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PROPOSALS FOR U.S. ECONOMIC GROWTH AND DYNAMISM

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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. To meet the opportunity of a new administration in Washington, even with the possibility of a divided Congress, Brookings has launched the Blueprints for American Renewal & Prosperity project, which is publishing federal policy recommendations in five challenge areas. These are racial justice and worker mobility; economic growth and dynamism; governance, both domestic and international; international security; and climate and resilience.

On this second episode from the Blueprints project, two of the authors with policy recommendations in the economic growth and dynamism area discuss their proposals. William Gale is the Arjay and Frances Fearing Miller Chair in Federal Economic Policy, a senior fellow in Economic Studies, Director of the Retirement Security Project, and Co-Director of the Urban-Brookings Tax Policy Center. His paper, co-authored with Tax Policy Center Senior Research Assistant Grace Enda, is a proposal for more economic relief and stimulus.

Richard Reeves is the John C. and Nancy D. Whitehead Chair, a senior fellow in Economic Studies, and director of both the Future of the Middle Class Initiative and the Center on Children and Families. His proposal, co-authored with Isabel Sawhill, is: A post-COVID plan for the middle class: Tax wealth not work, and provide scholarships for service.

Also in this episode, a new edition of Wessel's Economic Update, in which David Wessel, Senior Fellow and Director of the Hutchins Center on Fiscal and Monetary Policy at Brookings, says that although the federal debt is rising, interest rates are very low, and so President Joe Biden and Congress should still borrow more to pay for COVID-related relief to alleviate suffering and bring the economy back to full employment.

You can follow the Brookings Podcast Network on Twitter, @policypodcasts, to get information about and links to all our shows, including Dollar and Sense, the Brookings trade podcast; The Current; and our Events podcast. First up, Wessel's Economic Update.

WESSEL: I'm David Wessel, and this is my economic update. A few facts about the federal debt -- one, the federal debt is larger than it's been at any time since the end of World War II; two, because the tax code won't yield enough revenue to cover projected future spending, the federal debt will continue rising and is on an unsustainable trajectory, unless Congress does something; three, interest rates, the ones that the market sets, have been declining for decades. They're now at historic lows and, best guess, they're likely to remain low for the foreseeable future.

With those facts in mind, what should Joe Biden and Congress be doing budgetwise next year? Should they borrow more to pay for COVID-related relief to the unemployed, to those who can't afford to buy food, to prevent state and local governments from cutting back? Yes, both to alleviate suffering and to get the economy back to full employment.

Should they worry now about the federal debt? No. The federal government is borrowing huge sums of money and paying interest at less than 1 percent on 10-year debt. At those low rates, lower than the rate of inflation, the U.S. government can sustainable service a much larger federal debt than most of us used to think possible.

Looking beyond the COVID-19 pandemic, should Congress pay for spending increases either with tax increases or with offsetting spending cuts? It depends. We should not throw ourselves a party just because interest rates are low and we can borrow so cheaply.

A simple rule would be that we should pay for things that we consume today. That means defense, Social Security, medical care for older folks, park rangers, airport security, salaries of most bureaucrats. But, we should not hesitate to borrow at today's very low interest rates for public investments that will pay off in the future -- basic science, spreading broadband across the country, green energy, roads where they're really needed, health care and education for children and (phonetic) poor families.

Doesn't government borrowing crowd out private borrowing in investment? At some point, yes, but the fact that interest rates are so persistently low tells us right now that's not the problem. Low interest rates are a signal that there is a lot of saving in the world relative to the private demand to use it to fund investment.

While federal borrowing does tend to push up interest rates, right now and for the foreseeable future other more powerful factors are pushing interest rates down. And, I'm not talking about the Federal Reserve here. I'm talking about things like demographics, productivity, and technology.

Shouldn't we worry about bequeathing a lot of debt to the next generation? We should worry about our kids and our grandkids. But, what will be best for them 25 or 50 years from now, a smaller federal debt and less public investment or a larger debt and more productivity-enhancing investment and thus a higher standard of living? At today's very low interest rates, there's a good argument for the latter.

Okay, you might ask, how do we decide what's investment and thus okay to borrow for and what's not? It's hard. And, there's a temptation to say that spending one favors is investment no matter what it is. But, that shouldn't stop us from increasing federal spending on things for which there is strong evidence of a payoff in the future, like Pre-K or health care for low-income kids, or getting rid of lead pipes in water systems, or developing technology to arrest global warming.

If we can pay for infrastructure spending with, say, a higher gas tax or with higher taxes on the very well-off, great, let's do it. But, if we can't get that through Congress, better to borrow to make those investments than not to make them at all. But, if something is unsustainable, -- and I did say that the federal debt can't keep rising as a share of the economy indefinitely -- won't we have to do something someday? Almost surely.

Federal revenues measure that the share of the economy are at historic lows, and those revenues are not even sufficient to cover current federal spending let alone the higher spending projected in the future. Federal spending is rising primarily for two reasons -- one, we're an aging society, in large part because women are having fewer kids, and the federal government spends a lot on the elderly; and two, health care spending rises faster than other things, though actually not quite as much faster as it used to, and the government pays a big part of the National Health Bill.

