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Brookings Cafeteria Podcast
"The top economic issues in 2019"
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DEWS: Welcome to the Brookings Cafeteria, the podcast about ideas and the experts who have them. I'm Fred Dews. Today's episode is the first of 2019, and to continue the tradition, we'll kick off the year with a look at the top economic policy issues of the day and looking ahead. My guest here at the Brookings podcast network studio is a familiar voice: David Wessel, senior fellow and director of the Hutchins Center on Fiscal and Monetary Policy as well as a regular contributor to the show with his Wessel's Economic Update.

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And now on with the interview. David, welcome back to the Brookings Cafeteria.

WESSEL: Thank you. Good to be with you, Fred.

DEWS: So glad to see you here for the first episode of 2019. So as we get the year started how would you characterize the state of the U.S. economy?

WESSEL: The state of the U.S. economy is pretty darn good. Unemployment's at a 50 year low. Inflation is pretty close to the Fed's target. The economy seems to have a lot of momentum. It took a long time for the recovery after the Great Recession to get going but it seems to be doing pretty well. The risk of course is that this might not continue. There are a number of storm clouds on the horizon.

DEWS: I want to get to those storm clouds in a minute but let's stay on the unemployment rate. As you said it's at a 50 year low. There's another measure of the labor force which is the labor force participation rate. Can you talk about that and maybe some other indicators of the workforce?

WESSEL: Sure. So the first thing to note is there's lots of ways to measure the strength of the labor force. You mentioned the labor force participation rate—that's the fraction of adults who are working or looking for work. There's the fraction of people who are working part time but tell the government they really, really would prefer a full time job and so forth. Every measure of the labor market is getting better. There are not all great but they're getting better.

The one that's quite concerning is there still seem to be a lot of people in what economists call the prime ages, 25 to 54, although as a 64 year old I'm not real happy with that label. And there's still a large fraction of people men and women in that age bracket who aren't working and a lot of them are not looking for work. And so on one hand that's unfortunate, it means that they probably don't have the income that they could have, the economy doesn't have their potential. But it's also one of the reasons why people think the economy might be able to go on for a while because there are these workers on the sidelines who we could pull in.

DEWS: What does that have to say, then, about productivity, wage growth, some of those other indicators that we talk about a lot?

WESSEL: One of the biggest mysteries of the U.S. economy right now is why wages aren't rising faster given how tight the labor market seems to be. If you look at surveys of employers, if you walk down the street in many major cities, you see help wanted signs. We know that it's getting easier and easier for people to quit their job and find another one. You would expect at a time like this wages would be going up much faster than they are. And we really don't know whether that's because the economy has fundamentally changed. That is, that employers have more power and workers have less because of the decline of unions, the rise of the gig economy, and all those things. Or is it our wage increase is just around the corner?

Well, one factor that you mentioned which is relevant is the pace of productivity growth. Productivity, which is the amount of stuff we make for every hour of work, is the reason we have more stuff than our grandparents even though we don't work more hours. Productivity growth has been distressingly slow for the last several years and that may be one reason that wages are rising faster.

DEWS: So the Tax Cut and Jobs Act passed just over a year ago at the end of 2017. Do you think it's been good for the economy?

WESSEL: I think it has helped the economy grow rapidly. If you cut taxes and give people more money they spend more money. And so one reason that the economy has been so strong is this fiscal oomph that we got from the tax cut. But I think it was a mistake because the economy really didn't need that much fiscal stimulus; we were already doing pretty well. The argument for the tax cut by the proponents was if we cut taxes on business they'll invest more. If business invests more we'll have more productivity growth in the future and we'll live happily ever after. So far that doesn't seem to have happened. Now, I think it's too early to judge but so far it seems like this surge of investment that the proponents of the tax bill predicted just hasn't come yet.

