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P R O C E E D I N G S

MR. WITTES: Hi. We're going to get started. My name is Benjamin Wittes. I'm a senior fellow in Government Studies here at Brookings and the coordinator/director of the Campaign 2012 Project of which this is the third, I believe, event. I want to say just a couple of words welcoming you here about the project and what it is that we're doing, and then I will evacuate the stage to the people that you actually came here to hear from.

You know, rather than do, you know, sort of campaign punditry which we also try to do a fair bit of, but we tried to put together a series of events and papers this year that were from around the Institution, drawing on the sort of broad expertise in this building, or in these buildings, across a diverse range of areas -- discussions of, really, 12 sets of discussions of those major areas that the next administration or this administration in its second term, if it's re-elected, are going to have to confront.

And so, what we did in each case is we had one scholar write a main paper which talks about the record of the current administration, the critique of that administration's record by the opposition, and then tries to synthesize the critique and the merits of the record into a set of recommendations for how the next administration should handle the issue in question.

And in response to each of these papers, we asked two other scholars from somewhere else in the Institution, with a sort of different perspective on the issue, to write a briefer response paper. And so what we did -- and sometimes the response papers, you know, are overtly argumentative, take issue with the thesis of the main paper. Sometimes they sort of merely draw or draw on other areas that, you know, that are relevant to the subject that the next administration's going to have to consider as well. And for each of these sets we are putting together an event, of which this is now the third, in which all of the authors discuss the variety of ideas in the context of the ongoing campaign.

And so, today's event, as you know concerns Martin Baily's paper on Restoring Economic Growth and our commentators on the papers are Karen Dynan and Elisabeth Jacobs. And moderating for us in what is, actually for me, a great pleasure to introduce because once upon a time we used to work together at the *Washington Post* when we were both a great deal younger. He's Ben White from POLITICO. And so, thank you very much for coming. And, Ben, the floor is yours.

MR. WHITE: Thank you, other Ben. If you guys want to refer to us directly I guess you'll have to call him Wittes and me White, or whatever you want to do. A couple of Ben W.'s on the stage. It's good to be here. Thank you for having me. If I drool or babble or fall asleep on the stage, it's only because I've been up since, you know, I was up until 3:00 a.m. covering the primaries. I'm sure most of you guys are also on a few hours sleep, so we'll do the best we can under those circumstances.

Martin, I guess it makes sense to start with the critique of the Obama administration's economic record which is the sort of first piece of your paper, and specifically, do you think they did the right things, took the right steps? And on the stimulus, there's this debate now whether they could have gotten a larger stimulus and should have gotten a larger stimulus based on that Christina Romer proposal that never made its way to the President's desk.

MR. BAILEY: Well, I think they do deserve a lot of credit for doing the right things. This really was a very dangerous situation in 2008 and then 2009, early 2009, when Obama came in. So, it was very critical to make sure the financial sector did not collapse. It's become very unpopular and the bailing out of the banks and all of that, so it took a fair bit of courage, I think, to go in and say yes, we have to restore the banks and put up the TARP money in order to be able to do that. And I think that was done and without that having happened, the economy would be in much worse shape than it is now.

Then, the next part was the stimulus package and they decided on what it was, $800 billion stimulus, and yes, the answer now is well, it should have been much bigger than that. It should have been different than that. You can make the case, I think, that the stimulus package was kind of messy.

In order to get it through quickly they chose to, kind of, let Congress improvise on whatever they kind of wanted to do, so you got not really a coherent package. You got a computer printout of all kinds of different things, so it was not really something we can look back on. I mean, we can say, okay, 18th Street is being dug up as a result of the package, but it really wasn't really a coherent package of infrastructure or something like that. But maybe that was the only way to get it done quickly.

Should there have been a bigger package? Well, maybe, yes. I think probably would benefit -- in hindsight, maybe it should have been somewhat bigger. But the point that I would rather make is that it was almost impossible to turn the economy around quickly because the damage that had been inflicted by the crisis, and the recession was just so severe. We have not had, I mean, if you look back the recessions we've had in the postwar period, they was mostly because the Fed raised interest rates and wanted to stop inflation. And then, as soon as the economy began to slow down they could take their foot off the brake, and there was a natural recovery. There's a lot of natural resilience. Inventories, housing, all started to come back.

But in this recession we lost, oh, whatever the number is, $14 trillion worth of wealth. We lost 30 percent of housing prices. And then the recession built on itself, and we had an absolutely massive drop of employment. I sized it at 8.8 million from the private sector in terms of employment. So, incomes were down. Wealth was down. Housing prices were falling. I just don't think, even if we'd had a realistically larger stimulus package that it would have made a huge amount of difference. We were in for a long recession and I would have actually rather have seen the administration say that. There was quite a bit of debate about what the message should be in the planning, excuse me. Before he came into office and they decided no, that they believed they could turn the economy around, and that Obama should go ahead with all his other policies that he had promised to do. I think that was, in the end, a mistake. There should have been a more single-minded focus, and I think Americans should have been more prepared for just how long and how hard it was going to be.

MR. WHITE: So you think the Health Care Reform push was a mistake to do at all? Or a mistake to do in the manner and timing in which they did?

MR. BAILY: I think in the manner and timing in which they did. I actually think it would have been a better second-term effort. I mean, they took the position that they had to do health care because this was their one opportunity. He might not get re-elected so you've got to do financial reform since that was the crisis. You've got to do health care. They even thought they were going to do something on the environment, cap and trade as well. They didn't get to cap and trade in the end. Okay, I support the idea of universal health care coverage of some kind. I think it's a horror that we don't have that in the United States. But was it the right thing to do to introduce a compulsory health care at a time when the economy was crashing. At the same time, he introduced higher taxes on the rich.

So, having been part of the Clinton administration, I can sort of look back and say well, what happened to Bill Clinton when he proposed universal health care and decided to raise taxes on the rich? I mean, he got absolutely clobbered, and he lost the

House and the Senate, and he nearly lost re-election. That's somewhat the same thing that's happened to Obama. And if he does lose re-election, or maybe even if both House and Senate go Republican, health care is probably going to vanish anyway. So I would have preferred to see him concentrate on the economy, and then keep health care sort of on the front burner for the next phase of his presidency.

MR. WHITE: Right. I want to open it up to Karen and Elisabeth in just a moment, but one more question for Martin to bring it around to the campaign debate today. On CNBC this morning, Mitt Romney was interviewed and talked about his economic plan, and he was asked about the deficit impact of his 20 percent across-the-board tax cut, elimination of the AMT.

MR. BAILY: What did he say?

MR. WHITE: He said, and this -- I tweeted this and got a huge amount of response right away. He said, "Frankly, it can't be scored." And that's the truth, but people have made attempts to do it and (inaudible) to figure it $3 trillion, you know, depending on whether you give him credit for some increased economic growth. But, I wonder, what is your reaction to candidates saying something like that? Frankly it can't be scored because I haven't given you the details. He said that, too, which surprised me. And what do you think, in general, of the Romney economic plan and tax cut plan, in particular?

MR. BAILY: I think it's lousy. I think it's terrible. I think it's an abomination. We are in a deficit crisis. The global economy, or at least the U.S. and Europe are in a deficit crisis, so to be proposing massive new tax cuts, at this point, just seems to me to be ridiculous. We can't do that. And to say it can't be scored is to say okay, let's go back to voodoo economics. Let's go back to dynamic scoring. And the economy's going to grow, and we're going to get full employment.

You know, I would not raise taxes right this minute because that would kill the economy. We don't want to do what Europe is doing so I'm enough of a Keynesian to think that Europe has the wrong strategy of austerity, thinking that's going to grow the economy. So, what has been proposed, the sort of payroll tax cuts and stuff like that, to try to get the economy moving again, but certainly over the next few years, over the next five to ten years, we have to have in place something that balances the budget or comes close to balancing the budget. And that's got to include action on health care and on taxes. And so, I think he's just plying to the electorate saying he's going to cut taxes more. I don't think it will happen and it would be dreadful if it did happen. Not that I like paying taxes, but we've got to pay for our bills.

