Casey Mulligan
What Happens Next – 07.17.2022

Larry Bernstein:
Casey, thank you for joining us. In your opening remarks, can you describe what is causing the rise in inflation and whether that will result in a recession?

Casey Mulligan:
There's talk about a recession right now, and this is an interesting time where we could have a recession by one definition but not by the other. GDP definition: looks like we could have a recession. But nonetheless, employment be growing during that GDP recession. By definition, that's a pretty bad productivity recession, because productivity is GDP per worker.

But it was predicted. When we saw Biden's agenda in 2020, we tried to work out the consequences. And there's a lot of productivity-reducing elements of that agenda.

Maybe a bit of a surprise is how the Build Back Better hasn't passed, which has tax increases on business built in. But inflation has done that work for Biden. Inflation amounts to a pretty hefty tax on businesses, because the business tax code is an index to inflation. To oversimplify a bit, businesses are experiencing a lot of bracket creep, to use the Ronald Reagan term, and that's a big disincentive to invest. And investment's one of the ways we get productivity.

Ultimately, the capital comes to businesses from people, so that is raising their cost of capital because their owners and their creditors are paying more in tax and getting less in return. It also happens on the business side. They're allowed to deduct for their expenses for capital equipment and other investments.

But it's based on historical, not based on what it costs to replace the car, truck, whatever. Inflation is driving up those replacement costs. The end result is big hit on the return to capital. And that's a pretty effective way -- we saw it in the '70s -- of really killing off business investment.

Larry Bernstein:
With high inflation, there's an enormous cost to the suckers who are holding US dollar cash instead of real assets. That non-interest-bearing cash is funding our deficit now. Is inflation an effective way of paying for government expenditures instead of taxes?

Casey Mulligan:
Let me just point out the history around that. What you see time and time again is after a war that you get inflation. A war gets paid for in part with inflation. There've been arguments that it makes sense for wars because wars are unpredictable, and you can catch people by surprise. It's been a historical pattern.

And maybe COVID is like that. It was a one-time war with a virus. Maybe in that instance, surprising people with some inflation is better than the alternative ways of raising the funds. It fits in a historical pattern pretty well.

Larry Bernstein:
How did Biden's COVID stimulus bill impact the economy?

Casey Mulligan:
The COVID bill had a lot of funds for people who were poor and unemployed. You and I talked years ago during the Obama stimulus about some of those incentives. This was almost an order of magnitude bigger incentive. $300 a week bonus. Obama's bonus was $25 a week. That's so quaint now.

We saw that with businesses having incredible time getting people to work and of course being told, "Well, my pay for staying home is very good." The red states, even though it was money coming from Washington, put an early end to it. And we saw the red states get into early recovery.

Larry Bernstein:
You mentioned on a previous episode of What Happens Next that you expected the stimulus bill discouraged employment by those workers and that when the money ran out, then they would get a job. There is enormous demand for labor now, the JOLTS survey of businesses seeking workers is over 11mm jobs. Last month was the second highest on record. Historically when the Fed was trying to reduce inflation, they would trigger a recession when higher interest rates would trigger layoffs, so there was a transmission between interest rates and the labor markets. What do you make of the relationship between higher interest rates and the labor market?

Casey Mulligan:
I've never believed in much of a connection there. I think the Fed's jobs to keep inflation to a low, predictable level of inflation for people. I don't think they can affect the real economy that much. There are parts of the economy that would be affected. So, mortgages, maybe car loans. And those can translate into some of your headline employment numbers because already home construction is a pretty volatile industry in terms of employment. To the extent we see tepid employment growth, I would expect to see it the least in some of those interest-sensitive industries.

I worked for a president who was from that industry. President Trump was a commercial real estate builder. He wouldn't accept from me the idea that Fed policy doesn't affect anything.

Larry Bernstein:
During the 2008 housing downturn, workers who lost their jobs had trouble finding new employment. Today, there's enormous demand for skilled and unskilled workers in the economy. So would you expect workers to find new jobs quickly?

Casey Mulligan:
When I left the White House, I warned the president, "If we have a downturn, I'm worried that Congress will make it deeper." They'll come forth with packages, a safety net, on top of the safety net we already have, that allow people to make that transition more slowly. So, we haven't seen Congress do that yet, but it would fit the historical pattern, that they would come in and say, "Oh, it's time for the $300 a week bonus." Or maybe they would scale it back to a mere 100 a week. But that would make the transition a lot more difficult.