I also think that we have a long-term deficit problem. This made it worse. So I don't think the deficit is a problem today. The government doesn't seem to have any problem borrowing lots of money much of it from abroad at historically low interest rates. But we know this can't go on forever and it's unfortunate that they didn't take this opportunity to do something to fix the trajectory of the federal debt which is unsustainable.

DEWS: Let's go back to that idea of storm clouds on the horizon for the economy. There's a lot of talk recently at just about that issue. What do you think some of those storm clouds are?

WESSEL: Right. I think one reason people are thinking about the next recession is because it's been so long since we had a recession. And even though economists like to say that recoveries don't die of old age, you kind of know that sooner or later one's going to come. What's happened recently is, well, first of all, what's happened to the markets—

both the stock and the bond markets—seem to have turned pretty gloomy. That can make the economy slow down but you have to wonder; it's crowdsourcing—does the market know something that the rest of us don't see obviously? So that's one big thing.

Secondly, despite the president's attempts to suggest that the U.S. economy doesn't need the rest of the world, in fact we're very interconnected with the rest of the world. And the economies of the rest of the world are slowing down, and China is a big question mark. So the outlook for the global environment has gotten noticeably worse.

And then there are some sectors of the U.S. economy which have been weak, housing in particular. So I think there's a lot of reason to be concerned that maybe 2019 will be disappointing. It doesn't mean— we can't grow as fast as we have been growing forever without some surge in productivity or a lot more workers or something. So a slowdown in growth a modest slowdown would not be a problem. The issue is are we going to have more than a modest slowdown and is the market in particular telling us to brace ourselves for that.

DEWS: We recently saw that Jerome Powell, Fed chairman, announced, I think it was, a fourth increase in rates at the end of 2018 with some more expected. And yet President Donald Trump has been railing against that plan. Can you talk about monetary policy, what the Fed is doing, and what the president is saying about it?

WESSEL: Sure. So let's take these in two pieces because the president might be right in his criticism of the Fed but that doesn't mean it's a wise thing for him to do. As you know, the president is willing to say almost anything on Twitter and he has been on attack mode when it comes to the Fed. I'm not one of these people who thinks this is some violation of the U.S. Constitution or anything. The president can say whatever he wants. We did decide as a society to have an independent central bank because we thought that if politicians set interest rates they would do it poorly. So we delegated to a bunch of technocrats who were a little bit insulated from the political whims of the moment who we believe can take the long-term view when it comes to steering the economy.

I think the president's comments are counterproductive because they undermine confidence in the Fed. And if the markets think that the Fed is not going to be able to use its best judgment but it's going to be pushed around by the president, well then that could make the markets even more worried and that could contribute to unproductive changes in the market that could hurt the economy.

One thing I think is really significant is that I don't see any signs that Congress is joining the president in this attack on the Fed, and that suggests that for whatever else is going on in Congress most of the people there, both sides of the aisle, value Fed independence and have not joined the president and assaulting the Fed.

Now that's different from is the Fed following the right policy? There are a lot of people across the political spectrum—Larry Summers, the former treasury secretary in Democratic administrations, Larry Lindsey, who was an adviser to Republican presidents and was a member of the Fed board for a while—both of them have been saying the Fed is making a mistake and there's no reason to raise interest rates now because there's no inflation problem and they wish the Fed would hold off a while longer. So I think there's a really big question about 2019: is the Fed going to make a mistake as they often do and tighten interest rates too much and provoke more of a slowdown in the economy than they want? Or are they going to do too little because they're so cowed by all this criticism in the markets and we end up with an undesirable increase in inflation that leads them to raise interest rates a lot later? So it's a pretty tricky time.

For a long time, it was easy for the Fed to say, Well, rates are going to go up because when you're starting at zero there's nowhere for them to go but up. Now we're at the point where, as Jay Powell said in his press conference in December, rates are at the bottom range of neutral. What he means by that is sometimes the Fed has their foot on the accelerator. That's when they want to make the economy grow faster. And sometimes they have their foot on the brake, which means they want to slow things down. At the moment they're roughly, in their view, close to having neither foot on either pedal that may be okay. The question they have to answer is, is that the right strategy? Do we need a little more gas or do we need a little braking?