MR. WHITE: Karen, I wonder if you could talk a little about your housing paper. And there have been a number of attempts made to address the biggest drag on the economy which is the U.S. housing market. None of them have worked all that well. There's now a new one in the works to help people refinance. It would target a limited number of mortgages. Do you think there's anything that could be done that hasn't been done? And if so, what is it?

MS. DYNAN: So, my paper covers that issue. It's meant to be a complement to Martin's paper. I actually agree with a lot of what Martin says, but I do think the housing sector is so important and in a typical downturn, housing is what leads us out of the downturn. It pulls the rest of the economy along with that. And we really haven't seen any recovery in housing in three years. I'm talking about employment, construction, and prices. It's gone nowhere. So, we really have a very complicated set of problems in that sector.

There have been a series of programs over the last few years directly aimed at helping the housing market. I mean, there have been a number of programs, but I think you can put them in two categories. And one is the set of programs that are aimed at the foreclosure crisis. So, either trying to prevent foreclosures or trying to mitigate the cost of foreclosures that do occur. So, that's one set of programs.

The other set of programs are these refinancing programs, and you just mentioned one. And the background there is that the Fed has been working hard to reduce interest rates, you know, when the most widely quoted mortgage rates right now, the Freddie Mac mortgage rate, is now close to 4 percent. So, it's a really level, but if people can't actually get mortgages at that interest rate, it's not going to do the good for the economy that the Fed is ordinarily able to do. So, these refinancing programs, including the one announced yesterday, they're not really about foreclosure prevention. They're really about, as the President said yesterday, it's like a tax cut. It's putting more money into people's pockets because people can refinance into lower rate loans that have lower monthly payments, and that will stimulate the economy.

None of these programs have delivered as promised, and there are a host of reasons why that is so. Some of those reasons have to do with poor execution. The financial institutions who were supposed to implement these programs just found that they were overwhelmed with meeting the qualifications. So again, it's hard to point fingers at whether it was the design of the program or whether it was the financial institutions.

And then, there are some big fundamental design issues. So, one of the biggest design issues is that none of these programs were really aimed at one of our biggest problems which is underwater households. So, we have 11 million households who have mortgages that now exceed the value of their homes. It's $700 billion worth of mortgages. And some of these programs are kind of nibbling at the issue, but, really, it's a hard, hard problem to tackle.

The banks aren't going to do it by themselves. The issue there is that 72 percent of underwater mortgages are actually current, meaning people are making those payments. So, to wipe out all that debt for everyone, including the guys who are current, that would be enormously costly for the banks.

So, you know, how could you induce the banks? Well, you know, you could put taxpayer dollars into it but that's raising real issues of fairness. And that's a highly contentious issue politically, and I just don't see it happening. So, you know, in terms of kind of existing programs that we've been trying, yes, they're good and we should continue to do them. But they're not getting at some of our biggest problems.

MR. WHITE: And what about the notion -- the Romney idea that we need to hit bottom and that we're just prolonging the agony? That we need to let house prices, you know, hit their bottom. Maybe they're close to it now. And the foreclosure process to continue its painful course and finish at some point. And then we can base a recovery from there. I mean, is there legitimacy to that point that we're just sort of putting band-aids on a wound that just needs to bleed out?

MS. DYNAN: Well, so, I think, you know I was in the policy world before I came to Brookings and the question we really struggled with, whether it's better to pull the band-aid off quickly or slowly. And I think, you know, you can argue and certainly when the economy was in dire straights three years ago, it was the right thing to do to try to slow down the crisis so that you weren't layering pain upon pain. I mean, we do have issues, you know, structural issues that need to be worked out, and the sooner we can work those out, the more that will help the economy. So now, I think we are at the bottom of the housing market. And I think it does make some sense to accelerate -- you know, if you have a loan that pretty clearly can't be saved, someone who's been in limbo for maybe two or three years, lots and lots of loans that banks are trying to work out, people haven't been making payments for a couple of years. I think it makes sense to move those households through the pipeline, and then turn your attention to how to make that process as easy as possible on those homeowners and on their communities.

MR. WHITE: Which is what they're attempting to do with this foreclosure settlement, right? Essentially reform the foreclosure process to make it less abusive than it had been.

MS. DYNAN: We have other programs, as well. We have programs that are promoting short sales. We have programs that are trying to take these vacant homes and rent them out to people.

MR. WHITE: Elizabeth, I'm interested in your response to Martin's paper and you talk about the larger issue, the structural issues in the economy that have been troubling us for some time prior to this administration: income inequality growing, struggles of the lower income community to lose touch with the folks who are doing very well at the top. What are the big fissures in the economy that are, sort of, broader than the debate we're talking about now and that are being addressed at this point?

MS. JACOBS: Thanks for the question. I meant my paper to be a complement to Martin's as well. I think first and foremost, the demand issues in the economy really need to be addressed. So, I wouldn't want someone to read my paper on this with broader structural long-term issues as a critique. It's really a complement. My point was, really, that just getting back to the status quo, where we were prior to the recession, isn't good enough if you have a vision of shared prosperity for all Americans which I think all sides, right, left, both, all the candidates in the Republican primary right now, Obama, are all touching on these themes. So, clearly it's a shared goal. The question is how to get there.

In terms of, kind of, the contours of these broader structural issues, I lay out three. There are many more, and different, ways of taking a crack at it, but I think these three are kind of useful principles for organizing the way we think about it.

The first is inequality. Occupy Wall Street has kind of brought this to the floor, and I'm sure everyone here today is pretty familiar with the statistics. But from the 1940s through the 1970s, American's incomes were growing together, up and down the income ladder. Everyone's incomes roughly doubled. From the 1970s through the present, there's been a very, very different pattern. The incomes at the top have grown dramatically, about 275 percent for the top 1 percent, whereas incomes for the middle class have grown much more slowly. The vast majority of that growth is due to increased women's labor-force participation. So, it's really families are putting in more hours, and they're seeing more income. But that's a very different pattern than what we've seen at the top. So, that's, kind of, point one is that income inequality was around before the recession. The recession hasn't changed that all that much. You can kind of play with the numbers and it's made some difference, but the basic issue of a shrinking middle class is there and has been there prior to the recession. And just returning to the status quo of 2006 isn't going to do all that much.

Second point is economic mobility. Americans in the past haven't really cared all that much about inequality because we have this idea that in America, it doesn't matter that we're super unequal because I can be that rich guy over there if I work hard enough. The stats don't really bare that out and my colleagues here at Brookings have done great work, really putting some numbers behind this. If we were a perfectly equal society, a child born into the bottom fifth of the income distribution should have the same chance of ending up in the top as a child born into the top. That's not the case at all. I don't want to mix up the numbers but suffice it to say that if you're born into the bottom, you're far more likely to stay in the bottom. If you're born into the top, you're far more likely to stay in the top. It's quite difficult in America to make it to the top if you're born poor.

We like to think that we do better than many European countries at promoting mobility. We actually don't. If you look at a comparison of this inter-generational mobility across countries, Denmark, Finland, Sweden, and the U.K. which we like to compare ourselves to, is kind of the classic class-bound society versus the Horatio Alger America. The U.K. is actually more mobile than the U.S. So, even that kind of classic defense against inequality, this idea of mobility doesn't really hold up particularly well. The recession has done nothing to change that.

It remains to be seen, actually, what the recession will mean for mobility because we have a generation of kids and young adults being born into a very challenging economy. All of the economic evidence we have from past recessions shows that it's quite difficult and has a big impact on your career over the long-term to enter the labor market in a recession. So, if anything, the recession bodes poorly for a trend that was already not looking particularly good.

And then, the last piece is this idea of economic insecurity which is, kind of, the short-term version of the economic mobility thing. Insecurity is this idea of what happens to your income over the short term and there is a body of research showing that from the 1970s through roughly the 1990s, your risk of a big income drop was rising. And this wasn't just, you know, recession happened, and so a lot of people experienced a big drop. A recession would happen and income volatility, for example, your risk of losing half your income in a given year period. That would spike during a recession, but instead of going back down to where it was prior to a recession, it would plateau at a new normal that wasn't particularly a happy new normal, if you're interested in income security. And so, there's good reason to believe, particularly given the depth of this recession and how many people experienced really dramatic drops in their income, that we've continued up along this jagged upward trend which is not a particularly good place to be. So, I'm generally an optimist in terms of my view on the world except --

MR. WHITE: Could have fooled me.

