The Trade-Offs Between Economy and Health – Wall Street Journal

From Spanish flu to Japanese tsunami, governments grappled with the trade-off between public health and economic stability

By Greg Ip, Danny Dougherty and Anthony DeBarros March 20, 2020 11:51 a.m. ET

The coronavirus has unleashed a massive economic shock on the U.S. and the world. It began with disruptions to supply chains and restrictions on travel and is now rapidly expanding via spontaneous and government-imposed "social distancing" measures such as closing schools and confining regional populations to their homes. Entire industries are shutting down. It is "a sudden stop to the global economy," said Mohamed El-Erian, an adviser to German insurer Allianz.

There is no clear historical precedent for the scale and nature of this shock. Some economists see U.S. output falling by more in the coming quarter than in the worst quarter of the 2008-09 recession. Nonetheless, previous episodes of pandemics, disasters and crises offer clues about what to expect, how policy makers make matters better or worse and the likely long-term consequences.

A few lessons stand out. First, governments and the public always face a trade-off between economic stability and public health and safety. The more they prioritize health and safety, the bigger the near-term cost to the economy, and vice versa.

Second, at the outset of the disaster, policy makers are coping with enormous uncertainty. Early responses are often timid or off-target and more sweeping action is delayed by political disagreement.

"We learned that we need to prioritize speed, think in tranches, be visible and worry about how to pay for it later," said Tim Adams who served in the Treasury Department during 9/11 and Hurricane Katrina and is now president of the Institute of International Finance. "If you wait to craft the perfect response, you'll lose valuable time and you'll miss something no matter what."

Third, disasters often create permanent changes to habits, and the most affected industries and regions can take years to recover. New Orleans' population has steadily regained ground since falling by half after Hurricane Katrina but isn't yet back to its prestorm level. But for society as a whole, the scars heal remarkably quickly. Humans are immensely adaptable.

The Spanish Flu

While the coronavirus isn't a flu virus, the pandemic resembles the influenza pandemics of the 20th century, in that it is highly infectious and relatively lethal. The deadliest was the Spanish flu in 1918, which infected at least 500 million people world-wide (more than a quarter of the Earth's population) and killed 50 million or more, including 675,000 in the U.S., according to the Centers for Disease Control and Prevention.

Members of the American Red Cross handle Spanish influenza victims in St. Louis, Mo., in 1918. Photo: Zuma Press

Yet the economic impact was surprisingly mild. The National Bureau of Economic Research says a recession began in August 1918 and ran through the next March. The flu probably wasn't the cause. In a 2006 paper for Canada's Department of Finance, Steven James and Tim Sargent found little trace of the pandemic in international trade, retail sales, railroad passenger traffic and stock prices. They saw some effect on industrial production, which fell sharply in October and November but that was in part due to falling defense production as World War I drew to a close. They put the pandemic's effect at a 0.5% decline in annual output.

There are likely several reasons. Far fewer people worked in jobs that required close social contact. Farming, fishing and forestry accounted for 16% of American occupations in 1910 compared with 0.3% in 2004, according to Messrs. James and Sargent. Few workers had sick leave, and unemployment insurance didn't exist. Thus, workers who were sick or at risk could seldom afford to stay home.

The second is that governments, many preoccupied with war, didn't put the same weight on stopping the epidemic as they do now. The federal government had little formal role fighting infectious disease. President Woodrow Wilson never publicly mentioned the epidemic, John Barry writes in "The Great Influenza: The Story of the Deadliest Pandemic in History." Chicago's public health commissioner flatly rejected closing businesses, Mr. Barry wrote, quoting him as saying: "It is our duty to keep the people from fear. Worry kills more people than the epidemic."

Cities that took that attitude saw higher death tolls, according to a 2007 study by Richard J. Hatchett, Carter E. Mecher, and Marc Lipsitch. Philadelphia waited 16 days before restricting social gatherings, even allowing a parade to go ahead. St. Louis took just two days. The daily death rate from the epidemic peaked at a level five or more times higher in Philadelphia than in St. Louis.

The lesson: The more short-term economic pain Americans are willing to endure, the more lives they will save.

Asian Flu Pandemic

The 1957 Asian flu pandemic killed more than 1 million world-wide and 100,000 in the U.S., although some estimates are lower. It emerged in China in February, reached the U.S. in early June and then spread explosively when schools opened in September. On Oct. 7, 43% of Manhattan students and 11% of teachers were absent because of illness, and by the end of October, more than half of all counties nationwide were experiencing epidemics, according to a study by the Center for Biosecurity of the University of Pittsburgh Medical Center.

