelt had a nice touch. He started his fireside chats. He started a new patriotic narrative that you should spend money. You should not take all the money out of the bank when we reopen the bank. And people followed what he said, somewhat. But the narrative was too negative. There was too scary a narrative. People thought the Depression would go on forever and they didn’t want to spend money. Even with the help that Roosevelt gave, which was so well tuned, he couldn’t overcome that. And the Depression lasted for 10 years.

**Peter**: We’re speaking a kind of a historical way with Bob. Penny, you know that historically global economic disruption can highlight disparities. Are there policies that developed and developing nations that are similar or different that can act to mitigate the economic damage both for their own people but also to create stability worldwide in the face of those disparities? Penny?

**Penny**: The priority right now is to provide economic relief and that applies to all countries. As Andrew mentioned before, there is a true worry that there may be fiscal fatigue as the months go by. On the other hand, there are also some legitimate concerns about how much debt we want to take on. One thing to keep in mind, that makes this crisis unique, is that usually when we have an economic crisis, it’s because there was some market failure, because there was a problem in the private sector. Then the government comes in, economic policymakers come in, and they try to provide relief or a stimulus package and remedy the problem.

Here, the economy was working well prior to the crisis, more or less. The nature of the problem, the roots of the problem, are not economic. We encountered a biological problem and in order to address it, we had to shut down the economy, for good reasons, but nevertheless, we did shut down the economy. What this means is that the expectations of people from the government, from policymakers, are different from what we experience in other crises. Here, there is a legitimate expectation from people and from businesses to receive support. As I said earlier, I think what this crisis has done in many ways is it has accelerated pre-existing trends.

One of these trends was a trend towards technology adoption. Automation. Using more robots in daily work, and so on. The slow decline of retail. These trends have been accelerated in the current crisis and they have long run implications. We all expect some jobs to return to the economy once we open up again, but some other jobs are not going to return. Some people will remain unemployed, those who are most affected by technology. In some sense, what this crisis has done is it has accelerated technology adoption, but it has also accelerated disruption. This creates enormous inequities across the world. It’s more important than ever to try to provide support for those who are displaced.

Support means not just income support, it also means giving them a way to transition to new skills and the new jobs. We had to do that anyway. This was coming, and we have been worried about these developments for many years. But now it’s been accelerated, and we have to face this challenge very soon. Some of these trends, some of these developments, are actually desirable. Adopting new technology is a good thing. Within Yale, we are now pursuing online teaching. This is not to say that online teaching is a substitute for personal interaction, but there are advantages to having online classes. We can make the best of it. The fact is these transitions tend to be painful and time intensive, but now we’re forced to do it and we’re doing it faster. If we do it well, then we can all benefit in the future.

Peter, you talked about other inequalities. This crisis has exposed, more than ever, the inequalities that exists within countries, but also across countries. This is a public health crisis. The biggest inequalities, not surprisingly, appeared in the domain of health and the most vulnerable turned out, not surprisingly, to be those in poor health. What I find striking about what has happened in the last two to three months is as a society worldwide we’re willing to shut down the economy at a huge economic price to protect the vulnerable. And yet in normal times, we are not willing to allocate resources to strengthening the health care systems, and this is particularly true in this country, but it applies to other countries as well.

Investing in people’s health is something that we have to do in the long run. More generally, I would say, investing in human capital. By human capital, I mean both health and education. Education was another casualty, another collateral damage of this crisis. Schools closed and those students who have access to the internet and computers and have educated parents, could partly make up for the lost classes. But that doesn’t apply to students who live in settings where this was not possible. That applies even to our own country, the United States. But it’s even more relevant to other countries in the world. I would say that in the long run one thing we need to do all over the world is invest in people and invest in human capital. Ultimately, this is what’s going to make countries more resilient.