MS. JACOBS: My perspective here is really the kind of --

MR. BAILY: A few teeny problems. (Laughter)

MS. JACOBS: Exactly. It's really to say that it's a much more complicated issue than the already very difficult issue that Martin's put on the table which is this issue of stimulating growth through demand. That we can't just do that. We have to really address these broader issues, or else we're really not going to be the country that I think we would all like ourselves to be.

MR. WHITE: Which sort of leads to the obvious next question which is something that frustrated me about Occupy Wall Street. I certainly understood all the frustrations, particularly around student loan debt and the feelings of not having, you know, the access to jobs that previous generations had. But I never got a sense for, you know, two or three things that they wanted to see happen that would start to address these broader problems that you talk about.

Are there specific fixes or fanatic debates that should be happening in this campaign that aren't that would start to address these trends that seem very damaging for the United States as a society?

MS. JACOBS: I think -- I mean the tax issue is sort of -- it's the obvious one. It's not, I don't think, actually, your biggest lever. You have the Romney administration, Romney campaign's proposals, the distributional impacts would be exactly the opposite of what you might like to see if you're going to think about using taxes as a lever for addressing issues of inequality.

So the taxes are kind of bubbling around the campaign, but the bigger issues, I think, are issues of education and training. And those, again, are kind of on the sidelines. And it's actually surprised me, even prior to the campaign, just thinking about the way that the Obama administration, until very recently, has really addressed this issue of training and work force development issues.

You would expect, given long-term unemployment, given the huge problems with minimally enforced participation, given the changes in the economy, that this would have been kind of a bigger issue sooner. I think that the administration seems to have pivoted with the focus on manufacturing, with the focus on kind of this new work force development push. I think it's a little bit more prominent now than it has been.

But it just surprises me that it took until now for that to really gain steam, and I don't see it, so far, as being a major theme in the campaign. I mean, the most heat and light that came from it was Rick Santorum saying Obama was a snob for wanting everyone to go to college, which I think is a dramatic distortion of what he was actually saying.

MR. WHITE: Right.

MS. JACOBS: But I think that's really where the most traction is. Of course, it's incredibly difficult, right? I mean, you can use academics to talk for years about education and skills development and how difficult it is to figure out how to do it, but I think that's where, really, the most action is. And the other piece that, really, there's been very little discussion of, and I would be shocked if there's any discussion of, really, is just thinking about the way that we do social insurance. I mean, the only way we've talked about it, really, is through extending unemployment benefits. But this idea, particularly in light of the rising economic security issues over time, suggests that the way we build a social safety net right now, it's means tested for very low-income families.

Maybe there's some way of thinking about wage insurance programs, about a different kind of family leave program that supports the fact that families are moving in and out of the labor force, and women's labor force compensation is so much more important for family incomes than it's been in the past, that's totally off the table.

And I probably sound like a wacky lefty to even put it on the table here, but I do think that, in light of these broader issues and the way that families intersect with the economy now, that those are the kinds of things that might be worth thinking about in the longer term.

MR. WHITE: Martin, to get back to your paper for a minute, I don't think we talked about ideas for further stimulus. I mean, obviously, given the nature of the campaign and the lack of traction for much of anything on the Hill, it seems unlikely that, beyond the payroll tax credit extension, there's going to be a whole lot of stimulative stuff coming off of the Hill.

But if there were, what should it be, and are we in real need at this point of further stimulus?

MR. BAILY: Can I make a quick response to my discussions, and then I will directly answer your question. Thank you for the comments and complements; you didn't create a panel with a lot of dissension. Maybe that's a good idea.

In terms of the current inequality, which I agree very much with what Elizabeth said, I would just say let's not get too nostalgic about the good old days. It was mostly White males that were the beneficiary of this labor market that we sort of imagined that we had back in the past. And part of the challenge has been, now, the labor market has become more diverse, there are more women, more African Americans part of the mainstream labor market. That is, again, that's part of the problem that we're facing in the changing family structure. But I'm not disagreeing with your basic point that this is a problem and that we need to find ways to do something about it if the growth is going to become more productive growth. I don't really have anything much to disagree with Karen about.

You know, I think it probably, to say that we need to let the markets work and let the housing -- I mean, in some sense, that's what's happened. Everything that's been done has been to just try to ease that process along, I don't think any of the policies are designed to prevent the adjustment of the housing market. And I'm just a little hopeful that housing will start to pick up, as Karen expressed.

Actually, it was positive in the fourth quarter, an increase in residential construction, I think it will be a small positive in the first quarter. So prices are still falling slowly, but residential construction is picking up.

Okay. Now let me answer your question; so what should we do. Within the constraints that we do have a global fiscal crisis, so it's very difficult, even if we wanted to, clearly, politically, we could not come up with a new big infrastructure program, or even a new, I think, tax cut program because of the fiscal situation that we face.

So we can do, I think, a modest amount, and I think it was right to pass the payroll tax cut for 2012, and if it's necessary, I'd do the same thing for 2013. I think that's a good measure, it puts money in people's pockets. If you wanted to extend it, it doesn't currently extend, I think, to the employer side. If you wanted to extend it, that would make low wage workers a little bit cheaper to hire, so that would have an additional effect.

The extension of unemployment benefits, I think, is a good thing, too. I am a little bit more ambivalent about that; I wish we had in place some kind of wage insurance, wage subsidy program. And that's the kind of thing that a lot of policymakers say, oh, you economists always want wage insurance. And it's true; we've been wanting it since the 1980s, when I think it was first proposed in a Brookings book by Bob Layton and Robert Lawrence.

But, actually, the Germans have introduced such a plan and they have made it work, so we now have a possibility. So I'd rather do something other than just extending unemployment insurance, but given the political, we're probably not going to do that. I supported extending unemployment insurance, and let me stress that that's, I think, in line with what Elizabeth was saying.

The reason consumption is not growing faster is because households don't have the money; they are not saving a whole huge amount. The savings rate came back up a little bit, having dropped almost to zero. It came back up, and now it's beginning to go down. So, for the last year, households have been spending, increasing spending at the same rate, maybe a little faster than disposable income.

So if we want to get more consumption, we need to get more disposable income. The government can only do a certain amount on that, we need to start the cycle of the, the positive cycle of more employment, more income, more spending to get us back. There's a lot of support in this building for an infrastructure bank and an infrastructure spending program.

Again, my concern about that is the U.S. Federal Government, even though interest rates are low, we're pretty maxed out on our credit card, and I'm a little concerned about trying to guarantee a lot more spending that the private sector won't do by itself. What I think we could do is find ways to really bring capital in.

I mean, it really is not the case that we are in a capital shortage situation. Individual companies and activities, maybe, but the economy as a whole, or the global economy as a whole is not short of capital, there's lots of money sitting around, not only in American corporations, but in hedge funds and sovereign wealth funds, people are looking for money to spend.

So if we could break some of the barriers to these infrastructure projects, it would be possible, I think, to get private funding for them. What's required for that, the people investing need to be able to make an assessment of the risk. They can deal with risk, they can't deal what Frank and I call uncertainty.

Which is to say, is there going to be a stable means of paying back, is the political risk going to be so great that we don't, this project is just going to be taken away from us. If we could get the private sector through some of the regulatory barriers so that they knew they were going to get a reasonable return whether it's rebuilding the sewage system and water system, whether it's rebuilding some of the roads and bridges, creating new roads and bridges.

I think some of those things could be done, and there is plenty of capital out there. It's a struggle to do it, but I think that's possible. I've got some others on my list, but let me stop there, since I've already taken up a lot of time.

MR. WHITE: Karen, you wanted to respond?

MS. DYNAN: Yeah, I wanted to come back to the housing piece. So I agree with Martin that there are a lot of signs that maybe we have hit bottom, maybe things are starting to recover, but I worry a lot about the obstacles that are impeding recovery, and the recovery is going to be really slow.

So when I talked about foreclosure in a macroeconomic sense, those programs are all aimed at a supply problem; too many distressed properties -- and it's just a macro element of it; too many distressed properties coming on the market, and that's keeping prices low, but there's also a whole demand side component of that.

