

Three Pillars of the Economic Policy Response to the Covid-19 Crisis
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March 18, 2020

Governments around the world are in the midst of deploying a host of policies to deal with the Covid-19 crisis. The economic shock from this crisis is going to be huge, with an enormous human cost. The pain will fall disproportionately on certain people and sectors.

Some policies can be taken from the usual macroeconomic toolkit. Central banks have appropriately eased monetary conditions. Unemployment insurance and other forms of income support are essential to help displaced workers and distressed firms. The case for such support seems especially clear and uncontroversial in this case as there is no moral hazard – the local shuttered restaurant, and its employees, are of course not to blame for this health crisis.²

In several important ways, however, the current situation is unlike past macroeconomic crises. Most centrally, there is a direct conflict between some traditional recession-fighting policies and addressing the health crisis, which we believe must take priority. After all, normal macroeconomic policy would never incentivize workers and customers to stay home, though this is exactly what we might need now. Further, firms and households need to learn how to operate in a totally different environment given the need for social distancing. Finally, whereas recoveries from financial crises are famously drawn out, this crisis offers the possibility of unusually rapid recovery once the viral threat passes. Our aim is to offer a framework and some guiding principles useful for thinking about these novel elements of this pandemic-driven crisis.

We organize our discussion around three pillars of the economic policy response. First, following the advice of medical experts, we must do all we can to spread the number of infections over time, or “flatten the curve”. Second, policies should facilitate production and decision-making in a temporarily socially distanced world. Third, we should prepare to make

¹ First draft March 18, 2020. Minor updates March 23, 2020. We are Professors at the University of Chicago Booth School of Business and the co-directors of the school’s Initiative on Global Markets (IGM). The views here are our own and are not necessarily shared by any other institutions or organizations with which we are affiliated.

² As we write, there are many policy ideas being debated on this aspect of the policy response, which is not the focus of our essay. For frequent updates on alternative policy proposals and other analyses, see <http://www.igmchicago.org/covid-19>.

the post-virus recovery as rapid as possible. Even though these three aspects of the policy response will play out in sequence, policymakers should start acting on all three now.

Finally, we recognize that we are not medical professionals but rather are economists with different areas of expertise working together to try to understand a highly uncertain and scary situation. Toward that end, the Initiative of Global Markets at the University of Chicago's Booth School of Business, where we four serve as directors, will be hosting many views from throughout the profession on various elements of the pandemic at <http://www.igmchicago.org/covid-19>. The initial articles posted on our site, together with other recent analyses, have informed much of our thinking. Several of the observations we make here have been made before by others. We hope our synthesis, additional insights, and framework are helpful.

Pillar 1: Spreading Out the Number of Infections over Time ("Flattening the Curve")

The biggest social risk from the pandemic is that our health care system becomes overwhelmed so that people who could be saved are not because of insufficient care capacity. Policies that support spreading out the number of infections and enhancing the system's capacity should be prioritized, and those that do not support these objectives should be avoided.

The Issue: Distorted incentives for prevention

People might wonder, "if I am going to get the virus with a high likelihood at some point, why does it matter *when* I get it?" As has been widely discussed, the key observation is that if 500 people simultaneously need to be hospitalized for one month, they cannot all stay in a 100-bed hospital. If the cases are sufficiently spread out over five months then they can all be accommodated.

The Role of Government: Aligning private and social objectives

In the context of this capacity constraint, people left to their own devices will not take sufficient precautions with their health. Sure, no one wants to get sick, but people likely disregard the

fact that if they get sick and fill a hospital bed, it makes it more likely that others get sick – including doctors and caregivers – and makes it less likely that another sick person can also get a hospital bed. Relatedly, young people might make choices reflecting the fact that the disease is not as serious for them and ignore the more substantial risk it poses to older generations.

When people make decisions without fully taking into account the implications or spillovers for others – what economists refer to as externalities – there is an important role for public policies to help shape a better outcome for everyone.

Policy Implications: Sick leave, testing, insurance, reinforced distancing, capacity expansion

We should **enhance sick leave policies**. Firms might weigh the fact that a sick worker can infect the rest of their staff, but they are unlikely to internalize the positive spillovers for everyone else of keeping that worker at home. Further, since we know that people can transmit the virus even when they have no symptoms, this same logic calls for **significant encouragement of testing**. Once tests are readily available and can be administered without disrupting social distancing, the country as a whole will be better off with a level of testing that exceeds what individuals and firms would pay for on their own. As a result, **closing health coverage gaps** as relates to the virus, even if only temporary, is also essential.

And while flattening the curve is critical even if it doesn't reduce the total number of cases, most steps to *lower* the peak infection rate also *delay* the peak infection rate. This buys us time to **test and develop vaccines or other treatments and to invest in more hospital capacity**, which may in fact lower the total number of cases.

