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DEWS: Welcome to the Brookings Cafeteria, the podcast about ideas and the experts who have them. I’m Fred Dews.

Happy New Year! This is the seventh annual look at the top economic issues of the coming year. And to discuss the state of the U.S. economy, inflation expectations, and more, I’m joined by David Wessel, senior fellow and director of the Hutchins Center on Fiscal and Monetary Policy at Brookings, and also a longtime contributor to the Cafeteria Podcast in his Wessel’s Economic Update series.

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JOHN McARTHUR: Hi, I'm John McArthur with the Center for Sustainable Development at Brookings.

ZIA KHAN: And I'm Zia Khan with The Rockefeller Foundation. We’re the co-hosts of “17 Rooms,” a podcast about actions, insights, and community for the Sustainable Development Goals and the people driving them.

MCARTHUR: 17 Rooms is a new way of getting people together to take action on the 17 Sustainable Development Goals. In this podcast, you'll hear our conversations with dynamic leaders shaping actions towards the Goals.

KHAN: “17 Rooms” is produced by The Brookings Podcast Network. You can download and listen to it on Apple, Spotify, or wherever you like to get your podcasts.

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

WESSEL: Good to be with you, Fred. Happy New Year.
DEWS: Happy New Year to you, too. So, this is the annual state of the U.S. economy and looking ahead episode, so what’s your assessment of the state of the economy as 2022 begins?

WESSEL: It’s a really good question and surprisingly hard to answer. The economy seems to have recovered quite nicely from the COVID recession. Unemployment is down. The sales of goods and services are mostly up. And then comes Omicron. So my guess is, but I really want to underscore it’s a guess, is that we’re going to have an awful January and provided we don’t have another variant of the virus that things will resume what really in many ways is a boom later in the year.

There are two big questions. One question is will the workers who have stayed on the sidelines of the economy during the pandemic come back or not? And secondly, will inflation abate? Or will it be so persistent that the Fed ends up raising interest rates a lot and slowing the economy in the end by the end of 2022?

DEWS: You’ve talked on this show before about inflation expectations and you use the term “unanchored.” And that was back in October. Can you talk about where the U.S. economy is now in terms of inflation? And also what is that mean, inflation expectations being “unanchored,” and what is the outlook on inflation now?

WESSEL: Okay, so, current economic thinking, particularly at the Federal Reserve, is that if people expect inflation to be around 2 percent, the Fed’s target, that that will become a self-fulfilling prophecy. That if we have a spike in prices because, say, OPEC manages to raise oil prices or a plunge in prices because we have a really bad recession, that people will be confident that the Fed can deliver 2 percent inflation over time. And so they won’t demand big wage increases or build price increases into their business plans and so forth.

What happened during the pandemic is that we had a lot of demand for things that were in short supply. Some of it fueled by the federal government’s response to the pandemic—the fourteen hundred dollar checks, unemployment insurance—and some of it caused by disruptions to supply chain, factories closing in China, and stuff like that. So inflation has been running at a very rapid
clip, like better than 6 percent at an annual rate. And that’s a real startling thing for Americans who many of whom have never been through a period of high inflation since we’ve had such low inflation for so long. So the question is, are people seeing this as temporary—“transitory” was the phrase that Jay Powell, the Fed chair, used—or are they beginning to think that this is going to be a more persistent problem? There are some hints of the latter. Some union contracts are building in cost of living adjustments for the first time, and there’s been some blip in some measures of inflation expectations. So far, though, I’d say they haven’t become unanchored. That is that most of the surveys we have, and this is a pretty squishy weight thing, suggests that people are not expecting inflation to persist. That is, they have confidence that the Fed will do its job. And it’s important for the Fed to maintain that, which is why the Fed is beginning to move to take its foot off the monetary accelerator pedal.

DEWS: So, we’re approaching the second anniversary of the COVID-19 pandemic disrupting life as we know it in both the U.S. and around the world. Do you think the pandemic’s shock and the response to it are fundamentally reshaping economies? Or could it be that while monumentally disruptive and deadly, of course, we’ll eventually return to a pre-pandemic status quo?

WESSEL: I don’t think we’ll go back to a status quo, or status quo ante. This has gone on for too long to not change the way people live and work. What we don’t know is what things will change and what will not. One example, it seems highly unlikely that we will go back to a five day week in the office norm in the white collar world. It seems highly unlikely that after some spurt of, oh it will be great, we can do business trips and have conferences in person, that we will go back to all in-person conferences when technology has shown us that it might not be worth the travel time and the wear and tear. So, I think that we just don’t know how much it’ll change. But you can’t go through a period like this without having some effect on the way people live and work.

One thing that’s particularly worrisome is what about children who’ve had schooling disrupted for a couple of years, college kids who haven’t had the full college experience, high
school seniors who haven’t had the rituals of graduating from high school, and all that. So there may be some long lasting effects.

But do I think that the economy will grow more slowly, that living standards will stagnate because of the pandemic? No. I think we’ll discover that we have different patterns of work and life, we have different technologies, and we will adapt in ways that are really hard to predict. But it will be different.