Larry Bernstein:
You mentioned two different types of recession. One was where you see two consecutive quarters of declining GDP. Another might be an uptick in unemployment. How do you see this one playing out? Do you expect to see significant upticks in unemployment or just a decline in GDP?

Casey Mulligan:
I think it's been primarily a decline in GDP. Unemployment can go up for two reasons: people working less or people not considering themselves retired. Some of the policies will be targeted toward the unemployed but not targeted toward the retired and the others. But certainly, we have a productivity problem. That means that GDP's going to fall more than employment. And maybe employment doesn't fall at all.

Larry Bernstein:
What are your thoughts on the current state of the labor market?

Casey Mulligan:
One of my kind of mottoes is price and quantity – the headline numbers on the labor market at the quantity, how many people working. But there's also the price side. What's going on with the wages? What's going on with productivity? That side of the labor market is not doing well, and the productivity of the recession's going to mean low real wages for people. There are also these semi-retired people you're talking about. They're knowledgeable people, and that knowledge has to get passed on somehow. In the old days, it happened because the younger folks were guided by the older folks, right there at the workplace together. You have this generation of young workers who aren't getting the training and having to learn things the hard way. That's not going to be good for their personal wages and the economy as a whole, not good for productivity.

Larry Bernstein:
Young people used to learn in an apprentice-like fashion from older workers. How do you think Zoom culture will affect productivity and the knowledge transfer between the old and the young?

Casey Mulligan:
It’s something I tried to quantify in March 2020. I wrote a paper both about the closed schools where people are formally learning from older people called teachers, but also for the informal learning that happens at work, which is also very important. It doesn’t go in the schooling statistics. And that was a big loss. I estimated that half of the productivity growth for that cohort of people who were age 20s when the COVID came, they wouldn’t get.

They’ll always be a little bit behind. It’s like missing a grade in school. I deal with a lot of young people in my job and I always urge them, “Take that job that’s in person and put it on your resume that it was in person so that your next boss knows that you actually learned something rather than being a square on one of these screens.”

Larry Bernstein:
Casey, what are you optimistic about?

Casey Mulligan:
I always had a lot of confidence in the American people, generally. When we had that Obama stimulus, I was frustrated that the academics didn’t realize the problems with it, but the regular people did. And you saw a wave in the 2010 elections. So, I think people understand that some of these policies have gone too far off of the middle way. We saw that in Virginia, and I think we’ll see that nationwide. And that’s ultimately the strength. If I’ve got to choose between the people being wise, versus a few of the experts being wise, I’ll choose the people, because the people are in charge in our country, as they ought to be. And so I continue to be optimistic as I have been my entire career. And the American people maybe don’t have the technical expertise, but they have a lot of sense. And they can understand the big picture. And when they’re given an opportunity, they generally push our policies in a better direction.

Larry Bernstein:
As chief economic advisor during the Trump administration, you were responsible for writing the annual economic report of the president. How do Biden’s economic reports differ from yours?

Casey Mulligan:
Well, it's a big difference. Now I think a lot of the difference between our reports and Biden's is more that the Trump's reports were so unusual, historically. We applied economics over, and over, and over again. We have more supply and demand analyses in our economic reports than the entire history of economic reports. We use supply and demand for drug addiction, homelessness, energy. We had used it for vaccine innovation before there was any pandemic to vaccinate against.

Larry Bernstein:
Why do you think the Biden’s Administration’s Economic Report of the President reverted back to its previous incarnation?

Casey Mulligan:
They didn't serve special interests. A lot of special interest got angered, especially special interests within the government. To say that the FDA is a problem when you're running the government, of which the FDA is a part; to say that human, health and human services made big mistakes around opioids. Only a Trump-type of character would allow that stuff to be said. And we, the staff, realized that this is an opportunity to say things that haven't been said before.

I mean the other part would be that this is a different party in charge. They have a big emphasis on monopsony in that report, that the reason wages are low is because people, in effect, live in a one company town and they have nowhere to choose from. Totally opposite of what you and I have talked about.

It’s a very Marxist emphasis. Marx really liked to describe the economy as a one company town. Your choice is to work for the man or starve. And he liked to boil it down to that choice as if it were slavery. That's their conceptual framework in a lot of that report. And I think it's terribly misdirected. Human capital, the knowledge, health, the kind of things that you and I talked about today -- those are the things that raise wages. And when you don't have them, you have low wages.

Talking about the one company town is an entire distraction. I guess it justifies some additional level of regulation and maybe that's what they want.

Larry Bernstein:
In this week's Wall Street Journal, you have an op-ed about the role of firms that work for your health insurance companies that are responsible for drug distribution to patients. What were your key insights?