So, unless the economy evolves in ways that are far different from what we expect, we will eventually have to raise taxes or cut benefits or both. And, in any case, we need to continue to work to make the world's most expensive health care system more efficient so we can deliver good care at lower costs. Low interest rates give us more time, but they don't eliminate the need for those politically tough choices.

DEWS: And, now, here's my interview with William Gale and Richard Reeves on their proposals from the Blueprints for American Renewal & Prosperity.

Bill and Richard, welcome to you both back to the Brookings Cafeteria Podcast.

GALE: Thank you.

REEVES: Thanks for having us.

DEWS: So, I want to start by asking each of you to comment on what you think about the theme that both of the papers that you've co-authored in the Blueprints for American Renewal & Prosperity series are contained in, and that's economic growth and dynamism. And, I think I know what economic growth is, but what does dynamism mean to you? Bill, would you start with that?

GALE: Sure. Economic growth is just the expansion of the economy. We need more than that. We need shared and sustainable growth. We need a widespread expansion of the economy, a widespread boost in living standards, of all people, not just the wealth of the few.

Dynamism is a key part of achieving that. Nothing stays constant forever, and the ability to adapt to change is a central feature of what makes for a successful country, a successful company, a successful individual. At the macro level, that means adjusting fiscal and monetary policy to respond to changing conditions.

At the micro level, it can mean all sorts of things -- education policy, equipping people with the knowledge and skills so they can adjust to changes in industries or work patterns, unemployment insurance which lets people look for the right job after they've been laid off, housing policies so people can relocate if they need to, health insurance policies so people can change jobs if they want to or need to and get a better match, child care policies so society can reap the full benefits of having women be more educated than they were in the past, and so on -- energy and transportation policy that allows us to build without unnecessarily destroying the ecosystem. So, all these factors come together under the umbrella of the overall economy and how dynamic it is.

DEWS: How about you, Richard?

REEVES: Yes. So, I agree with everything Bill said. When economists talk about dynamism, they tend to think about how many businesses are being created, are people moving to jobs, what's happening to productivity. All of these things will affect any overall amount of growth.

But, the other thing I think I would add is -- to move slightly outside of this narrow lane of economics -- is to think about the idea of social dynamism is the idea of being able to move up, the idea of opportunity, the idea that you're not stuck in place, the idea there are opportunities in front of you, the idea that the future is reliably going to be better than the past.

All of these things are kind of as much about the way society feels and operates just about the economy. And, of course, as human beings we don't sort of do economics 8 hours a day and then society the remaining part of the day. We're all creatures who live both economically and socially.

And, so the concern is that the lower growth and the lower economic and social dynamism has truncated people's opportunities in the U.S. in a way that I think is causing a lot of the anxiety that we're seeing being played out, in not only U.S. politics but also the concerns the economists have about our future.

DEWS: So, this episode is the second in our series on the Blueprints project, and I asked our guests last week, Annelies Goger and Martha Ross, to talk about this at a very high level what their two papers were all about to kind of set the stage for the rest of this conversation.

So, I want to ask you both to lay out at a very high level the policy challenges and your solutions so listeners can keep that in mind as we go into more detail. Bill, do you want to get us started with that?

GALE: Sure. My paper has a very simple, direct point, and that is, we need to focus on helping the economy right now, even though there is a long-term debt issue hanging over us. We will have plenty of time to deal with the long-term issue, and we should not let it stand in the way of government relief or stimulus now.

DEWS: Richard, do you want to -- just, at a high level explain what your paper is all about.

REEVES: Now I'm wishing that my paper was as simple and direct as Bill's paper. The paper that I've written with Belle Sawhill, it does have a simple message, which is that the economic growth we have seen in recent decades, last (inaudible) 4 decades, has not been evenly distributed.

I've seen a rise in inequality, and in particular the growth of the incomes of the middle class -- I run the Future of the Middle Class Initiative here at Brookings -- but the middle class has been slower than the growth of the incomes of both the people above them and below them.

In fact, it's been about -- depending on how you measure it, half as quick the growth in the middle as of the top and the bottom, close to 40 percent than either 80 or 100 percent. So, it's not true to say there's been no growth in middle class incomes in the U.S. That's not true. But, the growth has been pretty slow, and it's been much slower in the middle than it has at the tails.

And, so that, again, I think that's a problem, and that's not going to be solved by economic growth alone. Even if we knew how to magically increase economic growth, there's a question as to who does that growth flow to, and in recent years it has not been flowing to those in the middle. So, there is something of a stagnation in terms of the rate of growth in the middle of the distribution. That's the problem.

DEWS: We'll take a deep dive into both of your papers here in a moment. I just want to flag for listeners that your papers and the others in this set on economic growth and dynamism are all on our website, Brookings.edu/blueprints. Bill, you mentioned just a few moments ago that there are concerns about the long-term debt. We have debt concerns about deficit that we hear every year, that Congress is debating the budget.