And I want to be clear, here, nobody wants to return to kind of the go-go days of the last decade where there was just so much support for housing and people got in over their heads. But at the same time, we've seen households or people pull way back from housing. A statistic I have in the paper is that one in seven adults aged 25 to 34 are now living with their parents.

That's up from one in ten a decade ago. So we really have seen a big contraction in the number of people who are willing to form a household and then willing to actually have the capacity to own a home. And I think, on this demand side, a lot of Martin's policies will help, because if we can restore jobs, obviously, people will be more willing to get out there and buy homes.

But I think the other big, big element, here is, we still have a big problem in terms of mortgage credit. And this is a piece of the financial system that we have yet -- or a big part of it we have yet to reform, and the big issue there is Fanny and Freddie. Those are big institutions, they were dominating the pre crisis system, they were poorly structured, they created a bunch of risk for the economy, everyone knows we need to redesign them.

But, as yet, we've done almost nothing to move that conversation along, and I think that is something the next President just -- I know they don't want to talk about it, because it's such a politically contentious issue, and there's just a lot of disagreement about what needs to be done, but I think that is something the next President needs to do right away.

Because the funds to fund mortgages just aren't going to come back into the market unless the funders know what the infrastructure looks like.

MR. BAILY: There's a Brookings book on that that Karen has a --

MS. DYNAN: Yeah, I should say that. Martin edited a book that --

MR. BAILY: Want to go to the bookstore and buy a book on that?

MS. DYNAN: It's a selection of essays that actually lays out -- I mean, I said there's a lot of --

MR. BAILY: You didn't not know there was going to be product plugging here.

MS. DYNAN: It lays out all the options. Exactly.

MR. WHITE: What are a couple of those options? I mean, it's one of these things that gets a little bit of rhetorical discussion in the debates, and the Republicans will say let's privatize them and let the market decide who gets a mortgage and who doesn't. Obviously, the administration has a different view, has put forward a couple of papers from Treasury.

But just quickly, do you have a view as to what it should look like?

MS. DYNAN: Yeah, I think -- so it's a highly contentious issue, it's not like there's no agreement. I mean, everyone agrees that -- or most people agree that the old system was not a good system. The fundamental problem with the old system was that there was this weird kind of quasi public/private structure to it.

And, basically, these were private institutions with shareholders that were able to borrow, like the government, and this just incentivized them to take a lot of risks they shouldn't have been taking. So I think there's widespread agreement that we need to fix that.

And part of fixing that is that people think that all of these kind of special affordable housing activities they were involved in, they really should be -- they're important, they may be important activities, but it really should be moved elsewhere in the government, and you should let these institutions just focus on mortgage finance.

I think the other area there's agreement is that when it comes to mortgage financing, our main role had been guaranteeing mortgages. But the thing was, the guarantee was complicated. It was a guarantee from Fannie and Freddie, but investors were treating it like it was a guarantee from the U.S. Government.

MR. WHITE: Right.

MS. DYNAN: And that was contributing to the problem that we had. And so I think the other area where there's agreement is that we need to make that guarantee explicit, it needs to be an explicit government guarantee so that we can have a national discussion about exactly how that's going to work.

Where there's disagreement, and you alluded to this, is just the scope of the guarantee, how much of it do we want, what portion of the mortgage market do we want to be covering. And the options that are out there range from nothing to options where you have a small guarantee during normal times, but then it's expandable if there's a crisis in the mortgage market, such that the government, you can expand those guarantees, the mortgage credit can continue to flow.

And I think a lot can be said for those sorts of proposals. But then, from there, you run the gamut up to a large portion of the mortgage market being kind of -- and there, the issue is that we need to decide how much money we want to spend subsidizing mortgages for people who perhaps are far enough up in the income distribution such that you don't think we should be targeting them in terms of housing policy.

MR. WHITE: Right. And, in terms of housing -- I'm interested in your thoughts on this, Martin -- there's the classic V-shaped recovery, you go back to what you were doing before; we can't do that, because we're not going back to the housing boom market, so we go to exports, we go to durable goods, purchases.

Do you think based on the numbers that we're seeing now, that's happening? Will it continue to happen? Are we on a path for ultimately stronger growth? I mean, today, the ADP jobs number looked pretty decent, 214,000, indicating on Friday be a less number, be pretty good.

I guess my basic question is; what's your view on the current trajectory of the economy, and do we have pieces in place to grow any stronger than we're growing now?

MR. BAILY: Again, if I can just quickly throw in a marginal comment to follow up on Karen, and then I'll directly answer your question. I think what was interesting in Karen's paper, and the papers that we had here in the forum was, what's the right role for government in the mortgage market.

And I think a lot of people, almost the whole, almost a consensus that the housing market is so large and so prone to crises that there has to be a role for government in trying to either stop or ameliorate or respond to a housing crisis. Because we've had a big, big housing crisis, but certainly not the first, and unlikely to be the last, so I think there's a legitimate role for government so we don't get into the situation we're in now.

To directly answer your question; I think, if we don't get a new problem globally, I think the U.S. is on track to recover. Not rapidly, not the way it did from '75 or from '82 because of the damage that's been done in the housing market. It's a slower process. But I think the pieces are more or less in place now for housing to be growing for the virtual cycle of rising employment to have a positive effect on household income and then on consumption.

So what are the dangers that could stop that from happening? There are several, unfortunately. One is Europe, which we've been flirting in and out of crisis all the time. The Europeans, I think, are not grasping their problem and dealing with it. They could deal with it, they have the economic resources to do so, and they don't sort want to, they're stuck, many of them, in the German austerity mode. And I would say that that's unfortunate. We need to see them really do something.

By the way, the United States is not helping, either, because the IMF has to be an important part of the solution. And we are saying no American money is going to bail out Europe, which means that not only is that limiting the funds available to the IMF to solve Europe's problems, but it's also discouraging China and other countries that might help. So a threat to the United States is in Europe.

The next threat, of course, is in -- you know, a weak global economy. If we start importing a lot as our economy grows but we can't export, the dollar is too high, demand overseas is weak, then that's going to retard our recovery. I think that's a significant danger for our recovery going forward is that we start seeing exploding trade deficits again, as we have in the past.

And, finally, as we all know, oil prices are a problem. Oil prices have induced recessions in the United States, and certainly could do so again. If the Strait of Hormuz were blocked and we saw oil at $200 a barrel, we'd be back right into recession again.

My answer to your question is, you know, typical economist; on the one hand, on the other hand. I think the basics are in place for the U.S. to recover, but there are significant risks, most of them outside the United States.

MR. WHITE: And before we go to Q and A; Elizabeth, do you think that the recovery that we're seeing now is addressing any of the concerns that you raised in your paper? I mean, it doesn't seem to be, it's early in the process, but the issue of income inequality doesn't seem like it's going to be any different.

And it sort of just goes back to what I asked you before about what should the recovery look like that would address some of that stuff? Like what are the jobs that need to be created to start to chip away at the disparity in incomes?

MS. JACOBS: Well, if I have the answer to that question, I would be running for President --

MR. WHITE: Somebody has to have it.

MS. JACOBS: -- so I will dodge your question. But I do think we need to recover, first and foremost, right? I mean, I should end where I started, which is saying that I think Martin's paper really covers the bases and really where we need to start. So that's my first not-so-artful dodge of your question.

But I think, as well, that there's opportunity in crisis, and I don't think the window is closed for actually taking advantage of it. Have we taken advantage of it yet? I'm not sure. I mean, I could sort of play counterpoint to Martin's argument against health care reform and say that, potentially, that was taking advantage of the fact that we were in crisis, so let's jam this enormous thing through that we've never been able to do because it's a crazy time, so let's do a crazy thing, and we did.

And did that address inequality the way I was talking about it? Not necessarily. But does it address some of the disparities and the fact that some people were getting great health care and other people were getting no health care. Again, a tangent, but the point is, in opportunity, in crisis, there's opportunity. Have we started to take advantage of it? Yes.

Has the conversation started to shift in a way that I think has the potential to be beneficial, developing policies that actually do address more directly some of the inequality, mobility, security issues, the education and training stuff is part of that. Yeah, I think that conversation has started, but whether we're really going to see policies that directly address it remains to be seen.

