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Jared Bernstein
Chair, Council of Economic Advisers

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Moderator: Mark Zandi
Chief Economist, Moody's Analytics

Introduction

President Barbara Van Allen

Good afternoon and welcome to the 757th meeting of The Economic Club of New York. I'm Barbara Van Allen, President and CEO of the Club. Recognized as the premier nonpartisan forum in the nation for the discussion of economic, social, and political issues, the Club is actually celebrating now our, I guess, 117th birthday, so we've been around a long time. And we've been lucky enough to host over 1,000 prominent speakers over the course of those many years with a, I think, great tradition of excellence which, of course, continues up to today.

I'd like to extend a warm welcome to students joining us virtually from Fordham University, the NYU Stern School of Business, Yeshiva University's Sy Syms School of Business. And also in addition to those online, we have some in the room as well from our largest-ever Class of Fellows, the ECNY Fellows Class of 2024. It's a select group of diverse, rising, next-gen business thought leaders. Actually there are over 80. And we also have a large number now of non-resident fellows who participate virtually.

It's an honor for me to be able to welcome our honored guest Jared Bernstein. Jared serves as the Chair of the Council of Economic Advisers. Previously he served as Chief Economist to then-Vice President Biden in the Obama-Biden Administration before joining the Center on Budget and Policy Priorities, where he served as a senior fellow from 2011 to 2021.

A former social worker, Jared has a long track record of devising economic policies to expand opportunity for working Americans. Jared previously served as Executive Director of the White House Task Force on the Middle Class and as an Economic Adviser to President Obama. Prior to his service in the Obama-Biden Administration, he was a Senior Economist and Director of the Living Standards Program at the Economic Policy Institute and served as Deputy Chief Economist at the U.S. Department of Labor under President Clinton.

Jared received his bachelor's degree from the Manhattan School of Music, his Master of Social Work degree from Hunter College, and his Ph.D. in social welfare from Columbia University.

The format today will begin with opening remarks and that will be followed by a conversation with Mark Zandi. Mark is the Chief Economist at Moody's Analytics, and we're honored to have him again as moderator. They'll take audience questions from those in the room, and we're going to end closer, as I just mentioned, at 1:10 p.m. As a reminder, this conversation is on the record as we do have media on the line and in the room. Without further ado, please join me in welcoming Jared to the stage.

Opening Remarks by Jared Bernstein

Tell me if I have any salad in my teeth. (Laughter) Thank you, Barbara, for that really nice introduction. It is a privilege to be here. I want to thank Molly Opinsky who helped me get here and helps me get to where I need to be. And Mark, it's great to have you here. Mark is a good, old friend of mine from, he's from Philadelphia. And it's nice to be here in New York with the Knicks kicking the 76ers butts. I'll be reminding you of that a few times during our meeting today.

I wanted to take advantage of the privilege of speaking at The Economic Club of New York to pull back a bit – don't worry, not too far – from the daily obsession that many of us share with the everyday data flow. In my conversation with Mark, I'll be sure to share with you CEA's, Council of Economic Advisers' and the administration's near-term economic outlook. But my hope is that you might find it interesting to hear how we in the Biden administration think about some of the big contemporary questions in political economy.

Questions like: What is the role of government in a market economy and how has that role evolved? Economists agree that market failures occur, and when they do there's a role for government intervention. But what defines a market failure? One perspective on the uptick of current economic policy interventions is that some governments, including our own, are diagnosing more market failures. And if that's true, why? Is there evidence in support of the prescriptions we've put forth to address these failures?

I expect you've heard President Biden inveigh against so-called trickle-down economics in favor of what he calls middle-out, bottom-up economics. This framing introduces the idea of not just market failure, but policy failure, invoking the need to replace a misguided economic policy of the past with a better one, where better in this case means better micro and macro-outcomes – stronger, steadier growth that is more broadly shared.

Our work to accelerate the spotting and correcting of market and policy failures raises some eyebrows, to be sure. A recent *New York Times* article quoted a Deputy Chief Economist from the World Bank critiquing the pursuit of industrial policies by stating "There are different ways of shooting yourself in the foot. This is one way of doing it."

In a recent speech, Managing Director Georgieva of the IMF argued for caution in this space warning that "Some of the measures announced or implemented last year were not always clearly related to market failures." Given the risk of political capture of economic policies, it is a warning to be heeded. Greg Ip of the *Wall Street Journal* recently wondered, I think reasonably, what's the limiting principle of industrial policy, meaning how and where do policymakers draw the lines between public and private activity?