Just kind of a political question -- is it fair to say that you know whenever a Democrat wins the White House, as we've just seen over the past few weeks, that the GOP rediscovers its concern about the deficit. And, more generally, I mean, can you talk about what are the concerns about deficit and debts and why we shouldn't worry so much about the short term?

GALE: We do have a long-term debt issue, but it's not a crisis. It's not something that merits immediate attention, especially given the state of the virus and the economy. So, Republicans, as you mentioned, they do say there's a debt problem when Democrats are in power, and they've acknowledged publicly that this is essentially a talking point rather than something driving their policy. But, there is a point at which we need to deal with long-term debt. It's just not anytime soon.

The best way to think about this is -- the best way to address the long-term budget is to have a strong long-term economy, and the best way to do that is to strengthen the economy right now. Besides the lower living standards that the economy is generating, there's a humanitarian concern as well, and that alone should cause us to act.

But, in fact, the economic weakness right now can be causing long-term damage. People are not working, women are leaving the labor force, kids are not getting the education they should be getting, normally functioning businesses are being forced to shut down. All of that will have deleterious, long-term consequences. So, if we care about the long-term economy and the long-term budget, we should be doing those things right now.

REEVES: Yeah, there's a legitimate argument of political economy about how much the government should spend, what the size of the government should be, what the tax take, what the fiscal requirements are, and so on, which you can have. That argument can be a sort of reasonable left/right, liberal/conservative argument.

There's something very different about (inaudible) you've had the economic equivalent of a meteorite strike in the pandemic, and you're trying to hold the structure of the economy together. You're trying to keep the engine running.

And, that's a very, very different kind of argument, and it feels to me as if some people, largely Republicans, are finding it hard to make that distinction, right, between a sort of long-run, philosophical argument about the size of government and a short-run argument about -- we've just been hit by this meteorite, we've got to keep things together. Is that fair, Bill?

GALE: Yes, this is a very different recession than recessions we've had in the past, because, in a sense we want people out of the labor force. We want people not dealing with each other until we can get the virus under control. And, so, everything that you said about the benefits of stimulus in this particular situation are amplified by the fact that interest rates are historically low, so the government has plenty of room to borrow money, and clearly financial markets are not worried about the fiscal status to the government right now.

One other thing I'll add is also consistent with all this is that historically countries tend to cut off stimulus too soon. We saw this earlier in the last decade after the Great Recession. It happened in the 1930s, it happened in Japan in the 1990s, and certainly Europe after the Great Recession.

So, historically, policymakers have gotten religion about fiscal concerns too soon, that is, before the economy is fully recovered. So, I think that there are several distinctions in the current episode from previous recessions, and they all point toward doing more now.

REEVES: Well, having served in the UK government in 2010, I have to agree.

DEWS: Bill, if I could follow up on Richard's point, too, because I think Richard's point about the tremendous impact that this event has had on the economy now kind of speaks to the distinction you make in the paper between economic stimulus and relief. So, can you talk about what that distinction is for a second?

GALE: Sure. This is one of the big ways in which this recession is different from earlier recessions. Normally, during a recession what you want to do is give people incentives to get back in the workforce. You want to give firms incentives to invest more. That's stimulus. Relief is similar but different. And, that's paying people to stay out of the labor force, making it possible for people to survive financially while they are observing the public health guidelines that we need them to observe.

There's also a third policy I should mention, which is anti-COVID policy. And, it can't be emphasized enough -- COVID policy is economic policy right now. We will not get the economy operating at full employment again until we get the virus under control. So, I think what we need right now is relief along with the anti-COVID policy, and then when the time comes, we'll see if we need more stimulus. It might well be that once the virus is contained that the economy bounces back fairly rapidly.

REEVES: I think this also underlines another distinction, which is implicit in what you're saying, about the concern over incentives. There's a concern when you're providing financial assistance to someone who's out of work or is in a difficult situation, but it's going to disincentivize work, right. So, it's a longstanding debate in that to what extent do different welfare benefits disincentivize work or incentivize them, and so on.

But, to some extent the politics of that, it's just completely different now, for the reasons you just said, Bill, which is we are a lot less worried about disincentivizing people from going to work when the purpose of the policy is to allow people not to go to work, in fact, to discourage them from going to work, right.

So, this is not just a sort of nuance difference in the economics of public policy. It's a reversal of the typical way we think about incentives in this area. And, again, I think there's been a bit of a difficulty of policymakers sometimes getting their head around that.

You're seeing some lawmaker saying, well, we're worried. You know, if we keep paying people, we might not get them back to work. I'm like, yeah, I get it, but it's sort of that's the mindset that you've got, which is you're worrying about the wrong kinds of incentives right now. But, it's very difficult to suspend your kind of convictions about the way the economy works in this extraordinary circumstance. I think we're seeing that -- that's one of the real obstacles here, I think.

DEWS: Thinking back to the spring when Congress did pass some packages of aid -- I don't know if we called them stimulus or relief back then -- but that was when the spread and the severity of the coronavirus in America wasn't anywhere close to what it is now in December, and yet Congress is now debating and may be on the cusp of a deal for an additional aid package.