Here, large externalities also abound. The addition of a single hospital bed removes from the public a person that otherwise might be spreading the virus. Improved hospital capacity in Chicago makes it less likely that infected Chicagoans use hospital beds or spread disease in nearby cities. Improved capacity in the United States spills over to other countries, and so on. In fact, society today might under-invest in our ability to respond to epidemics because we don't internalize the benefits offered to future generations that face future epidemics. This logic may support even some of the more radical proposals like employing the U.S. Army Corps of Engineers as temporary hospital builders (subject to national security concerns, of course, where we claim

no expertise) or dramatically subsidizing the enhancement of the country's ventilator production capabilities. Similarly, there are positive externalities from **increasing the production of medical masks and gloves**. A shortage of masks could tragically increase the risk that medical front-line workers contract the disease, which would both amplify the spread of the disease and hinder the medical system's ability to treat it. There's a public interest in covering the switching costs that might inhibit otherwise capable firms from producing key medical supplies.

Finally, our principles also help identify policies that could backfire. Well-meaning policymakers, concerned about workers' earnings, might incent firms to keep workers coming to the factory or store even when they are not needed. Though economically helpful to those workers, such a policy would unnecessarily hinder efforts to flatten the curve. Well-crafted policies that maintain at-home employment are clearly advisable, but we must recognize that **some policies which helpfully keep workers earning wages carry negative spillovers for the public health**.

Much discussion calibrates the severity of this epidemic based on early estimates of its mortality rate. We need to recognize that the mortality rate is determined not only by biology but also by our actions – we can reduce that mortality rate by slowing the spread of the disease and investing in treatment capacity. Expanded sick leave, widespread testing, filling insurance gaps, reinforcing social distancing, and expanding capacity have huge positive externalities for society. We must internalize this and act aggressively to save lives.

Pillar 2: Facilitating Production, Decision-making, and Community Support in a World with Social Distancing

For a period of time, firms, workers, communities, and families will be reorganizing in order to operate in a world of social distancing. The government should play a role in communicating critical information in a transparent and standardized way, disseminating best practices, protecting the communication and shipping infrastructure, and empowering community support networks to ensure everyone remains as healthy, productive, and safe as possible.

The Issue: Managing the financial and social burdens of adjusting to social distancing

For many industries, social distancing eliminates the possibility of production. Some firms can operate and are allowing (or requiring) employees to work from home, while radically but temporarily eliminating any reliance on travel or large gatherings. Households, likewise, are rapidly adjusting to potentially prolonged periods where school-aged kids remain home. This crisis will hit families in vastly unequal ways financially and medically and this may call for unusual forms of support from the community and public sector.

The Role of Government: Assisting in the social distancing transition

First and foremost, the government has to mobilize financial resources to support people who are medically affected or whose incomes disappeared overnight. If this isn't done well, nothing else will matter. There are many policy proposals circulating to address these issues and we hope something effective will be enacted. Our focus here will be on a second set of problems that arise right after the most immediate ones are attended to.

Providing reliable and transparent information about the disease is a public good as it coordinates expectations about the length and severity of the crisis so that firms and households can plan accordingly. Most are scrambling to learn best practices to run a firm or household in this period of social distancing and needn't all start from scratch. Given the unprecedented and rapidly evolving situation, local communities may uncover creative solutions to support each other and those in need. We need to make sure that government policies, which may work well in other times, do not hinder these efforts. Lastly, infrastructure is a public good, but what constitutes key infrastructure in the current crisis has changed. The government needs to adjust to make sure the newly needed critical services are delivered.

Policy Implications: Information sharing, best practices for remote work and education, protect the infrastructure needed for social distancing, creative support for community- and family-driven solutions

Planning in this sort of environment is exceptionally difficult, and will depend critically on views of the virus' trajectory. Much as government provides a useful service in forecasting the paths of hurricanes to help people plan, the government should **disseminate scientific information about the virus and its spread as transparently as possible**. For example, it is difficult right now

to obtain simple, consistent, and well-documented information on elements of how the virus spreads, how symptoms evolve, infection and hospitalization rates by age, geography, and health, and current forecasts for the duration of the harshest social distancing measures. This understandably reflects the novelty of the virus, but as scientific knowledge accumulates, the government can play a useful role in disseminating it. People are already making decisions using the best information on the pandemic that they can find. Improving that information is critical.

Next, smaller firms may not have the resources to spend much time figuring out how to most efficiently operate in a temporary period of remote work. In much the same way that governments assist small firms in learning how to import or export or farmers in how to get crops to market, policymakers can help **by collating and disseminating best practices on how to operate and organize with social distancing**. Similarly, families are struggling to continue work with kids at home, and schools are preparing to move to remote learning. Smart government policy can assemble common resources to ease the transition for households and school districts. Having everyone re-inventing the wheel is highly inefficient.