It is thus important to keep the bar high for intervening in market outcomes, but the examples I'm going to share with you handily clear it. In fact, many interventions, especially those in the competition space correct policy failures that unleash more market forces, like recent action on non-compete clauses in labor contracts or measures to offset unfair trade practices, which – as the economist, Michael Pettis, recently pointed out – unleash comparative advantages that were otherwise diminished by manipulated trade and capital flows.

Let's start by reflecting on policymakers' response to the pandemic-induced recession. Of course, when GDP craters and unemployment spikes as was the case in the pandemic-induced recession, we've known, since at least Keynes that there's a role for countercyclical, fiscal, and monetary intervention. What's notable here is that policymakers throughout the advanced economies enacted fast and generally effective policies to offset the shock. The policies took different shapes. EU governments did more to keep workers connected to their jobs. We did some of that but mostly expanded unemployment insurance benefits to the literally tens of millions who were laid off. We also hugely ramped up vaccine distribution of course.

Now, I have a set of figures there, and I'll take you through them as relevant. But as the first figure shows, V-shaped recoveries ensued across the G7. This is real GDP indexed to whatever it's indexed to. And as you see, the U.S. was leading the pack indexed to 100 in Q4. And as you see, V-shape recoveries ensued with the U.S. quite clearly leading the pack.

But let me show you two slides that get more at the uniqueness of the U.S. response, and that's the next page. The first slide on the next page shows how elevated unemployment insurance support, how elevated the unemployment insurance or UI support was relative to our own history, and it shows how these benefits coincided with a very quick return to full employment. And if you follow the dots on the scatter plot on the left from 2020 to 2021 to 2022, you see how quickly unemployment goes from 9% on the X axis all the way down to 4%. It's been below 4% for the last two years. And, of course, the magnitude of benefits on the Y axis is a big outlier.

Now some will reasonably look at that UI slide and shout inflation. And I've long held that the combination of strong demand and constrained supply amplified by the pandemic-induced shift in consumer preferences from services to goods led to inflationary pressures. But the slide on the right, which I suggest maybe you haven't seen before, shows that cumulative inflation was actually quite consistent across the G7 economies. Cumulative inflation, which is on the Y axis is about, you can draw a straight line through a bunch of those countries and, all of which employ different fiscal policies of differing magnitudes.

Where the U.S. is an outlier and it's quite a dramatic outlier is in real GDP growth, the X axis. We had similar inflationary outcomes of other G7 economies but have enjoyed uniquely positive growth. Of course, some of these other countries have been a lot more exposed to the war in Ukraine than we have.

Now these figures tell a cyclical story, but the absence of full employment has, for the last 40 years, been a structural shortfall as shown in the next figure. So if you turn to the page and look at the figure on the left, it shows that over the first half of post-war history, the U.S. labor market spent 64% of its quarters, almost two-thirds of the time with the unemployment rate below the CBO's estimate of the natural rate. And that means, you know, 64% of the time it was at or below full employment. Labor markets were uniformly tight in those years.

But over the second half of the period, starting in 1980, the United States achieved full employment in less than 40% of the quarters, a potent challenge to the assumption that labor markets naturally settle into full employment conditions. Now, for my many years of working with President Biden, I can tell you that he is acutely aware of the importance of full employment. And the fact that I focused on this market, I'd say market/policy failure, over much of my career is one reason he and I click.

The first chapter of the latest Economic Report of the President that the CEA recently published goes into great detail on the benefits of full employment, particularly distributional benefits, who benefits and how much they do, and the cost of persistent slack, which I'm happy to amplify during the Q&A or discussion with Mark. But as a teaser, I included one slide, and it's the slide on the right on that same page with the full employment tracker there on the left. That slide on the right shows the powerful impact of tight labor markets on racial unemployment gaps. Most recently, racial unemployment gaps, Black minus White unemployment, hit their lowest levels on record. And you see a cyclical dynamic in that figure.

Extended periods of tight labor market can also lead to reverse hysteresis or improvements in the economy's supply side. For example, by pulling more workers into the labor market who might otherwise be left behind or by improving other supply side fundamentals, including even productivity. The theory, which has some, but not a lot of evidence, is that when full employment labor markets boost labor costs, less efficient firms are forced to discover new efficiencies to maintain their unit labor costs and thereby their profit margins. It's sound logical, and I hope it's true. But the broader punch line here is that labor markets do not necessarily settle into full employment and the absence of these conditions is starkly counter to our worker-centered agenda.