Bill, and maybe Richard, too, can you talk about just a status of what Congress did in the spring and where those programs are now and where we are now looking ahead into 2021?

GALE: Sure. The Congress enacted the CARES Act very quickly. It was on the order of $2 trillion. It was basically negotiated over a 2 or 3-week period, which is unheard of in terms of speed and magnitude of legislation. So, there's no way to expect that they would have gotten everything right.

But, a lot of what they did made a lot of sense. They gave direct payments to households. They initiated pandemic unemployment insurance. They boosted food stamps or SNAP. They provided funds for health care for the states, for vaccine development. They did the Paycheck Protection Program.

And, you can argue with the evidence now some of those programs are more effective than others, but generally it was a very big effort aimed at relief rather than stimulus, for pandemic unemployment insurance is best example. They're paying people extra money to stay out of the labor force, as Richard mentioned.

There were some less desirable features. There are some corporate net operating loss provisions that kind of went way overboard. But, in general, it's easy to criticize Congress. In general, I think CARES was more or less the right thing at the right time. The issue now is it's all run out and yet the virus is still not contained. So, we need another round of what I think of as relief as we're getting the vaccine out and as we're observing public health guidelines.

REEVES: Yeah. I think I see -- just to underline what Bill said, really, -- I was proud of Congress during that period. It's not often you get to say that. And, there's this whole debate that Congress is gridlocked, and everyone's partisan, and they're all venal, and woe is me. And, fair enough, there's a lot of evidence for that (inaudible).

But, as Bill said, Congress just acted like a Congress for a while in getting that money for -- given that the uncertainties of what they were doing, I think it was pretty darn good policymaking pretty fast, passing the bipartisan way. They got a lot of money out the door. The problem is now.

And, there's this whole discussion now about people suffering from COVID fatigue. You know, we just had enough now, and so I am going to go to my parents for Thanksgiving. I am going to try -- just had enough (inaudible) COVID. The worst case of COVID fatigue appears to be in Congress, right. It's like enough already. It's like, oh, really? Do I have to do this again?

So, Congress is like the equivalent of the person thinking, oh, really? I still have to wear a mask? I still can't visit my parents? They're like, yeah, all of those rules still apply. And, so, actually, the problem is that Congress has COVID fatigue or kind of potentially fatal long-run economic consequences.

DEWS: Well, it feels like we're on the cusp of, in Congress, the new deal -- as we're recording this on Wednesday, December 16th -- do either of you know kind of what's in the deal or what's a possibility, and also, maybe more importantly, what's not in the deal?

GALE: What's not in the deal is enough money. The numbers they're talking about are in the hundreds of billions. They should be in the trillions. And, you know, it's easy to throw around these numbers, but I don't see that the situation now is less dire than it was in the spring. In the spring the unemployment rate was higher. It shot higher than it is now.

But, as Richard mentioned, the country is 9 months into COVID. There's a lot of fatigue, there's a lot of benefits that have run out, there's a lot of pain being felt economically in other social indicators. So, I think the debate right now seems to be whether there's a direct payment to households or aid to the states, and that seems like, to me, to be a bad debate, a bad set of choices.

I feel like we should be doing both of them as well as upping unemployment insurance, helping renters, and particularly appalling to me is the food situation in the country. The lines at food banks are always hard to see. They're particularly hard to see around the holidays, and they're particularly hard to see knowing that they are the outcome of long-term unemployment in a pandemic-stricken economy. So, I think we need, at the very least, for humanitarian reasons but also for just basic efficiency, economic reasons, we need to make sure people have enough food.

When the virus is under control, we may need more stimulus. We don't know, because we're not in that situation. There's an argument that the economy won't recover very quickly once the virus gets under control, but we really don't know. But, right now, I feel like we need a very aggressive relief package, and what's being discussed in Congress is quite a scaled back version of that.

DEWS: One of my understandings of what's not going to be in the bill, too, and you mentioned it, is state and local aid. Can you talk about why aid to state and local governments is so important?

GALE: Sure. First of all, state and local governments are big actors in the economy. They employ more than 10 percent of the non-fire (phonetic) labor force. Their spending is -- revenues are roughly half as big as the federal government. And, states provide many of the services that people think of when they think of government. So, they're a very important sector of the economy, both in people's lives in terms of their aggregate effects.

The issue that comes up in recessions is that states have balanced budget rules, and that means if the economy falls and their revenue falls, that mean they either have to raise other taxes to restore a balanced budget or they have to cut spending to restore a balanced budget. Both of those actions are bad for the economy during a recession.

In the same way that we talk about the federal government offering stimulus or relief during a recession, the states are doing the opposite of that, not because they're evil but because they're constrained by these balanced budget rules. So, they have to cut back spending or raise tax rates right when the economy needs them to be boosting spending or cutting tax rates.

So, from a macro perspective, you want the federal government to aid the states, to assist the states during recessions so they don't undertake policies that make the recession worse.

DEWS: Let's switch gears here a little bit. Richard, I want to turn to you now and talk in more depth about your paper. Your policy proposals are rooted in challenges facing the middle class, and you mentioned that earlier. Can you talk about what some of those challenges are?