And I would argue it's pretty contingent on who wins in November. Because I think that the two parties have very different approaches, and I happen to think that one of them makes a lot of sense and has a lot of evidence behind it for actually having some chance at gaining traction on these bigger issues than the other party. It's hard to connect the dots to them actually gaining leverage on any of this.

So that would be my non-answer answer.

MR. WHITE: Good enough for me. Let's open it up to you all for some questions and answers for these incredibly smart people. You'll get the microphone, if you could just raise your hand and identify yourself when you get the mic, and we'll try to answer your question. We've got the first guy in the back, there; I think there's a mic coming to you.

SPEAKER: Looking at the future, what are lower energy prices going to do for the U.S. economy? For example, there's a lot of gas that's going to be available, and natural gas on an energy equivalent basis is at $15 a barrel. If you work that into the U.S. economy, what do you think the effect is going to be?

MR. BAILY: I think there's a lot of potential in that. There are clearly some environmental issues around extracting the gas, and whether that can be done in a way that's safe. And I don't know enough about the technical side of that to pronounce, but I think if you do it right, you can get the gas out.

And gas is -- it's happening more quickly than I think many of us expected. Gas prices, natural gas prices are low already, and potentially, we can -- and get more oil as well. And I think it does change the equation for the U.S. It may even change the equation for U.S. manufacturing that we'll begin to see a return of industries that existing in the United States but you've never see new building or new construction in the United States and now that may change. I think the intriguing thing is if we've got enough natural gas that we could actually move toward a transportation infrastructure based on natural gas. Again I don't have the technical skills, but having read some of this stuff or talked to people who do, I think there is a potential certainly that you can shift trucks and buses. There even are some buses here in Washington that have already shifted. And maybe even eventually cars and create a distribution network. You'd generate a lot of jobs if you created a network like that. So I think with the environmental caveat, I think it's a very exciting possibility for the United States and for other countries that have the same opportunity.

SPEAKER: Not only that. For example, in plastics, hydrocarbons are 55 percent of the cost of plastics.

MR. BAILY: Exactly. You might bring back petrochemicals to the United States with all of this.

MR. WHITE: More questions. Right here in the front. And if you could identify yourself before asking your question.

MR. ALTMAN: I'm Fred Altman. I think part of the problem with income distribution is there is a lot of capital that's being very cautious and not being used. The risk for capital is all in using it. There's little risk in just stowing it away and not using it. Is there any feasible way of making it risker not to use your capital and thus improve the income distribution?

MR. WHITE: That's a good question. How do you get Apple to start spending its money? It's got a lot of it. Is there any way?

MR. BAILY: If my colleagues won't answer, I'll say something and maybe they can disagree with me. I think that's actually a dangerous strategy. I still think that the United States is still a little bit too local in its perspective on taxes on corporations. Most of the large corporations are global, have global opportunities and if they -- they can move overseas and they can move activities overseas, they can move their headquarters overseas. When Budweiser got bought out by Belgium, we all said, my gosh, they're buying out a U.S. company. I think the U.S. company wanted to be bought out because by being bought out by a Belgian company they can become a foreign company and then they can isolate their U.S. operations and they don't have to pay global taxes to the U.S. So I think we still here in Washington think about a national economy and American companies and that's true obviously of a whole raft of smaller companies. It's not true of the larger companies. So I think just as a matter of fact whether we like it or not, we have to make it attractive to spend that money here in the United States and I think we can do that and trying to sort of force them to use it here is actually a negative outcome. It will shift more activity overseas.

MS. JACOBS: I'll follow-up on Martin. I share Martin's perspective there. It is true that a lot of companies are sitting on a lot of cash. When you talk to businesses what they say is that it's the uncertainty out there. It's the uncertainty about the economy. So fix the economy and they'd be more willing to spend it. But I agree you're probably thinking that it's a chicken-and-the-egg problem and that's right. But there are other places where we can resolve some of the uncertainty. A huge one is what we're going to do about our long-term fiscal challenges which is exactly why it was such a bad thing that we've taken a path now a couple of times on really confronting what we're going to do it about it over the longer run and that comes back to something Martin said earlier. It just has to be a priority next year when everyone comes back to doing business here in Washington that we resolve that uncertainty and that we can couple it with things that are actually good for businesses. Tax reform is something that I think there's a lot of appetite for doing here in Washington.

MR. WHITE: And I wanted to follow-up on that too, Martin, what you thought of the corporate tax reform? It's not quite a full plan but ideals that the administration put forward particularly when it comes to increasing tax on foreign profits. The Republican candidates all say we need to go to -- obviously everyone agrees on a lower overall rate but not necessarily how you get there and not how you deal with foreign profits and repatriation. What was your general view on the corporate tax proposal that the administration put forward?

MR. BAILY: Corporate taxation makes my head hurt and so it's -- I supported in general the reform proposals that were being made. It was in the right direction which is to broaden the base, get rid of a lot of the deductions and lower the rates. Whether that becomes politically feasible even in the future remains to be seen, but I think that's the right direction to go in. Most companies will tell you they don't like high marginal rates. Our top rate is higher than other countries and it puts them at some disadvantage particularly with an extraterritorial system. So I think this was a really courageous effort by the folks at the White House and the Treasury to try to create a framework. And in a phone call that I was on with Treasury, I think they just said this was what they thought of as the first step of a plan. They realized it wasn't going to be enacted this year, but they thought if Obama wins that this would be the framework that maybe could form a constructive discussion on corporate taxes.

The controversial part of the proposal is this 20-percent tax so you sort of say we're not going to try to bring everything in and tax it at ordinary income or corporate tax income but you have to pay that minimum of 20 percent. I think intuitively there's a lot of sense to that. And let's remember why we had this extraterritorial system in the first place. It was to try to avoid companies sheltering profits in places like the Bahamas and Ireland and places like that. And that was the right thing to do except of course they are sheltering profits in Ireland and the Bahamas even though we have that tax system. I think it was a good start. I think if we get a more sensible political environment after the election I think there's some hope we might make some progress there. We've got to do something that I think at least keeps the revenue the same if not increases revenue and we have to make sure that we are putting our corporations on a reasonably level playing field with foreign corporations. If we can do those two things we will have won.

MS. DYNAN: May I ask a question? I'm curious. I sit over in Governance Studies and I think every time I hear uncertainty I think about political uncertainty. And I'm curious and I would ask this of Martin and Karen because I think you guys spend more time talking to actual business and Treasury certainly than I do. I'm wondering if people talk about the political uncertainty around the election as slowing the pace of recovery or not. I know at times people have brought that up as an argument. I don't personally have a take on it. I have no evidence either way. But it seems when I hear uncertainty it seems like there's a huge amount of uncertainty as to what direction economic policy will take depending on who's in charge of both branches of government. Both the Executive Branch and the Legislative Branch are kind of up for grabs. So I wonder whether that's part of why things are kind of moving more slowly than one might imagine right now because of the reason why we're all here, the campaign.

MR. BAILY: If you read Paul Krugman's columns, he makes fun of the so-called confidence fairy and now it's a sort of political thing with him because people say that everyone's so nervous about Obama's policies, if he were in a second term nobody wants to invest and that is a political -- actually a political argument. But I don't dismiss the confidence fairy. Krugman is clearly a very strong Keynesian and Keynes was very big on so-called animal spirits. It does make a lot of difference whether businesses and households have confidence in the economic future and clearly the political uncertainty is part of that. The main uncertainty I think is just around jobs and will the market grow if you're a business and if you invest? Will the market be there? That's the main thing. Karen, go ahead.

MS. DYNAN: I'll build on that a little bit. On the general uncertainty theory, when we were in disarray last summer. We had this gridlock and this terrible spectacle in Washington about the debt ceiling --

MR. BAILY: You're right about that.

MS. DYNAN: -- we really saw a pretty discrete fall in confidence. It was kind of broad-based. You saw it kind of in the direct measures of confidence, but then you were seeing it in the economic indicators that you expected to move with confidence. So that to me really did say that this is a real thing that can hold back the economy.