As in 1918, the pandemic coincided with a recession, but that was because the Federal Reserve had been raising interest rates to counter rising inflation. Messrs. James and Sargent found a "very small" impact from the epidemic on growth, mostly from absenteeism.

Also as in 1918, the lack of widespread social distancing may explain why the epidemic had so little economic impact. State and federal officials made vaccination, which was unavailable in 1918, their first line of defense. But only enough vaccine for 17% of the population had been produced by the time the epidemic peaked, and it was at most 60% effective, so it did little to mitigate the pandemic, the Pittsburgh study found. The authorities rejected social distancing, most schools remained open and many people weren't sick enough to require hospitalization.

Eli Lilly and Co. workers make flu vaccines in 1957. Photo: Associate Press

The 1957, 1968 and 2009 flu pandemics were highly contagious but much less lethal than the Spanish flu and, it appears, Covid-19. Those experiences may have contributed to initial public complacency over the coronavirus. Governments are now willing to take far more economically disruptive remedies than in those prior episodes.

September 11 Attack

When al Qaeda terrorists flew jetliners into the World Trade Center and the Pentagon, they delivered an unprecedented shock to the nation's sense of security and its economy. Commercial aviation was grounded for three days. The destruction to lower Manhattan closed the stock markets. Heightened security slowed trade with Canada and Mexico to a crawl. Nervous shoppers stayed away from stores and malls.

Economists predicted the attacks would tip a slowing economy into recession. People would be more reluctant to fly, work in a tall building or base their office in New York City.

The World Trade Center site burns after the terrorist attacks of Sept. 11, 2001. Photo: Mario Tama/Getty Images

The attacks forced airports to close. Photo: David McNew/Getty Images

But the U.S. bounced back remarkably quickly. It was later determined that a recession triggered by the technology bust had begun six months before the attacks and ended two months afterward.

One reason was the aggressive policy response. The day the markets reopened, the Fed and its counterparts in the Eurozone, Canada and Sweden all slashed rates. Low rates inspired auto manufacturers to roll out zero percent financing, sending sales skyrocketing. Fears of terrorism faded when new attacks didn't materialize.

Within two weeks Congress approved $40 billion for emergency rebuilding and defense and $5 billion in cash assistance and up to $10 billion in loan guarantees to airlines. Both parties agreed more stimulus was needed but negotiations soon bogged down over its composition. When a package worth $51 billion over one year and $94 billion over five years finally passed in March, a recovery was already well under way.

The lessons for the present go only so far. Back then, Americans were urged to defeat al Qaeda by continuing to work, play and shop. Today, they are being urged to defeat the coronavirus by staying home. Then, interest rates were high enough that zero-interest car loans seemed like the deal of the century. Not any more. Then, the shock was confined to the U.S. and short-lived; today, it is global and could last weeks or months, so no one can expect overseas strength to cushion their downturn.

Still American resilience prevailed. People quickly adjusted to heightened security. Airline traffic and demand for New York office space returned to their pre-attack levels over the next several years.

SARS in Hong Kong

Hong Kong's experience with Severe Acute Respiratory Syndrome (SARS) in 2003 was a dress rehearsal for the coronavirus. The virus first appeared in China, which tried to cover it up and then had to resort to drastic quarantines to quash it. It probably entered Hong Kong via a Chinese doctor who checked into a hotel there in February 2003.

Mass transit in Hong Kong emptied out during the SARS crisis of 2003. Photo: Peter Parks/Getty Images

Initially, the government played down the outbreak. By late March it broke out in an apartment complex and as news spread, social distancing arose almost spontaneously.

"Fears of the SARS virus took root in the whole city," Alan Siu and Y.C. Richard Wong, economists at the University of Hong Kong, wrote in a 2004 article. "Face masks were selling briskly and could be seen everywhere. Public places were disinfected several times a day. People washed their hands much more frequently and avoided going out to crowded places. Restaurants, shops, cinemas, and other entertainment venues were deserted."

The government eventually closed the schools and ordered anyone confirmed or suspected of SARS to self-isolate.

SARS sent the economy, with its dependence on travel and tourism, reeling. Between March and May, daily passenger arrivals and departures plummeted 80% while the hotel occupancy rate plunged from 80% to below

20%, Messrs. Siu and Wong reported. Unemployment jumped and gross domestic product shrank in the second quarter.

The social distancing had its desired effect: The breakout was contained by late April. The economy bounced back rapidly, without significant direct government support.