REEVES: If you like, there are two sides to this coin. One is that there's been slower income growth in the middle of the distribution. That's the result of a slow wage growth for a lot of middle-class workers, especially men, and some shifts in kind of family structure as well. So, there are lots of reasons behind that, but it's, I think, unquestionable that there has been slower growth in family incomes in the middle of the distribution.

At the bottom of the distribution, the safety net benefits have done their job, to some extent. Now, that does not mean that there isn't still a huge problem of tackling poverty in the U.S. It does just mean that for the people who are right at the bottom of the distribution, the bottom 20 percent, that a huge proportion of their income and service is accounted for through government transfers. And, the people who at the top, the top 20 percent, who I have written about before at some length, are doing just great, by and large, in their higher wages, et cetera. So, slower income.

And, then, it's costs, right. I mean, you had lots of conversation on this probably because Fred with, you know, colleagues about the cost of health insurance, for example. Obviously, the cost of college is another big one. People like Jenny (inaudible) have written a lot about the cost of housing.

And, so it's seeing this kind of a pinch between many of the expenses that middle-class families face. And, I guess we should mention the capacity to retire very well and save towards that, which is something Bill has a lot of knowledge about, and pretty sluggish income growth. So, that's the problem.

And, the question is like how quickly should we try and address that problem? We've been looking at that problem unfold for quite a long time now, and we haven't really had considered (phonetic) that action on a policy front to deal with it, more concern perhaps since 2016, about the condition of the American middle class. But, we've yet to see, I think, a sort of significant and bold policy action, and that's what we get into in this paper.

DEWS: You know, the coronavirus pandemic has certainly exacerbated the social and economic conditions for everybody in America. The bottom of the socioeconomic spectrum, in particular, -- and, Richard, you and I talked about that in a podcast interview back in the spring, that (inaudible) impacts on mostly women and people of color, frontline workers.

But, in this paper for the Blueprint series, you talk about the problems for the American middle class that the coronavirus pandemic is exacerbating. Can you talk about how the pandemic is making the middle class's problems even worse?

REEVES: The people who are being hit the hardest by the pandemic are those who have to work and can't work from home, all right. So, for the professional classes or those who have kind of flexible working -- who can work from home, actually the evidence is that those at the top of the distribution are doing really pretty well right now economically. In fact, the fact that they're spending less is a problem for the lower-income workers in their neighborhoods. That's pretty well kind of proven, too.

And, if you weren't reliant on employment income at the beginning of the pandemic, then you won't have seen such a big shock. It's the people who were in precarious employment positions, reliant on a paycheck, didn't have much by way of savings, and those would fall pretty squarely into our definition of the middle class.

I should say that, you know, I think we discussed this in the podcast before, Fred, that there are as many definitions of the middle class in America as there are middle-class Americans. I've been working on this issue for a while now and I've lived here for 8 years, and I still don't really know what it means to be middle class. I have lots of long, boring papers on the question on the Brookings website if people want to check them out.

For the purposes of our argument, we use the middle 60 percent of the income distribution. All of these (inaudible) are arbitrary, but it does have the advantage of being in the middle. The middle 60 and the average income for that group is about 70,000 for a family of three. Once you clear 40,000-45,000, if you were into that group, once you break about 150,000-160,000, then you're above that group. So, that's the kind of range we're talking about.

It seems that people by and large sort of -- not in six figures or low six figures if they are for a family of three, that's who the middle class are on our definition, and they're the ones who face this income squeeze over the last four decades, and some of whom, especially those in the lower quintiles, have been hit particularly hard by the pandemic, because, as I said, they need to work and they can't just do it by Zoom from home.

DEWS: A note to listeners. You can hear my podcast interview with Richard and Isabel

Sawhill from August of this year on the Brookings Cafeteria on their contract with the middle class and also visit our website, and you can find a wealth of information and ideas in their contract with the middle class. It's a really great set of ideas and interactives and data.

Richard, your paper proposes two major reforOne of them is eliminating the income tax for most of the middle class and reforming a whole bunch of other taxes, and also providing 2 years of free public college in exchange for some national service. Taking the tax side first, what taxes are you talking about?

REEVES: So, in terms of the cuts, the income tax, what Bill and I did was take a pretty simple approach and to say -- if we think the problem is that the income growth hasn't been as great in the middle class as it has for others, then what can we do about that? And, one way to deal with that problem is to reduce the amount of tax that we take off people's income, right.

Sometimes that's a pretty straightforward thing. How do we get more money into the hands of these families fast? And, one is to eliminate income tax for about 2/3 of the middle class. It's pretty expensive to go all the way the distribution, but we do that by raising the standard deduction for a married couple to $100,000, right. So, a married couple needs to get into that six figures before they outrun the standard deduction. So, that's a $1,600 average tax cut for middle class families.

For those who are towards the bottom of our definition of the middle class, you'd need to do more than that, because they actually don't pay very much income tax. And, so, there we propose a worker tax credit, which is effectively just like the ITC and other kinds of tax credit or wage subsidy to top it off.

