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An interview with Austan Goolsbee

"The countries that prioritized health not only had better health outcomes, they had better economic outcomes too."

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McKinsey's Adi Kumar spoke with Austan Goolsbee, the Robert P. Gwinn Professor of Economics at the University of Chicago Booth School of Business and the former chair of the Council of Economic Advisers during the Obama administration. He is a major voice in economics and serves on the Economic Advisory Panel to the US Federal Reserve Bank of New York. Austan shared his thoughts on the impact of COVID-19 on the US economy, how the pandemic has exposed political weaknesses, and how the US can best restart its economic engines. Stressing that the "virus is the boss" right now, he counsels US policy makers to prioritize public health and continue providing government sustenance until the pandemic is under control and the economy can safely reopen. The debt burden will grow, he says, but not beyond the limits of a recovered American economy to pay it back over time.

Will and compulsion in a pandemic

Adi Kumar: You and Chad Syverson recently published a paper with the National Bureau of Economic Research called, *Fear, lockdown, and diversion: Comparing drivers of pandemic economic decline 2020*.[1] There you attribute most of the drop in business activity in the United States to people's own decisions to stay at home, rather than government-imposed restrictions. Can you explain your hypothesis and its implications for policy makers grappling with strategies to reopen the economy?

Austan Goolsbee: We looked at phone records that tracked the locations of 2.3 million businesses around the country. These were mostly retail and services, the kinds of places people physically visit. When we plotted business activity against lockdown timelines through the pandemic, we found that consumer behavior was not aligning with lockdown orders. The visits had trailed off before these were imposed.

We began asking whether government orders drive behavior or not. It's the classic "identification problem" in economist language—was it causation or just correlation? The disease triggered fear and led people to stop going outside. Then authorities passed laws requiring that they stay at home. So it's important to figure out how much of what happened next—the sharp fall-off in consumer activity—came from individual choice and how much from public policy.

Our basic idea is to compare places where policies are different on either side of a state border. In Illinois we had shutdown orders, but across the border in Iowa they didn't. Several metro areas span that border and we have 110 different industries. Take barber shops as an example. If the policies were driving the activity, then we should have seen people still getting haircuts in Iowa but not in Illinois. But that didn't happen. In the same week, everyone stopped getting their hair cut by similar amounts. That kind of evidence leads to the conclusion that the 60 percent drop in consumer activity from pre-COVID-19 times to the depths of the pandemic was more about individuals' own decision to stay home. We found that only about 7 percent of the fall-off was due to the policy. Everything else we attribute to other factors, mostly fear.

In the United States, these findings are relevant to the debate about reopening. As we say, the virus is the boss. Slowing the spread of the virus, lowering the likelihood that people will catch it if they come to your business, helping them feel more comfortable and less fearful—those will be the key elements in bringing the economy back.

The frustrating thing about the United States right now is that most of the other rich countries have figured this out. Without vaccines or treatments, Germany, New Zealand, Japan, and other countries have stopped the rampant spread of the disease and are coming out of lockdown. Children are

[1] Austan Goolsbee and Chad Syverson, *Fear, lockdown, and diversion: Comparing drivers of pandemic economic decline 2020*, National Bureau of Economic Research working paper, number 27432, June 2020, nber.org.

> “A 60 percent drop in consumer activity from pre-COVID-19 times to the depths of the pandemic was more about individuals’ own decision to stay home.”

returning to school; people are returning to work. In the US, we had half-measures; we did not bite the bullet at the beginning.

The importance of safeguarding lives and livelihoods

Adi Kumar: Would you say then that health and the economy—lives and livelihoods—are actually not counterposed in a zero-sum trade-off? That rather, in order to have one, you need to have the other?

Austan Goolsbee: It is not a trade-off. Just look around the world. The countries that prioritized health not only had better health outcomes, they had better economic outcomes too. Here, where the main focus is on the economy rather than stopping the disease, we got the disease and it wrecked the economy. So the two go together, for better or worse.

Adi Kumar: This recession is like no other, in that a relatively healthy global economy closed in the midst of a steady if slowing growth: How much will the three-month lockdown and uncertainty around the policy response have damaged the fundamentals of the economy?

Austan Goolsbee: We don’t yet know. The economists are arguing about it, trying to figure out how much of the damage is permanent and what is temporary. But these questions can’t be answered until we know how long the virus is going to be with us in the United States. If we look at Germany or Korea, for example, the downturn will likely not be as long as it will be in the US, because they have turned a corner on the disease. If we can’t turn that corner, I don’t see how it ends.