Fortunately we've kind of for whatever reason snapped out of it this fall, things have gotten better more recently, but the events of last summer I thought really were instructive about just how dangerous it is to do things that make the American people think that we're not on top of the policy situation.

MR. BAILY: That's right.

MR. WHITE: I would add to that that I do in a lot of my reporting talk to CEOs and folks on Wall Street and the partisans are concerned about this idea that the Obama Administration is going to strangle job creation through more regulations. I think a lot of that is just rhetoric, but the larger concern it seems to me in most of my conversations is does our government work at all? Can it work under anyone? We are to the point where we constantly say next year we're going to deal with corporate tax rates, next year we're going to deal with the long-run trajectory of Social Security and Medicare. There is no longer any real reason for a lot of these people to believe that's actually going to happen. Maybe this election gives us another Democratic President or Republican Congress in which everybody is looking to 2016 and in the campaign maybe Obama has demagogued any efforts to deal with Social Security. Maybe he's put a real plan on the table. Regardless of the partisan viewpoint of a lot of the folks that I talk to, their concern larger than any one particular candidate is can our government work anymore? Does it work anymore?

MR. BAILY: Absolutely.

MR. WHITE: I think the guy in the back had his hand up first.

MR. VESARA: My name is Alejandro Vesara. This question is for Karen. Could you address further the notion of the fairness of the fairness issue, given the fact that in housing over the past 4 years because more aggressive actions have not taken place large because of the fairness issue with so many of the people you're trying to be fair to are taxpayers going underwater, losing jobs, losing wealth? It seems that this has actually worked in reverse. And on the other side of the fairness issue is the fact that a majority of the borrowers who got subprime loans, many of these predatory, many of these fraudulent, many of these with hidden fees and high costs, were made to people who actually qualified for prime loans. And not only the lenders were faulty in the origination of the loans, but also in the servicing of the loans. Could you address that, please?

MS. DYNAN: Sure. I should start by just saying I didn't mean to indicate that I wasn't sympathetic to the situation. There has just been incredible pain associated with the mortgage crisis. It's hard on the households that are directly affected and it's not just that they have to transition into a different home, it's that if they can't find housing nearby their children may have to be pulled out of the schools they're in, they may have to switch jobs or lose their job if they can't find housing nearby. And then on top of that they take a hit to their credit score such that they can't access credit in years to come. Then it's hard on their communities because these clusters of vacancies foster crime and vandalism and to the extent that everyone's house price is lower, that hurts everyone. And on top of that, tax revenues go down and public services may be cut which just makes the problem worse. So I really didn't mean to indicate that I wasn't very, very sympathetic to the situation.

I think the other point that should be made here is that you do get these caricatures about how people ended up in this situation and there is just a huge reach. It is true that there were some people who may or may not have brought it on themselves by using their homes as ATMs. Even there we should probably be having a conversation about whether there is something about our society that makes people feel like they have to do that to keep up with the Joneses. But the spectrum then runs to lots of cases of people that really didn't do anything to get into the situation. They were taken advantage of by predatory lenders. You mentioned that, but there is just a whole bunch of people who have lost their -- who played by the rules but they've lost their jobs so they can't make their mortgage payments. So I didn't mean to act unsympathetic to the situation. What I was more trying to say is that for all of those guys, there are lots of people who feel like they played by the rules who are just up in arms about something that they, and it's not me, it's they would characterize as a bailout for people who didn't play by the rules and that's just made the situation politically intractable. So I think that that is a big part of the issue there.

I think from the point of view of an economist, I think if you think your taxpayer dollars are scarce, and this is not sort of backward looking. I think you could say lots of things about whether we've done exactly the right thing in terms of policy over the last few years. But just as you look forward and if you get another dollar from taxpayers, do you want to spend that on an individual household? It's enormously expensive to try to wipe away the $700 billion of debt that underwater households are holding or that's the amount that's underwater. Or whether you want to take that dollar and give it to a state who could plug a budget hole and then we'll have to lay off fewer teachers. And that's a really complicated issue and I think that's one we need to struggle through.

MR. BAILY: Let me add one more thing to do that. Maybe you may have said this in your paper. A lot of the underwater mortgages are concentrated in very few states. California has over a quarter. I think California, Florida and Arizona I think account for almost a half. So one of the other problems in solving it, and I agree with everything Karen said, is that would you be giving half the money to three states? I think politically that's very difficult. Again that's not right and wrong, it's just the political reality.

MR. WHITE: More questions?

MR. SCARLIS: I'm Basil Scarlis. I've retired from the State Department dealing with European political and economic issues. I have a question regarding the housing crisis. My impression is that the Obama Administration has tried to do a lot but isn't able to do much with Fannie Mae and Freddie Mac, it really doesn't have enough authority to reform them or to even undertake fairly small programs that would improve the situation. Could you comment on that?

MS. DYNAN: Sure. I mean, I guess on some levels it seems like if the U.S. government now owns Fannie and Freddie, why shouldn't we be able to direct them to say have easier standards on loans? So a big thing that has obstructed refinancing is that the banks are having a kind of argument with Fannie and Freddie about they're called reps and warrant clauses where the GOCs have the right to tell -- even if it's something that couldn't be anticipated at all ex ante, but to tell a bank this loan you sold me is not a good loan even if it's like a case where the homeowner lost his job which nobody could have anticipated. So the administration has been able to do, and Fannie and Freddie have been willing to go along with, some things that are good. For example, they have revamped their refi program such that these reps and warrant clauses should go away. That's being implemented now and we don't know how it's going to work out. I think we should be taking all the steps we can in that direction. But the difficult thing is exactly right is that the director of Fannie and Freddie's regulator, FHFA, his mission is to try to conserve taxpayer dollars. And so any of these initiatives that aren't good for the GOC's bottom line they're going to have a big problem with. And that's something that seems to be kind of a sticking point, so really kind of to do something big and bold you got to have legislation. We got to have the big legislation that reforms Fannie and Freddie.

MR. SHILLING: Thank you. I'm Jed Shilling. Elizabeth's comments were very interesting about the fact that we can't go back to the status quo, that there are these fundamental structural issues that need to be addressed. And I'd be very interested in hearing a step or two down on what the structural changes are needed to be able to make sure we can assure the equity -- improve equity and things like that. Because to be a little radical for a minute, it seems to me that we have adopted much more the point of view that personal benefit and greed at the top is the driving force and there is no related public responsibility for the public welfare, has shifted things and created a finaceaucracy where the financial sector gets free insurance and a free financial safety net for all the financial crises we've had over the past several decades, whereas the public is not supposed to have that kind of a social safety net. So we have developed this sense that we take care of the financial sector and the big guys and while their bonuses were kept up after the crisis, they didn't start loaning back in this country the way they were supposed to with quantitative easing. They poured the money into Brazil and other places. Can you discuss a little bit what kind of structural changes are needed to address these very important structural issues that you've -- and all of you I think sure will have some comments on this. Thank you.

MS. JACOBS: I can start and I can reiterate what I started with in my opening remarks which would be I think taxes are a piece of it. I think education is a big piece of it both kindergarten through grade 12, college, the way we do with community college and the interconnection between vocational education and business. I think that whole system in the U.S. doesn't work particularly well right now. You ask actors on any side of the equation, employers, participants in the system, no one is particularly happy with now it's working so I think there's a lot of room for improvement there.

I think in some circles this ends up on the table first off but not necessarily in places like this. I think early education is a big issue. The gaps between poor kids and wealthy start very early and persist and that's an issue that you'd sort of expect increasing equality to diminish investment in public goods like early education because people at the top don't really need it, but it widens exactly the problem and it makes the mobility issue that much bigger a deal. So I think conversations about early care policy really do belong in the same breath as tax policy and vocational education which is kind of an unusual statement, but I do think we should talk more about it. So those would be where I'd start.