And, so, those are things that you could do pretty fast to get more money into the hands of middle class families next year. These problems have been unfolding over decades. And, so, if you want to get money into their hands fast, of course, you need to do retraining and so on, and I'll come onto that. But, there's something to be said for just making it quick.

Also, it seems like that we might be in an era where we're going to need at least a degree of bipartisan agreement around some of these proposals. I mean, it seems like a tax cut for the middle class might be something that you can get some Republican support for as well. You'll remember that the Tax Cut and Jobs Act was described as a tax cut for the middle class but was not a tax cut for the middle class. It would be nice to have a bill that actually did what it said it was going to do.

And, the second is the idea of 2 years of free college. This is something we really wrestled with, and I continue to wrestle with the pros and cons on this argument. But, I think there is an argument now that at least through K-14 the first 2 years of post secondary should be seen as a public good, but we also feel quite strongly that there's a case for all Americans performing some kind of service, not necessarily military service but civilian service. And, there are all kinds of reasons for that, which we get into on the other podcast that we did with you.

And, so, those 2 years of college would be free of financial cost, but it wouldn't be free if you lack a social obligation. And, (inaudible) think that will be a powerful incentive towards more service and also a powerful reward for those who perform that service. We call it as part of the contract. We call it Scholarships for Service, and we'd like the norm to be for all Americans to both get some post secondary education or training.

This would include occasional training, too, but also it should be the norm for all Americans to perform some kind of national service. So, the question like where did you do your service should be as common a question as where do you go to college? And, we've just combined those two into this Scholarships for Service plan, which would reduce the cost of college for middle-class families.

DEWS: I'm going to stay on this service question for a second and then go back to taxes, mindful of the fact that we have in Bill Gale one of the institution's top tax economists with us. But, almost --

REEVES: Yeah, I'm pretty mindful of that as well as we're having this conversation.

DEWS: You talk about K to 14 education as the new way of thinking as a public good. And, we've often thought about public education, K through 12, as a public good. And, I think it was really interesting in your paper how you kind of walk through the history of how that came about and how, at one point in America's history, having a high school diploma was enough to get you into the middle class and have a very successful middle-class life. And, that's no longer the case anymore, and so we have to push the boundary of that educational zone out some more.

REEVES: If you tracked the trend and number of years of education completed through to the '70s when it started to level off, if it hadn't started leveling off we'd be about 16 years now anyway. I've struggled with this, and it's important, I think, to declare one's inconsistencies.

Actually, in my last book, said free college is a terrible idea. And, the reason for that is because it's regressive on its face, right. The people who would most benefit from it are the ones who go to college the most and do go to the more expensive colleges for the longest, right. And, those are disproportionately kids from more affluent backgrounds.

But, I think that combining it with the idea of service, that changes my view a bit somewhat. I think that's a different kind of contract. But, secondly, the reason I've changed my view on this somewhat is that the arguments against making, say, the first 2 years of college free, and maybe all 4 years of college free, the argument's against that. But, it's regressive, that you don't need to pay for it, that the rich who will donate the paper are exactly the same arguments that you can make against K-12 education being free, and were made against high school being made free almost a century ago, or whatever it was.

So, why did someone pay for my kids to go to K-12 school? I could have afforded that.

That's (inaudible) regressive use of public money. And, so, it's actually quite hard to defeat (inaudible) against that. And, so, the question then is like to where's the line between the public and the private good? And, I'm increasingly convinced that we have to make at least some post secondary education and public good, from a financial point of view.

But, I also do think that this idea of rather than just continue to just write checks, but it'll say (inaudible) you've got to do something for us as well. It's a good moment, I think, to say to a new citizen or a new adult citizen, I should say, okay, well, you do your bit as well.

And, so, you combine the idea of public good with the idea of public service. And, I think that that's a nice way to make the contract clear but also a way, I think, to make the argument for the public good of post secondary education more palatable, because narrowly and on its face, there are problems with it. You know, you could do quintiles, and we have many colleagues doing that. Then, you can sort of see it as regressive.

I will also say that right now (inaudible) chosen to do 2 years, right. The model (phonetic) destination post secondary for middle-class American kids is community college. That's the model destination, followed by 4-year publics, right. And, (inaudible) at the bottom 80 percent.

And, so, you wouldn't necessarily think that from the debate about higher education in the U.S. right now, that the model destination for middle-class kids was community college. There's also a deliberateness to making these -- to doing the 2 years free as well.

DEWS: Just one more note for our listeners in last week's episode of the Brookings Cafeteria. Martha Ross talked about her proposal to expand opportunities for national public service in the existing organizations, also expand their stipend and also connect that to college tuition benefits. So, listeners can go check that out.

Let's go back to taxes. Richard, a few minutes ago you were talking about cutting a range of taxes for the middle class, but then we start having to think about the revenue side. We cut taxes. We have to increase revenues somehow. And, your paper talks about some ways to address those concerns.

REEVES: Yes, that's right. And, we have to talk about the (inaudible), because we have Bill Gale on the podcast as well. So, he's sort of glaring at me, saying, yeah, where are you going to get the money from? And, there were real arguments about what's the best way to help the middle class as well, right. This is a particularly bold proposal from Bill and I to cut income tax. There are many other ways that one could go about it.

