THE BROOKINGS INSTITUTION

BROOKINGS CAFETERIA PODCAST

The TOP ECONOMIC ISSUES IN 2020

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P R O C E E D I N G S

DEWS: Welcome to the Brookings Cafeteria. The podcast about ideas and the experts who have them. I'm Fred Dews. This is the first episode of the new year. So, once again, I'm pleased to present a look at the top economic policy issues of the day and looking forward. This is in fact the fifth year I've done this episode. So, it's certainly a tradition I'm happy to keep up.

My guests in the Brookings Podcast Network studio today are Stefanie Aaronson, the Vice President and Director of Economic Studies at Brookings and Louise Sheiner, the Robert S. Kerr senior fellow and policy director of the Hutchins Center on Fiscal and Monetary Policy.

You can follow the Brookings Podcast Network on Twitter at policy podcasts to get information about and links to all of our shows including Dollar and Sense, the Brookings Trade Podcast, the Current, and our events podcasts. If you like the show, please go to Apple Podcasts and leave us a review. And now, on with the interview. Stephanie and Louise, welcome to Brookings Cafeteria and happy new year.

AARONSON: Happy new year. Hi.

SHEINER: Yeah, happy new year to you too.

DEWS: So, thank you. This is a very popular episode listeners love to hear from our economists about what the top economic stories are today and what you expect them to be kind of in the new year. Let's start with what you think is the state of the U.S. economy today. Maybe Stephanie, do you want to start with that?

AARONSON: I think from the perspective of the labor market, the economy is doing really well. Unemployment is at historically low levels and the participation rate which had fallen precipitously after the recession has flattened out and even begun to creep up in recent years and that's showing through to wages, which have begun to rise even for people at the lower part of the wage distribution. So, measured by the perspective of the labor market, I think things are doing well.

DEWS: Is there any bad news in that story though?

SHEINER: So, this is Louise. I don't think there's bad news in the labor market so much. I do think that's a pretty positive story and more positive than we would have guessed. I think when you look at the economy as a whole some of the not so great news and some bad news is: on the not so great side productivity, which has been very, very weak over the past decade continues to remain weak. And in terms of looking forward, the household sector is doing very well, the labor market is doing very well.

Investment is not doing very well and some that is probably attributable to the continued effects of uncertainty coming from the trade war, weighing on businesses who aren't investing. So, those are places where it's not terrible news but it's not great news.

Looking at sort of more not very good news, even though the economy is doing well and we are starting to see some wage increases at the bottom, overall inequality has been continuing to rise and life expectancy, which you might think of as such of a mega indicator of how people are doing great, when it comes to something really important like their health, life expectancy is actually been declining after decades of rising. And not only is it declining but the gap between life expectancy at the top and life expectancy at the bottom has been widening. And so that's giving you an indication that even though the economy on sort of the numbers of sort of current economic activity looks pretty good if something is not going right for all American citizens.

NEISE: I agree. I think that the reversal in life expectancy and the rising disparity in life expectancies across people like different points in the income distribution is one of the most shocking developments in recent years in the US economy and it really is a sign that despite how well the economy is doing from a cyclical perspective that there are probably deep structural problems that are contributing to that phenomenon.

DEWS: On this particular episode, to start the new year a couple of years ago, Ted Gayer, who is now the executive vice president of Brookings, former director of Economic Studies, he had mentioned this life expectancy to climb to as one of the shocking findings of the year. I've interviewed Carol Graham about some of the issues in deaths of despair. So, you're right, it really is a shocking and disturbing trend that we're seeing. Talk also about the overall number that we call the GDP. The GDP growth. Stephanie, do you want to talk about where that is right now?

AARONSON: Yeah, so GDP has been growing at about 2 percent for actually, the last number of years, and I think most people think that's pretty much in line with the capacity of the economy to grow right now. So, in that sense it's a good number, we're in a late stage of an expansion and so we wouldn't expect GDP to be rising at much faster pace than its potential but I think that the number itself is just a low number and that's due to some of the structural factors that Louise started to get into that productivity growth has been very low. There's been a structural decline in labor force participation rate which also is contributing to low GDP growth and so, I think, we're sort of doing about as well as we can but as well as we can from that perspective isn't a very good number.