I would also just sort of broach the issue of unions. There's a lot of debate amongst economists as to how important the erosion of the labor movement in the U.S. has been for the shape of the income distribution. But there is some pretty compelling evidence and just comments and intuition suggests that it might have something to do with the way things look, what the future of labor looks like and whether -- I don't think the future of labor can look like it did in the past and there are lots of issues in terms of flexible workplaces and all of the kinds of things that you don't in an incredibly rigid labor-driven economy, at the same time labor unions have a lot to offer to workers at a time when workers haven't necessarily gotten their fair share. So I think that's a conversation that could be had too and that's a conversation that the parties have very different views on on the direction the country should take in that space. So those are sort of a few policy areas that I think if we spent more time kind of swimming around in that space we might be able to get some traction on the issues I laid out as structural problems.

MR. BAILY: If I may, a few years back I wrote a book on Europe when I was across the street and one of the examples in Europe that struck me, Elizabeth has written about Germany, but at that time one of the poster children for improving labor market outcomes was the Danish flex security system. And it's really quite a remarkable system because they've had high employment, low unemployment. It's a very good system in a sense that the people that lose jobs get financial support, but it's done in a very tough way. They can’t just sit around and watch TV. They have to participate in training. They have to look for a job. If somebody finds them a job, they have to go take the job; otherwise they lose the benefit. So it's a real tough-love plan, and in many ways it works very well.

In looking at how you would apply something like that to the United States, it's very expensive. They spend about 5 percent of their GDP on that, which I can’t imagine we would in the U.S. do that.

So one of the things, though, that may be a little encouraging is I think we are learning quite a bit. There's a lot of technical progress being made as to how to teach, how to do a better job of training. I don’t think it's gotten very far out into the world yet, but I think at least we're getting some better ideas about how you get better teachers. There are some very good schools. You know. It's always difficult because can you generalize the model of a good school and make it into a lot of schools. But I think there are now ways -- if you can chose teachers that fall in the upper half of their class instead of the lower half of their class, you get much better results. If you give training to teachers you get much better results.

There really is some new statistical evidence that's identified the benefits of good teachers which lasts even into the labor markets. So I think these are things we've only been finding out in just the recent years, even on the training side.

The Germans have a very good training system with their apprenticeship programs; again, I'm not sure you could translate to the U.S. But I think there's much more that could be done if we worked with businesses who are willing to work more with community colleges and create sort of short effective training programs to fill some of the kinds of gaps that we have right now.

There are, by reports, 3,000,000 jobs unfilled right now because of lack of skills. Two-thirds of employers in a survey response last year said that they had trouble finding people with the right skills. So these structural problems are affecting our ability to recover, so it's not just demand. It's demand plus these skills. And I think that we have to find efficient cost-effective ways of doing that, and I think research is uncovering some ways that that is possible.

MS. DYNAN: I'll just jump in quickly and say, so I agree with what Martin and Elisabeth said. And I actually think one of the pernicious things about the boom that we went through prior to the crisis is that we provided these great jobs in the home-building sector for folks that otherwise might've decided to go to college, and now the whole thing's crashed down. They don't have those jobs anymore and they've also kind of lost their opportunity, or it's just harder to go back to college when you're 20-something or 30 years old as opposed to being someone who's younger. So absolutely we need to focus in those areas.

I actually wonder whether we need to -- I wonder what technology can do for us and I don't know if my fellow panelists have any ideas on this front. But it just seems like, you know, you hear these incredible stories about courses being offered through iTunes and the take-up, and then the performance of these virtual students on exams and you just wonder whether that's an area that really holds a lot of promise for us. And then the question becomes, what can we do such that --

MR. BAILY: Exactly. Exactly.

MS. DYNAN: Colleges, particularly community colleges are taking advantage of these technologies.

MR. WHITE: I just had to put a political frame on the original question. I think the outcome of this campaign will depend upon President Obama's ability to frame the questions like you framed them, which is what kind of society do we want to be. Do we want to allow this economic inequality to continue? And if not, how do we address it? Do we want to make sure Social Security is sustainable and Medicare is sustainable, or do we want to go back to supply side tax cuts for the wealthy and, you know, policies that we've tried before? I think the extent to which he's able to frame it that way will have a lot to do with whether he wins the re-election. More questions? We've got some more time. Right here.

MR. SHILLING: Those are very good responses and I think those are very important. I just wonder if you have any comments on continuing the free insurance the financial sector gets for all the risk that it takes and then gets bailed out while the burden is on the rest of the public, both in terms of financial losses and the taxes they pay to cover them?

MR. BAILY: I will answer that. I'm not sure my colleagues will agree. I think we have to continue the insurance for the financial sector. It's not free. They do pay for it. They pay fees, and under financial reform they will be expected to pay fees for any bailouts. I think it is a good investment, even for a low-waged worker to have a more stable financial system.

You know, we did pass Dodd-Frank. It's having trouble getting enacted for various reasons. This is not the place maybe to go into that. But the goal, I think, is to have a stable financial system in which the banks and other financial institutions take risks but not excessive risks, and they are expected to pay if they get into trouble and have to be bailed out. But I think it would be a mistake to take away their safety net.

I agree we need a better safety net for low-income people, but I don't think taking away the safety net for the financial sector is a good idea.

MS. DYNAN: I'll jump onboard with Martin. I mean, like it or not, or like them or not, we need some sort of banking system. You know. We need some way to channel funds from people who are saving money to people who need to borrow money. That's exactly why congress chose to pass the TARP and why most experts, even if they really don't like financial institutions, why they think it was the right thing to do.

I mean, I think the game going ahead is that we have to reduce the risk-taking amongst financial institutions. You know. And financial reform has been a really important part of that. I just want to say it's a really tricky, tricky business. I mean, I think one lesson of the last few years has been that regulators aren't all-knowing. They're not perfect. They make mistakes. I mean, I think there is kind of widespread agreement that -- I wouldn't say widespread, but I mean there is a good amount of agreement that we need more regulation than we had in the frothy period. But from there, there's just a lot I disagree on what you should do. And you have to worry about it backfiring.

There are stories now, and I haven't seen any scientific evidence so I can't speak to how valid it is, but there are stories now that, you know, the effect of tightening regulations on banks has -- one of the effects has been to push some underserved households, or a good number of underserved households out of the mainstream financial system. So then you're kind of leaving them to depend on much, kind of, shadier lenders that might take advantage of them. So it's just a tricky, tricky business.

MS. JACOBS: And I would echo the support for that, that we need to be able to insure the financial system. It's not my area but I am fully brainwashed, whatever you want to call it.

MR. BAILY: That's a ringing endorsement. (Laughter)

MS. JACOBS: Yeah, exactly. But I mean I've seen nothing convincing to suggest to me otherwise. I was actually working on the Hill when we passed TARP, and so there were arguments coming in from all sides and, you know, I certainly wasn't brainwashed. I had plenty to evaluate. And it's just very difficult to see a sustainable path forward if we had not done what we did and to continue to insure the financial system.

But what I will say is that I think that the conversation around TARP and what Americans have seen their government do very publicly, and what people kind of understand government to have done over the last couple of years is to leap to support the financial system. But the ways that we currently support individual families aren't as obvious because a lot of government's benefits for everyday people just aren't obvious. We don't have a conversation about that in the same way.

And on top of that, we don't do as much for individual families. We haven't done as much and there's arguably more to be done. So rather than saying, you know, we have too much of a safety net for the people at the top and the financial system as a whole and we should bring everyone down to the lowest common denominator, I think the question actually should be about kind of changing the conversation to say everyone kind of understands, or to a certain extent that there is a degree of understanding of why we need to ensure the financial system. We need to have that same conversation about kind of the broader public goods that come with ensuring family security as well. And we haven't kind of taken that second step in the conversation, but potentially we could.

MR. RAMSEY: Clay Ramsey, program on International Policy Attitudes, University of Maryland, and this is for Ms. Dynan. About a year ago Martin Feldstein wrote an op-ed in the *New York Times* with an interesting proposal, not a modest proposal which you may remember. I'm going to try to reconstruct it. It had three players all acting voluntarily; banks, the government and the underwater mortgagee. The government and the bank, which undertake to write down 10 percent of principle, splitting the cost. The mortgagee would let go of the bankruptcy protection clause that says your residence cannot be part of the pot. First, do you recall the proposal? Second, is there something implausible about it, putting politics aside? But is there some reason that it might not work? I'm just curious as to what reaction you have to it.