One more thought that I conveyed before, but I want to repeat and emphasize, is that worldwide it’s more important than ever to resist this tendency and this urge to turn inward, to close the borders and become isolationist. This has happened many times in the past and it never served anyone well. In the current crisis, developing countries, especially low-income countries, are already hit hard and they will need help. They will need a helping hand from the richer countries. What we’re seeing right now is instead of lending helping hand, we richer countries tend to do the opposite. They’re closing the borders. This is going to affect immigration. This is going to affect trade. Trade and immigration are important in all countries. Where this is particularly important is to the low-income countries. Having a stable world, stable worldwide environment, is something that’s in the interest of everyone, not only the low-income countries, but also in the interest of the United States and the more advanced economies.

**Peter**: Great, thank you Penny. Andrew, I’m just wondering if you can do a very quick summary of your four-phase model for the economic consequences of the pandemic and how we get to recovery? Which I assume is the last phase.

**Andrew**:  Yes, sure. I think that it’s important in looking at the government’s response on the economic side to the crisis, to realize that there’s a bunch of different goals, and those goals will change depending on where we stand in the crisis chronology. The first phase was a liquidity run. We’re going to have all four R’s here. So quickly, “Run,” and that happened early on with lots of uncertainty, that was dealt with very well. That’s the kind of emergency response that we saw from central banks.

The second phase is a “Rescue,” “Rescue and Relief.” This is for handling people and businesses that really were living hand to mouth to some degree. You know, one week’s worth of payroll, or one week’s worth of buffer savings. We needed to get money, as quickly as possible, into the hands of those people and businesses. The “Rescue” phase is still going on, but it shouldn’t be confused. We shouldn’t think of that as a stimulus. It’s been called fiscal stimulus, but stimulus really is the wrong word. We are not trying to stimulate the economy. We are really just trying to rescue people, to keep them afloat.

The next stage, which we’ve already begun in some form and is a hazy line between “Rescue” and this next stage, is just the “Recession.” The “Recession” is going to last a long time. Generally, there’s a lot of noise being made now about getting states and cities to reopen and the government to say reopen. I think that’s a distraction. All the governors, all the mayors, the president, everybody, could go on TV tomorrow and say, “We’re officially reopened. Everybody is reopened. Go back about your lives.” And even in that world, all the people I know, who are my age and older are going to be pretty careful and not spending the kind of money that they usually spend. Travel and leisure will be way down. This is going to happen no matter what. This is a response that people are making by choice. I think the recession will last until we have a vaccine that’s widely available or really, really effective treatment and that will be by people’s choice. Government has some effect on this, but largely I don’t see us getting back to 2019 Quarter Four GDP until we are well past the stage where we have a widely available vaccine or great treatment. Or so many years have passed that we have heard immunity. I think it’s going to be awhile, and during the “Recession” phase the government is going to need to be creative and we’re going to need to worry about fiscal fatigue.

The last phase, Peter, which we’re all hoping to get to, is “Recovery.” That’s when the traditional tools of fiscal and monetary stimulus are needed, trying to make sure companies can borrow. Right now, they don’t really want to borrow, they just need to stay alive for another week. They’re not thinking about making new investments or hiring lots of people. They will need that during “Recovery,” which will happen after we have a treatment/vaccine. We may indeed need more fiscal stimulus at that time. We will still need dry powder. The “Recovery” phase, this is my concern that I mentioned earlier, will absolutely need a functioning financial system. You cannot have a recovery phase without being able to pump money through the economy, through the banks. My main concern, what I’m watching carefully over this time, is the condition of the banking system, because I don’t want to end up like Europe in 2011, or like Japan in the 1990s, where a very weak banking system can lead to a lost decade of growth.

**Peter**: Great, thank you Andrew. That framework, I think, is helpful to all of us trying to make sense out of the economy. At what level does the US debt to GDP ratio become a problem? Will people stop putting their full faith and credit in US Treasury obligations?

**Penny**: I would say I would not give a particular number. I think the United States is in a very strong position. It can afford to take on debt for some time to come. It’s not infinite, there is a limit to how much debt can rise, but right now I think we can take much more debt than other countries without being concerned about the long run prospects in this country.