SHEINER: I agree.

DEWS: One of the issues that we hear about a lot now especially when we think about U.S. politics and the federal government and what Congress is or isn't doing is the annual deficit and the accumulated federal debt. Can you talk about what the status of those two issues are? And also, I think what's really of interest to listeners is how do they affect the average American, I mean do deficits and debts matter. Louise?

SHEINER: So, I think that's a really interesting question because it's a topic of really great debate within the economics profession right now. So, in terms of just our deficits—so the deficit this year is something around 4 and a half percent of GDP which is a very high number for an expansion year and the debt is now about 80 percent, almost 80 percent of GDP. So, deficit is the annual difference between spending and revenues and debt is the accumulation. And so, the debt-to-GDP ratio before the recession was close to 40 percent, so it doubled and it has stayed high and is expected to just keep going up. And so, you might think that would be an issue of great concern. But if you had asked economists what would happen when your debt to GDP ratio doubled, what they would have said is interest rates are going to go through the roof, and instead interest rates are incredibly low and expected to remain so.

So, that juxtaposition of very, very low interest rates, despite rising deficits and high debt, is just a curious phenomenon that economists are really sort of trying to wrap their heads around. And I've done work that suggests that if the interest rates are going to remain low for structural reasons, then, you know, you really can afford more debt. Right? The interest costs on your debt are lower. It tells you that maybe there aren't great private projects out there to be doing that great investments and therefore sort of this crowding out is not such a big deal. And you might sort of say if interest rates are low this is a great time to be doing some investments and that's going to bring us right back to sort of the bad news story that we talked about, these structural issues. Right? So, we have these structural problems, we're doing well on average but not everybody in the economy is doing well and this is a good time to be investing in our people and in trying to do some policies that might help address those for the long run might be the best way to ensure future living standards remain healthy as opposed to sort of cutting the debt.

AARONSON: I think that's right. That with interest rates low, some of the negative consequences that this might have for the country, for individual families, it's just not apparent, and so it really could be an opportunity for us to make some investments that would in the long run boost productivity, raise education. Could be a time to make investments in our physical and our human capital that would boost productivity going forward.

DEWS: I do want to come back, in a few minutes to some more specific policy ideas that you both have for the economy. Let me stay on this interest rate question for a second, Louise, because that's the purview of the Federal Reserve and one of the monetary policy tools. Why do you think the Federal Reserve isn't raising interest rates these days?

SHEINER: I think you have to think about that question in two parts. So, it's true that the Federal Reserve sets interest rates but it does it against a backdrop of what sort of a neutral rate might be. So, it doesn’t set them kind of randomly. And so its interest rate policy is responding to this fact that sort of the interest rate needed to keep the economy at full employment of just much lower than it would have been in the past. Right? So, it's not that the low interest rates are caused by the Federal Reserve. It's more like the Federal Reserve are responding to the low interest rates. Now, why did they cut this year? That's a little bit of a different story. I'm going to let Stephanie take that on.

AARONSON: I think that there are two reasons. I think one is exactly what Louise said. I think they just realized that the neutral rate of interest in the economy is lower and if you look at the survey of economic projections that the FOMC puts out, you can see that over the last couple of years what they think of as the long-run rate— so sort of that's their estimate of the neutral rate—has actually come down quite a lot. And so, I think in part they're moves down have reflected just this realization that the long-run neutral rate the economy is lower.

I think they also had a couple of specific concerns. One is that they are worried about reaching their inflation target. So, inflation, despite the low rate, the very low rate of unemployment, it is below their 2 percent target. Not far below but it's below. And I think people would not have expected previously that with unemployment rate between 3½ and 4 percent, that inflation would still be under 2 percent. So, I think especially last Spring, they talked a lot about their worries about hitting their inflation target and I think to some extent the reductions in rates reflected that.

And then I think the second story is something Louise mentioned earlier which is the trade policy uncertainty and in fact, the real bite that trade has taken out of the economy and, I think, they viewed to some extent, the rate cuts—especially in the summer and early in the fall—as reflecting, sort of taking out some insurance against the damage to the economy being done by the trade wars.