This new structure of production will rely heavily on different elements of the infrastructure. **Communication capabilities in residential areas and the continuity of shipping and delivery services must be treated as critical infrastructure** in a world of social distancing and should be closely monitored and potentially subsidized.

Finally, this crisis surely will raise unforeseen problems that communities will have to solve. The government, including local authorities, must be **ready to flexibly accommodate and support creative solutions**. For example, families might find themselves without healthy parents to care for children. If judged safe from a medical perspective by health experts, the government may require firms to broaden their leave policies to allow employees to stop work temporarily to care for friends, neighbors, and loved-ones that are not technically considered dependents. Likewise, local ordinances should not be allowed to frustrate the smart redeployment of underutilized space. For instance, zoning or licensing rules might prevent the creation of temporary daycare centers near hospitals. This kind of innovation could be a common-sense way to assist healthcare workers that are on the front lines of the crisis.

Pillar 3: Take Steps Now to Facilitate Rapid Post-Virus Recovery

Unlike the aftermath of financial crises, this downturn allows for the possibility of exceptionally rapid economic recovery. The government can start taking actions now that will maximize the chances this happens, thereby minimizing the long-term economic damage caused by the virus. Delaying some decisions could be costly.

The Issue: The conditions needed for recovery will atrophy while social distancing is in place

Intervening events will mean that firms and workers will not all just be able to pick up where they left off before this crisis began. Both firms and people are already making decisions that could hinder the ability for all of us to return to normal. Policymakers should take steps now to make sure that the economy roars back as swiftly as possible once the health crisis is under control.

The Role of Government: Removing uncertainty, protecting capacity, coordinating recovery

Why would the economy not simply snap back to pre-crisis levels, or beyond, when social restrictions are lifted, in particular given the pent up demand? One key problem is that the capacity to resume depends on businesses surviving and workers being able to return to those businesses. Even if the firms are there and the workers are available, there will be uncertainty about the post-crisis economic environment. Firms will be unsure about the demand for their products, leaving them reluctant to hire back workers. Households will be reluctant to spend their income. The government can share information, adopt policies to coordinate actions, and provide incentives that can together facilitate a quick rebound.

Policy Implications: preserve the capacity to recover promptly and, when the time comes, offer incentives to accelerate the recovery and coordinate beliefs on when it is time to fully re-engage with the economy.

What can government policy do to ensure that the economy roars back once we can switch the lights back on? First, we need to make sure that the coordination failure, namely that firms wait for consumers and consumers wait for firms, is avoided. For instance, once social distancing is no longer required, **firms might be incentivized to hire aggressively by using a payroll tax cut.** And

in the meantime, creative programs might be designed to funnel income to furloughed workers, including via the tax code, to minimize the extent to which firms respond to the downturn with layoffs. **Preserving connections between employers and their employees**, when these matches are hard to quickly replace, will facilitate a more rapid recovery.

To mitigate concerns about the return of the current pandemic and the potential for future pandemics, it is important to coordinate policies across countries, to develop best practices, and publicly share information about future outbreaks. The virus may continue its spread in other countries even if it is controlled in the United States, and policymakers should clearly and publicly explain their plan to monitor and prevent a second wave of Covid-19. Absent such assurances, people may understandably hesitate to return to normal economic life.

We are discovering that our supply chains of masks, medical equipment, and drugs have fragilities in a crisis. Individual companies may not internalize the social cost of pandemics and disruptions to medical supply chains. While it seems unnecessary and inefficient to require the medical supply chain to be entirely domestic, we do need to ensure that they are reliable in a crisis. An analogue to financial sector regulation is quite apt. Banks and insurance companies are required to stress test their balance sheets and regulators analyze the system-wide effects that may arise if they become impaired. **It may be useful to develop “medical supply chain stress tests” to safeguard society against pandemics.** In the case of Covid-19 specifically, such a stress test could, when the time comes, help build firms’ and the public’s confidence that society is ready to quickly return to normalcy.

Lastly, many households will stay home for extended periods of time. Some work can be done remotely, but many people will have more time available than usual. This provides a **unique opportunity to make investments in human capital**. The government can provide online training programs and call on universities to develop them quickly. With education being an important driver of economic growth, we can use this difficult period to further improve our economy and strengthen our workers over the long-run.

Conclusions:

This is our attempt to use economic analysis to help during the crisis. We believe that the policy responses will be most effective if we recognize the crisis creates three distinct, but inter-related problems. These are early days and things are evolving rapidly. We hope the framework can prove to be durable and helpful.