DEWS: And just so listeners know, when would be the next time that the Fed would meet to consider an interest rate hike?

WESSEL: Well, the Fed meets eight times a year. The next meeting is this month in January 2019. I think it's unlikely that they'll change interest rates at this meeting. The markets seem to be thinking if they raise interest rates it will be either in March or June. But as the Fed Chair Jay Powell said the other day, they’re, quote, data dependent. And that's kind of a jargony way of saying we have a forecast, we think we're right, we think we might be wrong, we’re going to wait and see if the economy develops as we expect, if it does we’ll raise rates twice in 2019. If it doesn't we'll do something different.

DEWS: So what are some of the issues in the economy that we haven't already talked about that people should be paying attention to?

WESSEL: Well, I think that we've talked a lot about where is the economy right now today and where might it be in six months or 12 months. But one of the things that's disturbing to me is that now that we're 10 years past the Great Recession, now that we're pretty close to full employment, we have not been paying enough attention to chronic economic problems, problems that preceded the Great Recession, may have been exacerbated by it.

So, as we discussed, productivity growth is frustratingly slow. We don't really know what the magic formula is for more productivity growth, faster productivity growth. But we do know that one thing we should be doing is investing more both in the private sector and particularly in the public sector. That means infrastructure, it means R&D, it means education. So I don't think this government—either Congress or the president—has a coherent strategy for what might we be doing to increase productivity growth.

Secondly, there's a widening gap between winners and losers in our society. People who have college degrees continue to do better than people who just have a high school diploma. Some parts of the country are booming and other parts are really suffering, been left behind, ravaged by the forces of globalization and technology, and there are still persistent gaps in the earnings of potential of blacks and whites. We know from recent economic research that the chances that your kids will do better than you are frustratingly low. So all those things about the disparities in our society really get a lot of attention here at Brookings. But I'm afraid don't get enough attention from the people who make public policy. And although there are lots of interesting experiments going on here and there there's really not enough being done to wrestle with this. And I think this is a fundamental problem. Not only is it unfair, but I think it's tearing apart our society and contributing to the polarization that gets so much attention.

DEWS: Well, David if there were one policy idea for the economy right now that you could just wave your wand and implement what would that be?

WESSEL: So I think it's a good question and kind of afraid to answer it. But I think what I would like to see is that the Congress and the president would find a way to do a big, what's sometimes called a grand bargain, on the budget. And this grand bargain would do three things. One, it would reduce future projected deficits on the tax side and on the spending side, particularly spending on entitlement programs.

Two, it would make money available for the kind of investment we need so that the next generation and generations that follow live better than we do. So that means spending money or creating tax policies that foster investment, both by businesses, public investment, education stuff like that.

And third, it would be a great opportunity to cope with climate change at the same time. So one way to do these things is to impose some kind of carbon tax which raises money in the future but gives us some money now that we could use for the priorities that I think we're underspending on.

DEWS: Well, David I want to thank you for spending your time with us today and I look forward to more of your economic updates in the year ahead. Happy New Year to you.

WESSEL: Happy New Year to you, Fred.

DEWS: You can learn more about David Wessel at the Hutchins Center on Fiscal and Monetary Policy on our website, brookings.edu.

"The Brookings Cafeteria" podcast is the product of an amazing team of colleagues, including audio engineer and producer Gaston Reboredo, with assistance from Mark Hoelscher. The producers are Brennan Hoban and Chris McKenna. Bill Finan, Director of the Brookings Institution Press, does the book interviews, and Jessica Pavone and Eric Abalahin provide design and web support. Finally, my thanks to Camilo Ramirez and Emily Horne for their guidance and support.

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Until next time, I'm Fred Dews.