Let me turn to another obvious market failure, and that is inadequate investment to mitigate climate change, which has served as a motivator for our industrial policy as market forces alone have not yielded sufficient progress on shifting our economy from a fossil fuel-based energy system to one based on cleaner sources of energy. For relatively proven technologies such as solar, IRA-style production tax credits can lower the cost of adoption. Such support is not about picking winners, but rather about sending lasting demand signals that allow private industry to make clean investments.

A key principle that CEA has elevated in this context, one that speaks to Greg Ip's question that I mentioned earlier about limiting principles of industrial policy, is that once these technologies achieve cost parity and become cost-competitive with existing energy sources, government intervention can dial back. The costs of inaction are already present. Last year saw 28, a record 28 weather and climate-related disasters in the U.S. causing losses of over $1 billion per event, and the probability of lasting damages to human health, food insecurity, social instability rises if we fail to meet our climate targets.

But there's also enormous upside to this transition. By targeting clean energy resources, our economy could unlock lower energy prices, greater energy security, create new industrial sectors centered around innovation and production of new energy technologies. With an upbeat investment tempo that has surprised many of us, targeted support for clean energy technology is clearly pulling in significant private investment.

Since President Biden took office, private firms have announced more than $500 billion in new manufacturing facilities in the United States, including in solar, wind, batteries, and electric vehicles.

Now let's turn to trade policy, where the intellectual evolution among some economists has been, I think, particularly nuanced. Summarizing broadly, trade and political economists have historically viewed expanded trade flows and their corresponding capital flows as unequivocally positive, as they lowered consumer costs, expanded the economy's supply side, extended the reach and depth of financial markets. And, if you listen to the rhetoric around 2000, prior to China's accession to the WTO, even inculcated democratic values.

Now there's solid evidence for some of these claims, but they overlook distortions that I learned about back at the Economic Policy Institute in the early 1990s, when we were perennial skunks at garden parties warning about what came to be called the China Shock. While recognizing the benefits of expanded trade, we also saw the sum of our trading partners – most notably China – had persistent surpluses that stemmed from management of both currency values and their consumer spending share of GDP, a key variable that has long been suppressed.

Anyone willing to look at these dynamics quickly saw that the old textbook, identitybased explanation for trade deficits – profligate countries under-saving relative to their production and consumption – was insufficient to understand what was happening to global trade. We now know that if a trading partner suppresses their own internal consumption, then exports their excess savings and excess capacity our way, such unchecked flows can wreak havoc ranging from financial bubbles – see Ben Bernanke's global savings glut work circa 2005 – to the hollowing out of high-value-added jobs in communities exposed to these forces.

Ignoring warnings back then has turned out to be costly to Americans. Communities lost crucial enduring businesses, I'm sorry, communities lost crucial anchoring businesses, often in manufacturing. When they complained about the impact of globalization, they were met with woefully insufficient offsets, and perhaps even worse, a promise from political and policy elites that the next trade agreement was going to work out much better for them than the last one had. We're still very much in the throes of the economic and political fallout from those days.

In the context of my comments today, we know that trade generates both positive and negative externalities, invoking a role for government to boost the former and dampen the latter. We at CEA have worked hard to elevate this both/and perspective, balancing both trade's benefits and costs when considering policy.

Most recently, you see these dynamics in play in discussions that Secretary Yellen, Treasury Secretary Yellen had with her Chinese counterparties during her recent visit. Based on the industrial policy rationale described above, the risk that China could manufacture and export excess capacity of heavily subsidized goods into sectors like EVs and clean energy upending our domestic investment plans must be viewed as a risk of China Shock Part 2.

Yes, people are consumers who benefit from positive terms of trade. And domestic businesses benefit and grow more quickly than they would otherwise, due to a deeper supply of intermediate inputs. There's even evidence that more trade boosts the productivity of domestic firms who face broader competition. These are all benefits of trade that we will continue to pursue. But people aren't only consumers. They're also workers who seek not just incomes but dignity from their jobs. I like to think that economists have moved beyond the simplistic assumption that all you needed to know about trade flows is that they lower costs.