SHEINER: Yeah, and I think one thing that's interesting when we think about Fed policy—so, we're talking about it so far since they're responding to economic developments in the way they always have and I don't think that's exactly right. I think something else that's kind of changed in the way people perceive things is for a long time, the real worry was inflation. Right? We had the experience of the ‘80s of really high inflation and that was kind of the predominant theme. Now, I think that's much less of a concern. We haven't seen, as you said, inflation move up. Our models haven't worked that well in terms of relating inflation to things in the real economy.

And so, I think there's a willingness that there didn't used to be to sort of test the proposition a little and see how far we can go in letting the real economy thrive instead of saying oh, we're getting close to full employment, we better pull back. And so, I think one of the interesting things is, as you said, the unemployment rate is [at a] historic low right now, is that because things in the labor market have changed or because the Fed has a different perspective and is allowing it to go that low. And I think in part, because as we talked about before, the wage gains at the bottom are so valuable and the concerns about inflation are almost more like are you going to hit your target as opposed to go over it, it’s just changed the calculus. And I think Chairman Powell in particular is willing to say, yeah, the models might be predicting inflation is going to be around the corner but honestly they haven't worked that well. So, we're going to wait a little longer. I don't know if you have any thoughts on that Stephanie?

AARONSON: I think that's right, that the unemployment rate has fallen considerably for groups we typically think of being as more disadvantaged in the labor market. That African Americans, Hispanics, low-skilled workers have much lower unemployment rates than they've seen in decades and I think Chair Powell has voiced a willingness to let's see where things go. He's recognizing the very strong benefits that come from having such a low unemployment rate and I think that relative to recent decades that he's willing to let this ride a little longer. And I think that's been a gradual change in the attitude of the FOMC in recent years and I think that recently he's just given a much clearer voice to that attitude of having a slightly different weighting of the risks right now.

DEWS: Let me just interject … the FOMC is the what?

AARONSON: Federal Open Market Committee and that's the policy arm of the Federal Reserve system that makes the decision about interest rates and monetary policy more generally.

DEWS: Okay. Okay. Let me circle back then to this question again of debt and why it matters to the average American or maybe it doesn't.

SHEINER: So, going back to what I said before. The way we used to think about it, debt would be bad because it would reduce investment. If you reduce investment, then you're going to have less capital and you're going to have lower creditivity and you're have lower wages. So, that's one sort of macro-economic channel through which debt is bad and another is in some sense what is debt, it says well, we're going to borrow now and eventually the bill comes due and so we're thinking about well, the sort of balance between current people and your children's generation debt was passing something along to them that they would then have to pay for it. So, it was kind of like having a party at their expense was a view.

Now, if you decide that you can keep debt high and not actually have to raise taxes, you just pay the interest costs which are really tiny relative to the growth rate of the economy, then it's not such a trade-off. At the same time, I think, most economists would say, this is not going to last forever and in fact we really don't know that much about what interest rates will be in 10 years. We're thinking that they're going to remain low but we might be wrong and we have the structural changes in our economy, that means that deficits are expected to keep rising. So, it is something that we should be concerned about eventually but I think just these low interest rates just put much less urgency on that.

DEWS: I wonder if you could say anything about the Tax Cuts and Jobs Act that was enacted just two years ago, December 2017. What kind of affect can we see in the economy now if any?

AARONSON: I think we definitely saw some effect of the tax cuts on the economy soon after it was passed. There is a definitely a boost to consumption in the second quarter of last year of 2018 that reflected the tax cuts and I think throughout the year, there was some boost, particularly to consumption.

I think the bigger question is that the legislation involved a very big change to our corporate tax system and there were claims at the time that we would see of rush of investment as investing became cheaper because of the changes in the corporate tax law. And I think that it's just much less clear that we've seen that. That there really has not been a pickup in investment over the past year and a half and I think that it's always hard to tell.

So, there've been other things going on in the economy like the trade wars which I think could affect investment as well. We talked about trade uncertainty depressing investment. But all signs point to there not having been a particularly large pickup in investment in response to the tax cuts. Would you agree?