In three months, if our public health is more in order, then we will see. But we’d better hope that normal recovery rules *do not* apply. Because the normal assumption for unemployment that goes up like a rocket is that it comes down like a feather. Even in boom times in the United States, the unemployment rate only comes down 1.5 percent a year. If joblessness went up 10 percent in a month, under normal rules, it will take years to come back. In those years, bankruptcies pile up, secondary implications mount for bank capital, and the result could be a financial crisis. The chances of this happening escalate the longer a downturn lasts.

But we already have evidence that normal rules are not applying. At one point we lost 22 million jobs in a one-month period; then in May and June the job market rebounded beyond expectation. I do see two potential speed bumps. If we can avoid hitting them I think we could recover with little permanent damage; if not, we are in for a tough ride.

The first bump is that government relief money sustaining small businesses and the unemployed will stop flowing. If that happens, and Washington cannot agree on further relief and rescue, then unemployment will climb again as small businesses shut down. The second speed bump has to do with state budgets. Epic downturns like this one suppress tax revenue; in response, states raise taxes, lay people off, and cut spending. We have already seen some actions by cities. In Nashville property taxes were raised 34 percent. Chicago is debating its own property-tax hike, because they can do little else to meet laws in place requiring balanced budgets. Without federal relief, states and cities will experience tough times, and the recession will be made worse. So our ability to navigate those speed bumps will determine what will be permanent and what will be temporary.

What policy (and federal dollars) can do

Adi Kumar: You believe then, that the federal government should continue pumping dollars into the business community, in particular small businesses, and help states through their own budget crises?

Austan Goolsbee: I think it must. If it stops, then we get into a negative spiral. This isn't a permanent policy. But in this crisis, we have to get control of the virus and keep the relief and rescue in place to sustain the economy until it can restart. These times are exactly what debt is for. You cannot pay for a once-in-a-century event all in the same year. On June 6, 1944, you can't have General Eisenhower canceling two-thirds of the landing craft because the D-Day landing isn't revenue neutral. We are going to pay for this relief. The right way is to pay for it over time, which is what debt allows you to do. But we need the money now, or the recession will be much worse.

Adi Kumar: I very much agree with you, but governments have already enacted massive fiscal and monetary stimulus measures. How concerned are you that growing debt could weigh on future growth and long-term economic health?

Austan Goolsbee: I think failure to control the virus would have the worst impact of all on economic growth, on innovation, as well as on public health. Whatever the negative impact of adding debt, far worse would be uncontrolled viral spread. It is extremely unlikely that the United States is in danger of creating a fiscal crisis of the kind sometimes seen in emerging economies, where interest rates spiral out of control and the market decides the government cannot pay back the money.

The debt capacity of the US far exceeds any of the forecast levels. I have said this for a long while, now. We have added trillions in debt before: during the George W. Bush administration we had an unpaid-for tax cut of $2 trillion; the war in Iraq cost nearly that and had not been budgeted. During the Obama administration, recession stimulus was above $1 trillion and under Trump we have another $2 trillion tax cut. None of these unpaid expenditures drove up the US interest rate. We will have higher taxes in the future to pay for this crisis. That's a fact. But protecting the lives and health of millions of people is worth it and is at least as important as any of those previous priorities.

A worsening outlook?

Adi Kumar: The various forecasting institutions out there—the International Monetary Fund, the World Bank, the European Central Bank, the Federal Reserve—at one point worsened their forecasts, both for the 2020 GDP contraction and for the post-2020 rebound. The estimates are partly based on scenarios of a second outbreak. Do you agree with the shift in outlook?

Austan Goolsbee: Yes, I agree. In early March, when few COVID-19 deaths had been confirmed, I wrote of a potential epidemic in the *New York Times*. I said that an epidemic in the US would have a far greater impact on the economy here than it had in China, because our economy is much more dependent on face-to-face services than is China's. I believed then that the damage here would be severe. And sadly that is exactly what is happening. The spread of the virus is worse than we had hoped, and because of that, I think the downgrades to the economic forecasts, especially for the US economy, are warranted.

Adi Kumar: Austan, the US unemployment picture is bleak. More than 40 million jobs were lost as of June. Considerable uncertainty shrouds job recovery, and automation could accelerate and exacerbate that problem. Where are we going? What do you believe are the best- and worst-case scenarios for job recovery?

Austan Goolsbee: Hypothetically, say that in two months we had a vaccine and could manufacture and distribute it at scale. I think we could quickly go back to what we were doing before COVID-19 began. Of course that is not realistic scientifically, but it reminds us that this isn't like a normal recession. Bouncing back is more plausible here than in a normal circumstance.