MS. DYNAN: So I very vaguely recall this proposal, but I'm sorry I don't remember the details so I don't have my instant reaction to the specifics of the program. I mean, I'll reiterate the fact that we have a huge problem when it comes to underwater households and we should be thinking about all sorts of creative solutions to the problem.

I think one lesson of kind of the foreclose crisis response endeavors has been that -- and these programs -- I mean, the real world is just a lot more complicated than we academics sometimes think it is. And that was not to say anything about Marty in specific, because he is an expert in a lot of different areas. But again and again we've been thwarted because we had a program that looked terrific on paper and looked like the answer to all our problems, and it turns out we didn't understand quite all the institutional constraints that were out there in the banking system, but I'll look at it. Thank you for the suggestion.

MR. BAILY: I think one of his features was try to get people to move from nonrecourse loans to recourse loans, but you gave up this -- because one of the characteristics of -- some states go different ways on this. But one of the things that characterize the U.S. markets compared to other countries is that you can walk away from your house and mail in the keys and that's been argued and there may be something to it. That's one reason that so many people did that. They walked away and mailed in the keys.

So his effort is to say, "Okay, we'll give you some kind of break but you'll have to give up that ability to just walk away and mail in the keys." And it may have done something. My understanding is if you compare the recourse states with the nonrecourse states, there are some differences but it's not all that large. I've also had conversations with mortgage bankers who say, "Yes. If we're in a recourse state we can go after the family. They've walked away from their house and we can go and try to make them keep paying." But in our legal system that’s just not worth it for the bank to do it, so I don’t think it necessarily makes a lot of difference.

MS. DYNAN: So I've also heard them say that -- I mean, I think they're looking pretty carefully at these people's assets and liabilities.

MR. BAILY: Yes. It's not worth --

MS. DYNAN: I think in a lot of cases it's just not worth it because they just don’t think they'll ever recover.

MR. BAILY: So recourse, I don’t think is -- maybe it's an interesting issue. I don’t think it's the dividing line.

MR. WHITE: Gentleman in the white shirt?

MR. FINBURG: Hi. My name is Michael Finburg. I’m a student at the George Washington University. I had a question. You guys mentioned the debt ceiling crisis from this past summer. As you know, at the end of this year we have a similar type of situation where Bush tax cuts expire, payroll tax cuts expire, sequestered, and a likely increase of the debt ceiling again by January or February. So --

MR. BAILY: The debt ceiling -- and the appropriations are due. It's a real witching hour at the end of the year. Yes.

MR. FINBURG: Yes. It's going to be a fun couple of weeks after the election. So I was wondering what you guys thought was the best economic response to this and what the likely political response would be in the five minutes we have left.

MR. WHITE: We have five minutes left, so three minutes for that.

MS. DYNAN: Well I can start with -- and this is -- a question for the audience or perhaps -- Sarah, you're a college student; maybe you want to take it on. I think the political response entirely depends on the election on who the actors are, right, because it's all during lame duck, so it's going to be a bunch of people who what they do depends on their future. And that means that the mix of actors involved is a big fun game theory problem for someone to kind of figure out all the variables and game-outs. So I really have no idea. You know.

If I had a little bit more time to think about it, like weeks or months, I could put together some kind of set of strategic options that you might see in how to act, given various election outcomes. But I really think that that's -- in some ways, from a political perspective, as far as what will happen, you have to go through that exercise to come up with any kind of reasonable answer. Anything else is armchair punditry at its worst.

MR. FINBURG: And isn't it possible, given the way the payroll tax cut was extended, that this debt ceiling issue could come before the election? I mean, the numbers would seem to indicate that we might hit the statutory gap prior to November.

MR. BAILY: So let me take up the debt ceiling thing a little bit. First of all, I thought it was just outrageous that an advanced country, the leading economy in the world was going through this horrible exercise at a time when -- so, just express outrage that we did this.

I thought at the time that Obama handled it very badly, because it felt like he'd given away all his power. He basically said, "The world's going to come to an end if you don’t increase the debt ceiling." And the republicans obviously turned around and said, "Okay. Well, you better do what we say then, because we don’t think the world's going to end." And they had various people write columns in the Wall Street Journal saying, "Oh, no, it wouldn't be that much of a problem." So, from a game theory point of view, it seemed to me like Obama played it really badly.

Now if you actually look what happened, he didn't do so badly. He actually was able, first of all, to include defense in the sequester which was part of the negotiation. And so that’s putting a lot of pressure on republicans and democrats, for that matter, to try to come up with a solution because they don’t want to see defense get cut, so that party did well. And he even managed to exclude some of the programs for lower-income people so that they wouldn't be subject to this sequester. So somewhat to my surprise, having thought that he completely blew the whole negotiation, he actually came out of it better than I had thought. What that means for December I'm not quite sure, but that was my observation.

MS. DYNAN: I have a small observation too, which is, it's not necessarily going to be the lame ducks issue. What they can do -- we learned this last time so I thought I'd bring it up -- is they can just kick the can down the --

MR. BAILY: Yeah.

MS. DYNAN: I mean, these guys are going to come back. And if you’re not going to be in office anymore, it's not clear you want to spend your last month in office, like, cleaning up this enormous mess that has been left to you. You could kick the can down the road, pass a several-month extension and then leave it to the new congress, in which case, going back to Elisabeth's point, it's highly dependent.

MR. WHITE: And arguably, that would be the right thing to do, wouldn't it? I mean, you know, have the people who were actually duly elected to decide big issues like that? We probably have time for one more quick one if there is somebody who didn't get a question asked that they'd like to ask.

MR. GUZNER: I had a question. I don't know if it's short. Merrill Guzner with the *Fiscal Times*. You know, the short-term stimulus, Martin, that you've discussed in your paper and the long-term structural problems that Elisabeth was addressing, it seems to me that there could be a relationship, and I'd like to hear you just address it slightly.

You know, most of the stimulus we have now is tax-driven, which is a very inefficient form of stimulating the economy. And it distributes its benefits unequally. In other words, the higher income you have, the more you get. So it is possible that the slow nature of the recovery is actually being driven in part by the nature of the stimulus that we've used, and do we need a greater discussion about the kind of stimulus that we use in a way to foster a more equal distribution?

MR. BAILY: Obviously, you want to get the most bang from your buck out of a stimulus. And so, if you just make it across-the-board tax cuts, the rich pay most of the taxes and so you'd get a smaller effect. But I don't think that's actually what we've done. I mean, some of the stimulus has been mailing checks. So you mail a check for $500 to every tax-paying family, so that does not just affect the rich families, that goes to every tax-paying family. And I think the evidence is that most of that was spent. It wasn't necessarily spent the same month but it was spent over the next several months. So I don't think that kind of tax cut is so inefficient. You want to get something out there quickly and you want to get it out to the people who spend it, so I'm not so opposed to that. In fact, I might even want to do that if we went into a double-dip, something like that.

It's harder to do the shovel-ready projects and that kind of stuff and get that money out there quickly, so I don’t necessarily agree with you that that’s why the recovery is slow. As I say in my paper, I just think this was such a damaging episode. And what it did to the housing market, the financial sector, and then to employment -- the stimulus we did was probably about as good as we would -- well, I wouldn't go that far, but in terms of stimulating, it did about as much as we could do.

MS. JACOBS: And I would add to that that I think sometimes the less economically efficient option is the only politically possible one.

MR. BAILY: Yes, it’s the only politically possible one.

MS. JACOBS: And that, you know, there's a reason why the stimulus looked like it did. You could've designed a more perfect economically targeted stimulus but it wouldn't have gone anywhere.

MR. BAILY: Exactly.

MS. JACOBS: And, you know, I would much rather a somewhat less economically efficient, less well-targeted program that actually does also help the people who really need it most than nothing at all. I would love the world to be perfect and for me to be able to design my dream program and have it be politically expedient as well, but so far I haven't come up with that magic formula that’s both sort of economically perfect and politically perfect. And given the political reality, getting anything done is a small miracle. So the fact that we got done what we got done, I think, is a pretty important accomplishment.

MR. WHITE: We’ll have to end on Elisabeth's perfect world. Thank you to Karen, to Martin and Elisabeth. A very good discussion.

MR. BAILY: Thank you for coming. Great questions.

(Applause)

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