SHEINER: Totally. Right. I mean I think it is early to tell and it's hard to tell. But if it was a huge impact, we would know it most likely and so, I think maybe there'll be some impact but it's not going to be nearly large as the proponents suggested.

DEWS: So, we've talked a lot about kind of the current state of the economy. Let's try to look a little bit ahead in perhaps the future state of the economy, not forecasting but just kind of where we're headed. And one question that comes to mind is for both of you, what are the economic issues that you think Americans should be paying attention to as 2020 starts but maybe really aren't paying attention to? Louise?

SHEINER: Yes, I'm going to go back to what I was talking about before which is investing in people and in particularly investing in people at the lower portion of the income distribution and poor families. I think one thing that's quite interesting in economics is over the past 5 to 10 years there have just been paper after paper that have been able to track the long-run effects of government programs, and have found that they actually have much bigger and longer run effects than you would have guessed. So, providing health insurance to kids, providing income to poor families. If you traced people who received public benefits and you look at how well they do, they have more education, they have higher wages, they have more stable lives. So, the evidence, I think, is just sort of solidifying this view that government can actually help and make the structural change in the economy.

And so, I think when you're thinking about the election and the proposals those are the kinds of things to look for and to see what different approaches there are to those. So, I mean certainly on the Democratic side, I think there's consensus that we need to be doing that and then there's sort of some different questions on like what the approach is which I think is interesting.

DEWS: One of the proposals is universal basic income. Can you just break out what that actually is all about?

SHEINER: Yeah. So, universal basic income, there are many variances of it but the basic idea is everybody gets a check. Every American would get a check every month. Some variants would say everybody gets a check and we're going to get rid of other programs, but let's say not, let's say we're just going to add on sort of people already getting money and that way it helps get out of poverty.

And then I think that the economic question on that is about the universality. So, some of the Democrats are for universal programs, like universal basic income or Medicare for All. So, this idea that we're going to spend money and everybody is going to get the same thing, every American. And others are going to say no, let's target the tax dollars to people who really need it. Like why are we going to give a thousand dollars a month to somebody who already is a multi-millionaire, that's a waste of taxpayer money. And so, you might target it by like expanding their earned income tax credit or making the child tax credit refundable.

And so I think from an economic perspective the targeting sort of seems to make sense because we think that, you know, when you spend money and then you take it back in taxes, that's distortionary, but I think from a political perspective, it's less clear. And I think one thing that we have realized, speaking very broadly, people are really polarized and there's resentment about programs where people benefit but it's not me. And so this idea of universality, which is very common in many other countries, especially on health care, has in itself an appeal beyond the sort of direct efficiency consequences of targeting taxpayer money and I think that what that tradeoff is, I'm not really sure but I think that there is trade off to be made. I think there is some appeal in universality, at least from my perspective.

AARONSON: I think that's right, from the longer-term perspective programs that are more universal have just been shown to be more durable. So, I think the classic example of that is Social Security and Medicare, which actually its funny people are interviewed, they barely view these as government programs. And that's how in-grained they are in our national psyche. And so I do think that there's an advantage to having a universal program and then thinking about what that means for efficiency and how you pay for it that adds on complications but it definitely has an appeal.

DEWS: Well, since we're now talking presidential politics let's stay here for a minute. Let me ask you both, what about some other policy ideas that we've heard on the campaign trail that might require major increases in government spending? And again this is on the Democratic side. Is that possible in an era of high federal debt, going back to what we were talking about earlier? I know you want to talk about whether that's politically feasible but are those kinds of spending programs possible coming from an economic point of view?

AARONSON: I mean, I think actually one of the things economists would probably agree on right now is given the low interest rate, there is the scope for government spending and the ideal would be if we were really spending it on investments as Louise has said. So, I think, when you think of a program like Medicare for All or just some of the other ideas for a public option in providing health care that would increase access to health care, I think we know that that would pay benefits in terms of increasing people's well-being and productivity and I think it's those types of programs that economists would think are more worthwhile even given our high levels of debt rather than spending the money on things which are more transient and not going to pay dividends and boost our GDP growth in the future.