**Peter**: What is your view on how the current monetary policy will affect inflation?

**Andrew**: I’m happy to take a stab at that. Inflation is one way that the markets tell us that we are defaulting on our debt. The currency of the United States is one form of our debt. Overall, the Federal Reserve, to a first approximation, has no power to affect the overall amount of US government debt. All they can do is change the composition of that debt from bonds, government bonds, that are somewhat longer in duration, to currency, which is kind of an immediate shorts, the very shortest end, of the government debt yield curve. Overall, the markets would tell us that we have a problem if you see either spreads going up on longer term US government debt, or some hint of inflation on the shorter-term US government debt. We are nowhere near seeing hints of inflation and I think that overall, if you view inflation as a form of default, the two questions, the question that Penny answered earlier about just how much debt we can have, and the recent question about inflation, are really the same question.

When you look historically, countries that have hyper-inflations, have them because they have lost control of their fiscal side and they’ve responded simply by monetizing that. It’s still a default. It’s the same government debt. It’s just that they’ve decided to monetize it instead of default on the longer-term stuff. I’m not worried right now. I’m not worried about the US defaulting on its debt. I think we have significant room. Penny is, I think, correct to not give a number, but we should remember Japan is at about 250% debt to GDP. I’m not suggesting we go there. I’m just saying we have a lot of room before we get there. I don’t think we would see an inflation problem unless the market started telling us they didn’t want as much of the short end of our curve as they currently do. In summary, I’m not concerned right now. I think about it as one piece of the broader problem, of how much debt we can have. I think that we are still within the range where it makes sense for us to deal with this short-term problem that we have, that’s very severe, even though it’s taking a little bit of a long run risk, as you always are, at least a little bit, by taking on more debt.

**Penny**: Can I add one thing? I fully agree with everything Andrew said. I just want to add to that, that we have right now, we have about 15% unemployment. The pessimists predict it will go up to 20 to 25%. Oil prices are at an all-time low. I just don’t see inflation as a concern, at least in the near future with such pressure on labor and wages and oil prices that low. Down the road, one day, we’ll have to worry about it. We cannot take debt forever. We cannot take on debt forever without facing the consequences, but this is not the right time to worry about it.

**Peter**: Let’s address something unexpected from this pandemic. Because of how the world is responding to the COVID-19 pandemic, including implementing social distancing measures, we’ve seen a significant reduction in carbon emissions. What does this say about approaches to addressing climate change?

**Andrew**: This seems like a big think, Bob Shiller, kind of question to me.

**Peter**: Bob you want to give a try at that?

**Bob**: The pandemic has reduced carbon emissions quite a bit, but it’s only because many people are sheltering at home. They’re not traveling, and some manufacturing is shut down. This is not a sustainable solution to climate change. It shows how big the reductions must be though. But, for all the world shutdowns, reduced carbon emissions are just about in keeping with the goal of the 2015 Paris Climate Accord. We did that in a kind of extreme and disruptive way to our lives.

As I’ve been saying, the most encouraging aspect of recent events after the coronavirus, is the sense of community was growing, the sense of heroism of working people. There is an atmosphere of a world community at war with a common enemy, the virus. I think that this leads us to a period when there’s a possibility of our actually reaching a consensus on enlightened environmental policy and making the innovations to our institutions and laws and customs as we’ve already done, I think, in this pandemic. We’ve already been learning how to do things differently. The spirit is here and I’m hopeful that we will see progress on important environmental policy.

**Peter**: Penny, Bob, Andrew, thank you so much for taking the time to join me for Yale Talk as we wrap up the academic year. It’s clear from our discussion that although medical research and public health interventions will end this pandemic, we will need the expertise of scholars from economics and psychology and history and many other fields to fully recover from this crisis.

The challenges ahead are serious, but I’m encouraged by the scholarship and research of Yale faculty members and universities around the world. Our faculty, staff, students, and alumni are making substantial contributions to addressing all aspects of this pandemic. They are modeling what it means to rely on data and on analysis to make decisions. Together we can overcome whatever lies ahead and emerge stronger.

To our friends and members of the Yale community, thank you for joining me for Yale Talk. Until our next conversation, best wishes and take care.

The theme music, “Butterflies and Bees,” is composed by Yale Professor of Music and Director of University Bands Thomas C. Duffy and is performed by the Yale Concert Band.