But, there is a kind of question then about where does the money come from, and, indeed, how do you think about the tax base more generally? So, what we do is we propose increasing taxes on what we call the three C's, just so it'll be easy to remember -- capital, consumption, and carbon. The polite thing to do at this point is a phrase you used on that, drawing heavily on the work of our colleagues or building on the work of our colleagues. The truth is, sort of cutting and pasting the work of our colleagues -- Bill Gale, Adele Morris, and others.

We essentially argue to increase some of the taxes on capital and expand the estate tax, increase step-up basis. We argue for increasing the corporate tax rate to about 25 percent. We can argue about that. We argue to the introduction of a carbon tax, a carbon tax at $25 a (inaudible) to just north of 100 billion a year, according to Adele Morris's work.

And, then lastly, -- and this is Bill's work directly -- a consumption tax, right. The U.S. is quite unusual in not having a national consumption tax or the VAT, a value added tax. We propose basically just copying Bill, 10 percent, which is still pretty low by international standards.

And, even when you do lots of work to offset the potentially regressive impact of that, which Bill's proposal does, that still raises you 200 billion-ish, maybe a bit more. And, so, there's money to be raised. It's to be clear that's a pretty significant recasting of the tax system. What you're doing is you're taxing carbon, and you're taxing spending, and you're taxing capital in order to tax income less. And, by income in this case, we largely mean wages, right.

And, so, look, we have to raise quite a lot of money to do things you want to do. In fact, we should raise more money. The question for tax policy is always what should we tax? And, that's just not an economic question, that's a normative question. That's a question of like what do we want to encourage, what do you want to discourage, et cetera? And, it's pretty clear, I think, that (inaudible) we should tax wealth more than work, and that we would have a more sustainable and fairer tax system if we rested more of the burden on consumption and capital and carbon than on working people, on the wages of working people. It's rebalancing.

GALE: Let me just add -- the case for imposing higher taxes on the affluent, I think, is particularly strong. First of all, their income in the top groups has gone up dramatically in the past 30, 40 years, but average tax rates haven't. In a progressive system, you expect the share of income going to taxes to go up as income goes up.

In addition, there are a number of ways to raise taxes on the wealthy that don't necessarily hurt the economy significantly. One, for example, would be taxing capital gains at death. Another is enforcing the system better. Tax evasion, which is illegal, not paying of taxes, runs about $600 billion per year. It's 3 percent of GDP. We'll never capture all of that, but we could capture a significant share of it.

And, we know where it is, basically. It's mostly in sole proprietor income and rental income and farm income. And, evasion rates in those categories are over 50 percent, that is, more than half the income earned in those sectors is simply not reported to the Internal Revenue Service. So, we can get a lot of money there.

The other thing I'll just say is the case for a carbon tax is overwhelming and has been overwhelming for 20, 30 years. And, occasionally you see kind of green shoots of interest or support in this, and I'm hoping we can, next year or the year after, implement this as part of a broader transportation and energy package.

DEWS: Well, implementation, I think, is a key question. And, I kind of want to use that to pivot to kind of wrapping up this conversation. And, mindful that there is a new administration coming to Washington in just a few weeks, but possibly with a divided Congress, and even if it's not divided, I think it's going to be a close Congress between Republicans and Democrats, I want to ask each of you if you're hopeful that some progress on these and related policy ideas can happen.

GALE: I have hope but I would describe myself as pessimistic that we're going to solve any big issues, if we get a split Congress. The tribalism is rampant up there, tribalism being if you're for it, I'm against it, just kind of a reflexive response. And, we've seen way too much of that in the past, but I expect we will continue to see a fair amount of that in the future.

Let me just be clear. It's not an accident that this is happening. I mean, policymakers are very good at understanding the incentives that they face. And, you know, they wake up every day and say are we going to cooperate or are we going to fight. And, so far, every day the last several years they've decided they want to fight. And, I think that reflects these deeper divisions in society -- I'm not a political scientist, I don't want to espouse too much on this -- but I generally am pessimistic about the ability of a split Congress to get big things done.

REEVES: I'm not a political scientist, either. So, we will have to add that caveat and then go on to make political science claims anyway. So, I assume split or very, very narrow Congress. I share a lot of Bill's pessimism about the possibility of getting big things done. I think it will be hard anyway, given their crisis that's been inherited. Their house is on fire. And, so, you're simultaneously going to be trying to deal with the fact that the house is on fire in the shape of the pandemic and try and do your structural reforms at the same time. And, so, I think it'll be a huge left.

And, I agree the problem is if they're for it, we're against it problem. But, there are a few things I'd want to look out -- one example which is the prospect for movement on apprenticeships, right. Annelies Goger, one of the colleagues here, is an expert on this.

The House passed the Apprenticeship Bill a couple of weeks ago. And, that's a classic area, where, actually, Donald Trump invested more in it. He had a commission on apprenticeships, et cetera. Everyone's in favor of them in theory. But, both sides are digging in on these quite technical issues around -- does the employer credentialize them?