SHEINER: But I mean the Democrats are also proposing major tax increases right? So, they're not actually proposing just major expansions of spending. If you're going to do something as expensive as Medicare for All, I don't think most people would say, oh, that's fine, let's just do it and just not worry about it all. So, the tax ideas that people are talking about are various ways of taxing high-income people more—Elizabeth Warren has a wealth tax and that's getting a lot of attention. And I think that there is just increasing emphasis on that on the Democratic side, not on the Republican side at all and so that's a really big disparity.

I mean the recent tax bill that was passed had huge benefits for people who own corporations which tend to be wealthy and so it's hard to know, a lot of these things poll quite well when you ask questions to people but that doesn't mean politically they work when people actually campaign on them. But I think that is where the debate is. It's should we raise more money and spend more money and just become a little bit more European, I think, and we'll see where that goes politically.

DEWS: Let me advertise here, a new Brookings initiative called Policy 2020 in which scholars are writing what we're calling Voter Vitals papers that kind of break down and explain a lot of the policy ideas that the candidates in the presidential election have. It's at Brookings dot edu slash policy 2020, tons of great information there.

SHEINER: Can I also advertise?

DEWS: Absolutely.

SHEINER: So, one of the things that we've done at the Hutchins Center, we've talked about this here, is we have a budget game called the Fiscal Ship and the Fiscal Ship is a way of looking at all the policies that people have proposed and seeing how much they cost and what kind of revenues you get from alternate policies. So, at fiscalship dot org, it's free and it's something to you keeping attention to during the election year.

DEWS: Absolutely, thank you for that. So, as we're moving into this election year are there economic policy issues that you hope the presidential candidates will focus on?

SHEINER: Mine are really the ones I've been talking about which is—and I don't necessarily know what my ordering is in terms of which ones or which way—but I think it's really, really important that we address the rising inequality. I think it's just really bad for our country in general just to have widening gaps and not feeling like we're all in this together and so I would pour a lot of money into poor kids in particular, which I think are great investments and we know that we've had the declining mobility, if your parents are not rich then your chances of being rich are very low. And so this whole idea of the U.S. is a meritocracy, it's not true anymore and we need to do some major investments to make that so.

AARONSON: Yes, I think that the political frustration that we see directly reflect the fact that well-being has not really increased for those at the middle of the distribution of income and lower down and that we really do need to take steps, policy needs to take steps, to try to rectify that situation or I think that we're in for a lot more frustration within the political system.

I'm a little heartened actually by the fact that I do think people are beginning to recognize the crisis that we're facing and I think that the ideas that have been coming out of the Democratic field over the last six or eight months actually represent a much broader and more active attempt to deal with the problems than I think we've seen for quite a while.

DEWS: Louise, you've talked about a policy idea of investing money in poor kids and the results that that could have. Stephanie, if you could implement any economic policy idea this year, what would that be?

AARONSON: I think I'm basically agreeing with Louise that I think the diagnosis that the increase in inequality over the past few decades really is the largest economic problem facing the country and we should be doing what we can to address that.

And actually, I think if we were to do that, that would also help solve some of the other challenges we face around having low productivity growth, having relatively low participation rates. And so I think that those types of policies would actually improve the economy along many dimensions in addition to making it work better for everyone.

DEWS: Well, Stephanie and Louise, I want to thank you both for taking the time today to help us understand the state of the U.S. economy but also exploring some ideas for making things better for everyone. I appreciate it.

AARONSON: Thank you.

SHEINER: My pleasure.

DEWS: Happy new year.

The Brookings Cafeteria podcast is the product of an amazing team of colleagues, starting with audio engineer Gaston Reboredo and producer Chris McKenna. Bill Finan, the director of the Brookings Institution Press, does the book interviews and Lisette Baylor and Eric Abalahin provide design and web support. Finally, my thanks to Camilo Ramirez and Emily Horne for their guidance and support. The Brookings Cafeteria is brought to you by the Brookings Podcast Network which also produces Dollar and Sense, the Current and our events podcasts.

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Until next time, I'm Fred Dews.

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