Finally, and partly in honor of Mark, I will discuss a market failure that looms particularly large in both the Biden administration and in the public's thinking right now – the long-term shortfall in affordable housing. It is a shortage that evolved over the last two decades. And by tracking the extent to which supply has failed to keep up with household formation, we estimate its magnitude to be north of 2 million. As a result, the figure on the last page, the figure on the left on the last page shows that 45% of renters are now cost-burdened, meaning that they spend 30% or more of their family income on rent, more than twice the share who were cost-burdened in 1960.

As you see, this problem has been growing for a while now, but more recently it has been exacerbated by a lock-in problem, a cause of which is seen in the figure on the right. This one shows the effective mortgage rate – the average of outstanding mortgages – against the rate of a new mortgage. That spread at the end of the figure, which I think we circled, is at a 40-year high, and it means people who'd like to move are locked in to their lower mortgage. That dynamic, in turn, is significantly reducing housing market churn and making the first rung of the ladder unreachable for too many families.

Part of this market failure stems from the fact that housing markets are partially regulated by local governments that understandably consider the preferences of resident home owners and developers, both of whom prefer higher land values. And it's true that land use in zoning can be a reasonable part of community planning, separating industrial areas from schools and residential areas for example. But they can also reflect historical racial exclusion and they can lead to overly tight restrictions on where and how we can build housing. In that sense, they've surely contributed to the supply shortfall.

Now, Mark and our friend and housing expert, Jim Parrott, often reflect on scarce land as part of the "pencil out problem," a related market failure in this space. The problem is that given the costs they face, too often it doesn't make economic sense for housing developers to build affordable housing. In response, we've developed ambitious plans, which we believe would support the creation of two million units of affordable housing. Part of the plan is direct subsidization of affordable unit construction through programs like the low-income housing tax credit, or LIHTC, and the HOMES renovation project. LIHTC has funded 20% of all new multi-family units since the late 1980s creating more than 3.5 million affordable units. It has the unique advantage of being favored by builders, bankers, and low-income housing advocates, making it a strong candidate for bipartisan support.

We also propose a new Neighborhood Homes Tax Credit to support building or renovating affordable homes. This credit hits the "pencil out" problem by covering the gap between the cost of construction and the sale price. To try to nudge open some zoning restrictions, we offer bidders a higher ranking on infrastructure and other supports if their application includes a plan to push back on exclusionary land use. And we're continuing to look for ways to advance the production and the preservation of accessory dwelling units and manufactured homes.

I can tell you with 100% confidence that President Biden considers building more affordable housing one of the most important pieces of unfinished business in our economic agenda and one we won't stop fighting for until we close that gap between household formation and available affordable housing.

I hope I've given you a sense of the worker, family, and community-centered lens through which we view market and policy failures and the role of government in addressing them. Thus far, the track record looks positive in terms of hitting and staying at full employment, helping to stand up critical, domestic industries to fight climate change and ensure more resilient supply chains, pushing back on the exporting of excess capacity to some of those key industries, and deriving a robust agenda to increase the supply of affordable housing.

Our work is far from done. No victory laps here. And there's more unfinished business besides the housing shortage, including an equally important shortage of affordable childcare. But, as I've explained and as I've emphasized, in many of the areas in which we're intervening, we see welcome evidence of middle-out, bottom-up growth on behalf of working Americans. With that, let me turn to Mark for our chat and then I look forward to your questions.

Conversation with Jared Bernstein

MARK ZANDI: Well, it's good to be with you, Jared, great speech. I want to thank The Economic Club of New York and Barbara for the opportunity to be here. I'm a little surprised you invited me back after Lael Brainard, but thank you. I want to do three things...

JARED BERNSTEIN: First of all, you should listen to the guy with the tie.

MARK ZANDI: I was looking around to see if I was alone. I'm not alone...I want to do three things in our conversation. We've got about 20, 25 minutes, and then we'll turn it back to the group. First, I want to talk about your speech, a few questions about that. Then I want to quickly turn to current economic conditions and the outlook, because there's obviously a lot of things top of mind there. And then maybe we can venture into the election a little bit and talk about economic policy. We'll see how that goes.

JARED BERNSTEIN: Certainly I can talk about economic policy.

MARK ZANDI: Okay, very good. On the speech, industrial policy, kind of a dirty word, or at least it has been a dirty word. It's been applied to the policies that the administration has passed. And, you know, clearly a very fulsome legislative agenda from the American Recovery Act to the infrastructure legislation, CHIPS, IRA, a lot of stuff.