SARS's most important lesson for the coronavirus episode is the imprint it left on the collective psyche. When new epidemics emerge, Hong Kong's airport is quick to check arriving passengers' temperatures. Shortly after the territory reported its first coronavirus cases in late January, it moved to restrict travel from mainland China and closed schools, government offices, major tourist attractions, libraries and swimming pools. Surgical masks became ubiquitous, which, like mass vaccination, helped prevent infectious people from spreading the disease.

So far, that has held infections down, and the city hasn't been locked down. Nonetheless, the economic fallout has been just as bad as in 2003. The government has responded with significant fiscal stimulus.

Global Financial Crisis

The 2008-2009 financial crisis wasn't a natural disaster, and didn't directly kill anyone. Yet like the coronavirus, it began as an isolated shock that soon engulfed the global economy and forced policy makers to respond creatively.

At first, the Fed lowered interest rates, and encouraged banks to borrow from its discount window. In early 2008, President Bush and Congress authorized $168 billion to send $600 checks to most individuals.

By March the crisis reached the core of the financial system. The Fed and Treasury bailed out Bear Stearns using emergency authority. That September, Lehman Brothers went bankrupt. Then, the Fed and Treasury bailed out Fannie Mae, Freddie Mac and the insurer American International Group. After the stock market cratered, Congress approved the $700 billion Troubled Asset Relief Program, which the Treasury used to inject funds into banks, securities markets and car companies. In early 2009, newly elected President Obama ushered through a $787 billion fiscal stimulus plan.

The financial crisis caused the worst recession since the Great Depression but thanks to the Fed, TARP and stimulus, it didn't become another depression. It also left policy makers with a reservoir of tools and tactics that they are now resurrecting.

U.S. Treasury Secretary Timothy Geithner testified on Capital Hill in 2009 about the Troubled Asset Relief Program. Photo: Win McNamee/Getty Images

The crisis also left a legacy of deeply divided politics. Though TARP turned a profit for the government, much of the public saw it as a bailout for the very people who caused the crisis, sentiments which gave rise to the Tea Party on the right and Occupy Wall Street on the left. Those views persist, which President Trump and both parties in Congress must navigate as they contemplate bailouts and other measures to combat a new shock that some say is on a par with the financial crisis.

Japanese Earthquake and Nuclear Meltdown

The earthquake and accompanying tsunami that struck Japan's Tohoku region in March, 2011 left 19,000 people dead or missing and triggered a meltdown at the Fukushima Daiichi nuclear power plant. Swiss Re ranks it the costliest natural disaster in history, at $239 billion. The region supplied intermediate parts to manufacturers and the resulting shortage in parts caused the shutdown of plants around the world. Tourism, fishing and agriculture were all severely hurt, often over fear of radiation. Industrial production shrank 16% between February and March, and Japan tumbled into recession.

The initial economic response was typical of disasters: The Japanese government spent heavily on rescue and reconstruction, which helped propel a recovery in the economy. The government poured resources into rebuilding the region with the result that its manufacturing production had recovered to its pre-disaster level by 2014.

A rescue worker on a body recovery mission in 2011 after an earthquake and tsunami devastated Japan. Photo: Paula Bronstein/Getty Images

Hiroyuki Nakata, an economist at the University of Tokyo, says the response worked as intended in the short term, but less well over the long run. "Subsidies given to the firms in Tohoku after the earthquake had positive direct and spillover effects, but the size of the package may well have been too big—the subsidies let zombie companies survive."

Responding to public fear of radiation, Japan took all of its nuclear generators off line over the next few years. Nuclear power's contribution to Japanese electricity generation sank from 25% in 2010 to 5% in 2018. Whether this was scientifically justifiable is questionable. A study by academics Matthew J. Neidell, Shinsuke Uchida and Marcella Veronesi last year found the resulting rise in electricity prices led to less home heating in cold weather, causing 1,280 deaths from 2011-2014. Yet they note no direct deaths have been attributed to radiation exposure, though they cite projections that radiation will eventually cause 130 deaths from cancer.

The disaster illustrates the tensions between balancing the public's legitimate aversion to harm against the known consequences and likely economic costs. Until recently, the coronavirus seemed to present the opposite risk: The public wasn't taking the threat seriously enough, forcing the government to take more disruptive steps, to limit human interaction, while seeking to offset the resulting economic cost through fiscal and monetary policy.

As in all these past disasters, the coronavirus pandemic confronts governments, business and the public with crippling uncertainty and painful trade-offs. The main difference is that this is on a scale and breadth never seen in living memory.

Note: the Online version of the article is entitled *Lessons for the Coronavirus Crisis From Six Other Disasters*, while the title of the print edition is "The Trade-Offs Between Economy and Health," published in the Wall Street Journal, at p. B1, March 21-22, 2020. Both versions have important graphs not included here.