The best *realistic* scenario is that we do enough testing, supply the population with enough masks and other protective equipment, and slow the spread of the virus to the levels we see in New Zealand, Korea, China, Germany, Japan. Then our employment picture would improve as theirs did. Here unemployment went up by more than 10 percent in a month. They had increases too—but by 2 percent in Germany, 1 percent in Korea. Those levels do not translate into economic destruction.

As for the worst-case scenario, that is the ramming of the two speed bumps I spoke of. In this scenario we have a full-blown public-health crisis a few months before the presidential election. That situation would be terrifying. And Washington would be unable to respond, because of political polarization.

It is to the credit of the government that it was able to pass the CARES Act [Coronavirus Aid, Relief, and Economic Security Act] despite the partisanship. It was done on a few weeks' notice—a multitrillion-dollar program to provide urgent relief. But I'm afraid the government won't be able to do it again because of the approaching election. If more relief doesn't come through, we ram the first speed bump—millions of small businesses just shut down.

The second bump comes when state and local governments institute massive cuts in the face of the recession. That would make the job market materially worse, with millions more people added to the unemployment rolls. If you have double-digit unemployment rates for an entire year, and it is not improving, we could be talking about serious social unrest.

In the financial crisis and recession of 2008–09, unemployment reached 10 percent and society was beginning to experience cracks and dysfunction. That rate came down slowly, 1.0 to 1.5 points per year, which was pretty good. But people did not feel that we were recovering, such was the damage. What if unemployment was still that high or higher in 2022? That would be a mess.

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Policy and politics in a crisis

Adi Kumar: Your mention of the 2020 presidential election is apt. The financial crisis of 12 years ago hit at exactly this time in the political season. The election was coming and a less-polarized Congress was working together, passing some big pieces of legislation, like TARP [Troubled Asset Relief Program] and economic-relief packages.

Austan Goolsee: That's right. I don't know if it is just a terrible coincidence, or if there is something about these periods, when leadership is uncertain. The 2008 experience was sobering. Eventually Congress did do something, but only after some scary events. It was almost as if the crisis had to prove to the legislators that we were all going to die if they didn't do something. Then once they did act, everyone was upset about it for years after. "Why," they asked, "did you give the money to the banks? Why were there no conditions and no punishments for misuse of the money?"

That reckoning has yet to happen for the CARES Act, but it is going to happen. That also makes me nervous—the legitimacy of the government in dealing with the crisis could be undermined. If the crisis goes on too long, people will start saying, "Your process, whatever you're doing, is not working." When that happens, it will be very difficult for the government to keep doing what it needs to do. The Obama administration passed its first stimulus as soon as it was in office.

Adi Kumar: February 17th, 2009, less than a month after getting in office.

Austan Goolsbee: Yes, less than a month. The economic news after that was bad for quite some time. People started saying, "You passed your big thing that was supposed to save the day, but unemployment is still really high." A certain argument for limiting spending was heard then as now: we can pass some stimulus now but go back and pass more later if need be. But in 2008–09 we could not go back to get more. Congress had moved on. They were saying, "Why should we do this? It doesn't work." That could easily happen again.

Nothing undermines the legitimacy of government relief faster than finding out money went to dead people, money went to the president's friends, the lack of transparency on who gets what. We have $5 trillion in federal lending that is going to big business, backed by $500 billion under the control of the Secretary of the Treasury. Of the $5 trillion, only $150 billion has gone out the door. So we have a trough of money as never before seen, and zero clarity on who gets it or how that is decided.

I see problems ahead. In a $5 trillion program, chances are high that money will go to undeserving companies or things will happen that stink badly of corruption. This will undermine the legitimacy of government aid. The headlines will be dominated by stories of misappropriated funds. We were extremely transparent with the funds during the last financial crisis and they seem to have concluded that transparency makes people mad—they find things to criticize.

Adi Kumar: All the warts.

Austan Goolsbee: Yes, the warts. But the lesson I learned was the opposite. If the Obama administration had been as secretive as the present administration has been—I think the stimulus bill would have gone nowhere. It would have been the source of scandals, and in a way those spinning the scandals would not have been wrong. It is the public's money. They have a right to know what the government is doing with it, where the programs are working and where they aren't.

Adi Kumar: The crisis of 2008 broke into the presidential campaign. Senator McCain suggested postponing one of the debates, because he felt the candidates should be dealing with the crisis. But Senator Obama was opposed, and the debates continued. That disagreement seems mild in the light of the present election. Can you comment on the degree to which the candidates today are driven by electioneering as opposed to policy? And the extent to which people's confidence in the economy is determining their confidence in the political leadership?

“In this crisis, we have to get control of the virus and keep the relief and rescue in place to sustain the economy until it can restart.”