JARED BERNSTEIN: You mean, ARP, the Rescue Plan.

MARK ZANDI: The Rescue Plan...sorry, the Rescue Plan. Yes, I'm going all the way back to 2008, the Rescue Plan. Do you consider the words "industrial policy" as a criticism or...

JARED BERNSTEIN: Not at all. Not at all. I mean sometimes we call it industrial strategy to get away from that, but I think they're synonyms. No, not at all. And, in fact, the insight that I would like to share with you, and the reason why I think that, is that I believe we've been – and I think I have great evidence – that we've been doing industrial policy since this was a country. Obviously, anyone who has looked back at the early days of this country knows the famous, before he was rap artist, Hamilton's annual survey of manufacturers, which is a very intentional industrial policy, and I think there's a fair argument that that, you know, embryonic industry policy is different than a more mature economy.

But I think more to the point, the thing that always got under my skin is that industrial policy in this country or favoring some sectors over the others has been an integral part of our tax code ever since we've had a tax code. And the way that industrial policy played out or was derived was whoever had the best-connected lobbyist got the best industrial policy, or the most goodies out of the tax code. And that is a, not a thoughtful type of industrial policy, and I think it's given rise to some pretty significant distortions in sectoral imbalances in our economy.

So we've always had industrial policy. We always will. Every country does. I think the difference is not whether you have it or not, it's whether it's thoughtful or not. And, you know, the rationales which I gave in my talk, which you can agree with or disagree with, was an effort to show how we think about that.

MARK ZANDI: Yes, I mean I think about your policy, the policies that have been passed in the administration. I don't think of them as industrial policies. Like the Recovery Act and the Infrastructure, I just view that as straight-up fiscal policy. You know, the economy is in trouble. You may debate the size of the plan, the elements of the plan, but the economy was obviously still struggling because of the pandemic, trying to get out. The Infrastructure, that's straight-up fiscal policy. I mean that's what the federal government is all about, helping with that.

The CHIPS Act, and the IRA, I tend to think of them as national, there's industrial policy aspects to it, but it's also national security. You know, for example, the CHIPS Act, that's about bringing semiconductor, there's a lot of things in there but a big part of that is bringing semiconductor production back into the United States. And we can see a need for that in the context of the pandemic, our exposure to Taiwan, because all the chips are produced in Taiwan. Obviously in the context of the tensions with China and the impact that has on the ability of Taiwan to produce those chips and get them to the rest of the world.

And IRA, the same deal, it's climate change, yes. But it's also getting off of oil and reducing our exposure to – because it's a global market and prices are set globally – to other producers like Saudi Arabia. So I'm surprised that I haven't heard that kind of perspective, so I'm trying to explain the logic behind that.

JARED BERNSTEIN: Sure. Let me speak to that. So, the intersection in the Venn diagram between industrial policy and national security is there. It's a notable intersection. But I think, you know, let's not get, I want to try to avoid getting too hung up on rhetoric. So it seems unquestionably true that when you write a check for extended unemployment insurance benefits, that's countercyclical policy, not industrial policy. But there are parts of the American Rescue Plan, there are parts of the Rescue Plan that very much favored the purchasing of, say, clean energy, you know, heat pumps, and a program to make it less expensive, temporarily, so cyclical, countercyclical, make it less expensive for you to put solar panels on your roof. So people who do that have jobs in a downturn. So there's even an intersection there.

I kind of take your point on the bipartisan infrastructure law, that's public goods. But a big chunk of the public infrastructure law is to build charging stations across the nation. Well, you can't really have an effective EV sector and address range anxiety without that. So that seems, again, an intersection. But I think more, what you're pointing out are intersections.

Now when you talk about CHIPS and IRA, here we're talking about direct tax subsidies that aim to stand up, a much bigger presence in a particular industry. And that's typically, I think, a pretty good definition of industrial policy. I think, you know, rather than, to me anyway, and we may see this differently, you know, the question is, it's not so much, is that industrial strategy or policy? But is it wise? Are you picking winners in a way that has problematic outcomes? And again, the speech was designed to address that potential critique.

MARK ZANDI: Got it. Let's turn to one aspect of the market failures you described, and that's housing. That's, for me, kind of an area where I focus. You mentioned Jim, Jim Parrott, who has done a lot of work in this area. You call out, I think appropriately, policies that are focused on increasing supply. Obviously we've got a shortage. Prices are high. Rents are high. We need more supply. LIHTC, Low-Income Housing Tax Credit, the Neighborhood Homes Tax Credit, HOMES, which is block grants to state and local governments, that kind of thing.