Casey Mulligan:
They're called the pharmacy benefit managers. Trump called them the middlemen. A lot of people, Democrats and Republicans, call them middlemen because they don't make the drugs, they don't have a retail outlet to hand out the prescriptions to the patient. They are in the middle. They've created competition where there really would be very little competition. They get the few drug companies we have, they get them at each other's throats while offering very big discounts. Especially on the older drugs that are far from the innovation stage of things.

It really helps save patients money but most important, encourages utilization. That's how they get the rebates. They go to the drug company, and they say, “hey, if you give us a good discount, we will make sure people will take your drug when they need it.” And they say that to the other drug company that's competing against, and as a result they get some great discounts and big utilization.

So many of these new drugs are lifesaving drugs. And you get people utilizing them. That saves on hospital costs, makes people healthier. It's almost like the market bootstrapped itself into competition. We have these patents there that are stopping competition, and the market figured out a way to create it anyway.

Larry Bernstein:
Drug prices differ around the world. I was in South Africa and my daughter needed a specific drug and it cost a small fraction of the price as in the US. This has been a hot political issue that American pharmaceutical firms price discriminates based on the country you live in. And it seems that most frequently the American government and American consumer subsidizes people offshore. Is that true?

Casey Mulligan:
Europe doesn't have these middlemen; the patients and plans don't need to hire somebody to get them a deal because the government has already put a price control on it. Their generic market is now very healthy, later in the drug lifecycle. I mentioned the stage of the drug lifecycle because the innovation happens upfront. It's an investment decision, like any other industry. Should we spend the multi billion dollars to try to discover a better treatment for this condition? The rate of return on the new drugs are really important for that innovative process. And the Europeans really legislated away any return on that. It's a theft of intellectual property. The Chinese will come and just take our formula if they can, whereas you're not going to be able to get much money for your formula in a European country. One of the things Europeans have had to deal with is they get the new drugs later. The companies aren't in a big hurry to roll out their new drug in Europe when there's not going to be much revenue for them. So, I think they get drugs about three years later. They got the vaccine about six months later. And it's not an accident.

Larry Bernstein:
Pre-COVID, the pharmaceutical industry was viewed in the political arena as charging egregious prices. And then with the vaccine, the public persona of the pharmaceutical companies improved dramatically when they successfully offered a working vaccine. What do you expect the pharma reputation to be post-Covid?

Casey Mulligan:
The pharma companies were headed for a very sweet spot as they really made this big problem a lot more manageable. And they did it in a hurry. From an image perspective, I think I'm worried that they overshot it, that now they're getting the vaccines for the kids and encouraging that they be mandated. It gives the perception that the companies are trying to use our public policy to pad their bottom line by expanding their market beyond where it merits expanding. We can debate whether it merits expanding, but from an image perspective, the pendulum's swinging a little bit back.

The marketing of the vaccine became a political thing. In fact, I'll take some personal blame for that. One of my career regrets is that when we did our analysis of pandemic vaccines before the pandemic, we talked about, the private sector needs to be manufacturing this stuff. They can do it quick. They can do it on scale if anybody can. Keep the government entirely out of manufacturing. I wish I had gone one more paragraph and said, "Keep the government out of the marketing," because the government is terrible at marketing.

Larry Bernstein:
What do the middlemen do in the pharmaceutical distribution? How do they help consumers and insurance companies provide you the maximum value of pharmaceuticals per dollar of insurance?

Casey Mulligan:
Coke and Pepsi's a good example. There's a little restaurant across the street from my house called The Maple Tree, and they've just got one restaurant. But they tell Coke, "Hey, Coke, if you give us a deal, everyone in this restaurant's going to have Coke." And they tell Pepsi, "Hey, Pepsi, if you give us a deal, everyone in this restaurant's going to have Pepsi." That really inspires a lot of competition. And they get quite a good deal. And more soda gets drunk.

The PBMs are doing the same thing around these drugs. They'll say, "We've got a couple treatments for this condition. Hey, manufacturer A, if you give us a great deal, you are the treatment that will be used on our members." And they say that to manufacturer B as well, and they really get them fighting it out to be the exclusive one. And that increases treatments for that condition, and it's much cheaper.

They also have a massive computer system. So, you can go to a lot of different pharmacies, and in their computer will be how much Larry owes based on his health insurance. And that's saved the patient a lot of time. They don't have to take the receipt home and mail it in to the insurance and get the check and cash it. That's been all cut out by the middlemen.