Austan Goolsbee: There are deep issues in those questions. I remember very well the first 2008 debate. I was at the debate preparation. We were in Florida, and that debate was supposed to be about international policy, including trade. Suddenly, in the middle of the prep, everyone stands up and runs into a corner with their phone. And I’m sitting there wondering, *What the heck just happened?*

Well, Senator McCain had just announced that he was canceling the debate and suspending the campaign to deal with the crisis. It turned out to be more of a stunt but, in general, major economic shocks and how leaders react to them will massively affect people’s voting behavior. That is the natural course of things in politics.

The present recession is unique, so there is no historic playbook. We can’t say what is happening now is just like what happened in 1823 or something. Our second quarter GDP could contract by minus 35 percent. Unprecedented. And the third-quarter number could be plus 20 percent. Again, there has never been anything like this.

Minus 35 and plus 20 are annualized numbers, but if the GDP for the year is minus 15 percent, that would be the worst GDP year on record. The incumbent, however, might say, “I just had the biggest quarter ever.” And the opponent would be saying, “We are having the worst year of all time.” We won’t know whether people credit the incumbent with the recovery or for the bad economy, until the election is decided.

A real problem is that the pandemic could affect voting or be used to undermine the process. The incumbents nationally and locally can decide on the mechanics of voting. We have had chicanery to prevent absentee voting, and in-person voting has also been tampered with. That is a very creepy scenario, and I hope we do not go down that road.

Paul Volcker and credibility

Adi Kumar: Austan, we met the day after Lehman Brothers declared bankruptcy. At that strange moment, you were an economic advisor to the Obama campaign. What did you take from those days that can be applied to the current situation? And in what respects does the current situation call for a different response?

Austan Goolsbee: That is a critically important consideration. There are some parallels between the present crisis and 2008 and also previous crises. But for some of the reasons we have highlighted, this crisis is also very different. My mentor was Paul Volcker, whom I worked with closely during the last crisis. And he consistently reminded us that in a crisis, the only asset you have is your credibility. I think that is important to keep in mind.

One takeaway from the 2008–09 experience is to protect your credibility. Early on, my friend Larry Kudlow said that the virus was contained when it clearly was not. That was not merely embarrassing, it undermines credibility. Some governors started saying, “Everything is fine, people should go out,” and then they go out. Now that the virus is resurgent, it is that much harder when the time comes to say, “Now it is *really* safe.” People will ask the messengers, “Wait, aren’t you the people who said it was safe before and it wasn’t?”

So one lesson we learned is that credibility matters a lot. Another is that long-term unemployment is a horrible island. Those stranded on it have a terrible time getting off. The economy can come back, but some groups were disproportionately hit and are left behind. We must prioritize these groups and get people back on the job rolls after this crisis as fast as possible. If that involves even more government money, then we must be prepared to spend it. Because a slow return to normalcy is no fun.

In the aftermath of 2008–09, we forced financial institutions to build up more capital, and that is a success story. If this pandemic had struck then, we would have had a disaster that could have taken down most of our financial institutions. The forced recapitalization then gave us some cushion to deal with the crisis today. I’ve been thinking of the idea of contagion. It creates fear, whether of a physical disease or of financial ruin. And the two are linked. The fear created by financial contagion causes people to pull their money out of financial markets. The fear created by the pandemic stops people from going to the doctor, to restaurants, to hair salons.

In financial crises, recovery measures are of little use, as the Fed [US Federal Reserve Board] reminds us, until we stop the run on the banks. With the pandemic, life cannot begin to return to normal until we control the disease. The two are closely linked.

Reason for hope

Adi Kumar: Austan, we have naturally focused on the economics of this crisis, but it is first of all a humanitarian one. People are suffering; loved ones are dying. When you think about how we can help people and how we can come out of this, what gives you the most hope?

Austan Goolsbee: Yes indeed, you are right to put the emphasis on the humanitarian character of this crisis. The most hopeful thing for me is that several countries now have beaten the pandemic and are coming out the other side. The great majority of us will physically survive this catastrophe. The influenza pandemic of 1919–20, coming on the heels of a terrible world war, took an even higher toll. But our grandchildren will ask us, “What was it like during the great 21st-century pandemic?”

The world is linked, so we all have a long way to go. We have to bring down the infection rate and need more testing. But from a policy perspective, in the economics sphere, there is not cause for despair. The great majority of us will come through physically, and the policy solutions for the economy are well within our reach. Let’s strengthen our resolve to control the pandemic. Once we do that, we can take care of the rest.

Adi Kumar: Austan, thank you for giving over of your Sunday morning to talk with us. It was a real pleasure.

Austan Goolsbee: Thanks Adi, great to see you again.

Adi Kumar is a partner in McKinsey’s Washington, DC, office.

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