The Republicans see apprenticeships as a thing the unions did back in the day. So, it's like digging in around this. So, it sort of feels to me as if there is scope for a huge bipartisan deal on something like apprenticeships, right, that really should be -- we should be grey on all kinds of fronts. Will we get it? I think it's a good test, because they're almost creating reasons not to agree and getting dug in. A 10 percent of compromise on each side would get a huge bill on the apprenticeships through, is my guess, right. Are they going to get that 10 percent?

But, we're in an era of politics now where it feels like you give these people an inch, they'll take a mile, right. It's like trench warfare. It's like World War I warfare. And, unless we can create a culture with (inaudible), you can just give a little bit without being slaughtered by the other side or by your side. They were looking over their shoulder. Then, there's no hope for compromise. And, so, this is a much deeper question that we have colleagues who are better equipped to answer than us.

GALE: I will repeat the caveat that I'm not a political scientist, but I think Richard made a really good point there at the end, which is that people who want to compromise are worried about their own party, the other side. They're worried about being primaried from the extreme sides of the spectrum. And, that's kind of a new threat, opposite of the kind of typically the way we think of politicians as gravitating toward the center in order to get more votes.

DEWS: One final note for listeners before we kind of wrap up with the larger question that I want to ask you, and that's -- in last week's podcast with Martha Ross, Annelies Goger also talked about her apprenticeship policy proposal. So, a lot of synergy between these episodes.

So, again, expanding out kind of into the biggest picture that we can think of, we've just gone through an extraordinary presidential election. In some ways we're still kind of going through it -- huge outpouring of democratic activity, democracy with a small D. Richard, you end your paper with a statement that a prosperous middle class provides the foundation for a strong society and a health democracy. Can you expand on that point?

REEVES: Yeah, however you define it, the middle class is going to account for a significant proportion of the population. We actually argue at the beginning of the contract that we spoke to you about before, Fred, that actually the U.S. is to some extent the middle-class nation. That's one of the reasons I moved here.

What I mean by that is it's got a sense of independence, aspiration, opportunity, et cetera, right, the opportunities for self-betterment, and so on, away from sort of deferential politics and societies you get in Europe. So, I think Joe Biden actually, when he came to launch our project a couple of years ago, he talked about middle-class values, right.

And, that sounds so old-fashioned, right, the idea of -- and it might even be a little bit sort of controversial to talk about. But, actually the values of when you work hard you can get ahead and you can get your kids to college and you can have a decent retirement. Okay. If that's a judgment call, well, it's one that 98 percent of Americans agree with him on, that those are (inaudible) paid reasonably well, you should be treated well, you should be able to send your kid -- all of that stuff.

And, so, actually, peculiarly it's a much bigger crisis in America than it would be in another country, precisely because the prospect of rising into the American middle class has been one of the great engines of upward mobility for this country and arguably for the world. That's why we attract so many immigrants, right.

But, also, the idea that once you get into the middle you can enjoy a good life and you're not going to see the folks above you running away with the disproportionate share of the riches. That's also important, too. So, a strong middle, it's very important as a way, that kind of updraft, as a place that you can go, a place to aim, right. These are highly motivating for people, but also kind of sense that once you've made it there, then you can look around and feel like, yeah, I'm sharing this country as well and I'm contributing to this country as well, rather than feeling you're being left behind.

And, so, for political reasons and cultural reasons, not just within the U.S. but more generally, the state of the American middle class is hugely important in that broader sense, but look on (inaudible) more narrowly, which is that unless middle-class Americans (inaudible) feel that they are getting a fair shake, then the political consequences, they could be quite significant. And, I think that if we haven't learned that in the last few years, then we haven't been paying attention.

DEWS: Bill, in a similar fashion, can you situate your policy proposals for more economic relief and stimulus in that same context in the health of our democracy in our society?

GALE: Absolutely. Again, the gist of my proposals are that we address these problems now, that the benefits would exceed the costs, that we have time to deal with long-term debt well in the future. And, I just want to leave you with this.

Imagine an economy where people had enough food to eat, had affordable, effective health insurance, they lived in affordable housing, they were assured of living in a safe neighborhood, assured of getting a quality education, and assured of being able to use that education to work, while another quality worker took care of their children during the day. That's not socialism, that's well-functioning capitalism, and that's what we should be aspiring to.

And, actually, I think we have the mean to make significant dents in those problems and help people move along the spectrum toward those features that I mentioned. But, it will require significant government intervention. It's not something the market can do by itself. So, I think good policy supporting the things that Richard mentioned and that I just talked about is essential to a healthy democracy and a healthy society.

REEVES: Well, let's leave it there. This has been a fascinating and important conversation. Bill Gale, Richard Reeves, thank you both for sharing your time and your expertise with us today. I really appreciate it.

REEVES: Thank you.

GALE: Always a pleasure. Thank you.

DEWS: You can find their papers in the Economic Growth and Dynamism theme in our Blueprints for American Renewal & Prosperity series on our website, Brookings.edu/blueprints.

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