DEWS: Well kind of more in the present tense, then—Congress recently passed, and President and Biden signed, a $1.2 trillion dollar infrastructure bill in November. Do you expect that piece of legislation to produce any noticeable economic benefits soon?

WESSEL: Noticeable economic benefits, yes. Soon? No. So the very nature of government infrastructure spending is that it takes a long time before it actually gets into the economy and gets done. But that’s okay because some of these are long-term investments. So for instance, getting lead pipes out of the ground across the country will surely have a huge payoff. We know that lead in the water really hurts kids, their development, their ability to earn a living, and all those things, so that over time we’ll be better off. That’s going to take a while. Getting a network of electric vehicle charging stations is a prerequisite to getting people to buy electric vehicles. Or getting broadband to communities who don’t have it, which we know is now essential, we learned that during the pandemic. All of those things will take time. So, it is a good investment in our future that will pay off. But I don’t think we’ll have seen many of the benefits a year from now.

DEWS: So kind of related to that question, since it’s such a massive piece of federal legislation. You wrote a book published last year, “Only the Rich Can Play,” in which you told the story of an overlooked at the time provision of the 2017 Tax Cuts and Jobs Act that was meant to address left behind communities. But it’s turned out to be a tax haven for wealthy people. Is there anything like that in the infrastructure law?

WESSEL: The short answer is, I’m sure there is. And the long answer is, but I don’t know what it is. One of the things that is a problem is when we do these huge pieces of legislation which
go through very quickly, there’s all sorts of things that get stuck in. They don’t like, put a little red flag on it and say, Look at me. Sometimes the language is so abstruse that unless you know what they’re talking about, you don’t realize it’s a special tax break. I don’t know that there is a lot there because the real mischief tends to be done on the tax side, and there isn’t a lot of tax stuff in the infrastructure bill. But, in the Build Back Better bill, if it ever gets through, will definitely be a big issue to look for those things. And I hope the reporters are on the case.

DEWS: I’m sure you’ll be on the case there as well. And if listeners are more curious, they can go listen to an episode of Brookings Cafeteria from October in which I rebroadcasted an event in which you and others talked about your book, “Only the Rich Can Play.”

So, David, everyone talks about inflation, and I know it’s a massively important issue. But what are some of the other economic issues that Americans should be paying attention to, but aren’t?

WESSEL: Well, I think some people are. Look, there are a couple of things, big economic challenges, that we’re only now struggling to cope with. One is the widening of inequality in our society across almost every dimension. The gaps between places that are prosperous and places that aren’t. There’s an interesting economic paper which showed that mortality among middle aged people is higher in places that have lower incomes. And so the gap in mortality, if you look across American counties, is growing along with the widening of the difference between incomes in the best off and worst off counties. The difference between the earnings of people who go to college and don’t. The lack of intergenerational mobility, the number of kids who are born to poor families that seem to be trapped in poverty. People are worrying about them. And that’s the problem is it’s getting worse. The pandemic may have exacerbated some aspects of that, but it’s also opened the door for government programs like the child tax credit or other things that might help ameliorate them. So that’s one.

And the second one, which again, people need to pay more attention to and a lot of people are, is climate change. We’re not good at doing long-term fixes, things that we have to do now that
might be a little painful that will pay off in the future. And so I think that I think it’s getting more attention in part because we’ve had such extreme weather events, and the Democrats are willing to talk about climate change a lot. So I think that’s another one that over the next several years, we’re either going to come to terms with this or not, but it’ll be huge consequences if we don’t.

DEWS: Well, last question now, and it’s the question I’ve asked at the end of this format episode before. If you could implement any one economic policy idea right now for this year, what would it be?

WESSEL: So, to pick up on my answer to your last question, Fred, I would say a carbon tax. We need to do something to address climate change. It’s going to be hard, un-impossible, to do it with lots of little fixes trying to regulate here, subsidized there. Like many economists, I agree that one way to make the market work for us is to put a tax on carbon so that then consumers and businesses and governments have an incentive to go to cleaner technologies so we can head off catastrophic climate change. But if you ask me the odds of that happening this year, I’d say there, if you can go below zero, that’s where I put them.

DEWS: Well, I guess we’ll have to leave it there then. David, thanks as always for sharing with us your time and expertise on the Brookings Cafeteria.

WESSEL: You’re welcome, always a pleasure to talk to you, Fred.

DEWS: You can learn more about David Wessel, his research, and the Hutchins Center on our website, Brookings Dot Edu.

A team of amazing colleagues makes the Brookings Cafeteria possible. My thanks to audio engineer Gaston Reboredo; our audio intern this semester, Skylar Sutton; Bill Finan, director of the Brookings Institution Press, who does the book interviews; to my communications colleagues Adrianna Pita, Chris McKenna, Chris Peters, and Colin Cruickshank for their collaboration. And finally, to Ian McAllister, Soren Messner-Zidell and Andrea Risotto for their guidance and support.

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Until next time, I’m Fred Dews.