But at the end of the day, it feels like – and correct me if you feel differently – it feels like at the end of the day the real issue here is local government, state and local, mostly local government. They're setting zoning and permitting rules that make it very difficult to build, particularly high density, in places where the housing is needed. That's a tough one, right? I mean how do you address that?

JARED BERNSTEIN: It is a tough one. First of all, let me just say that a lot of what I learned about this, I learned from you and Jim.

MARK ZANDI: It's all wrong.

JARED BERNSTEIN: Well, if I'm wrong, then you're wrong. And the contribution you two have made to this sector is really notable, really important, and frankly, inspiring. So I mentioned, I blew by this in the speech and I was trying to keep timing manageable, but one of the things that we've been doing, which is small, but I'm kind of in the camp where anything at the margin helps. If you can do something that helps at the margin, you should do it, and then you can try to maybe build on those margins. And this is an example of that.

So what do we do in government? I mean, one of the things we do is we deal with support projects, Bipartisan Infrastructure Law, with grants, with loans. What if we made a connection to some of the projects that we're supporting? Well, a lot of people bid for them. We can't always reward every bid. How about if we give you a higher score in your bid, a better chance of getting your bid if you're doing something to push back on exclusionary zoning? I mean somebody offered this up at a meeting we had in the White House, and I was like, ding ding ding. Like that really made sense to me. And so we're starting to do that.

And one example, and I think I have maybe ten examples now, which is tiny, but that's a start. One example is, I think it was a train station, a transportation depot in, I believe it was in Minneapolis, where they got their bid, in part by saying, well, we're going to build affordable housing near this train station. Even though it's not zoned for that, we're going to push through that. And I actually think, we have a long list in the chapter on this in the Economic Report of the President of localities that are trying to do precisely what you said in terms of pushing back on land use restrictions.

I live in Alexandria. We just had a vote about this to allow plots for single-family homes to have at least duplexes. It passed, which I was pleasantly surprised by. I actually think that's going to end up being sort of a higher end part of the market, but it's a move in the right direction. So I think that the fact that this redounds to the local sector is, and New York State just passed a budget with, I think, some ambitious plans in terms of creating more affordable housing. So I think that that's, you know, part of the answer is localities doing more, and I see some of that happening. I actually feel a little bit upbeat about it.

But I wouldn't discount, and I know you wouldn't either, the federal government's role. I mean LIHTC, I gave you the numbers in the talk, 3.5 million affordable units, and builders like it, banks like it because they buy the credits from the builders, and it lowers their tax liability. And low-income housing advocates like it. So there's bipartisan support for LIHTC. I mean people may not know this, but you know that tax bill that passed the House, this House, this tax bill passed the House. This was for, on one side it was tax credits for research and development, business tax credits. On the other side, it was a child tax credit, which is very important to us. It also had 2,000 units of LIHTC in it. Now, it got stuck in the Senate. But that got out of the House with LIHTC in it.

MARK ZANDI: Okay, let's turn to the economy's performance and the near-term outlook. And, by the way, really cool charts. Really good charts. I'm a connoisseur of charts and they're pretty cool. I do like that scatter plot with the countries and inflation.

JARED BERNSTEIN: Isn't that something?

MARK ZANDI: That's pretty eye-opening.

JARED BERNSTEIN: That's an Ernie Tedeschi chart for the record.

MARK ZANDI: Yes, he's good at charts. Okay, I'm not going to let you off the hook here. I'm going to ask about inflation. Before we do that, let me butter you up a little bit and let's talk about what's gone right, and that's the job market. I mean it's like, I mean I've been at this for 35, 40 years...So what's going on, other than policy? I mean policy, you can take credit, but what's going in the labor market do you think that...

JARED BERNSTEIN: So let's talk about both because we've got to talk about inflation, and I do not shy from that one bit. So, let's first talk about what you alluded to, and I'm going to bring inflation into this. So I think this is one of the more remarkable periods of macroeconomics that I've lived through, which is that we have had, you know, depending on the measure that you look at, 5½, 6 points of disinflation.

Take the CPI, it peaked at 9.1%, last seen at 3.5%. All that disinflation has occurred while giving up almost nothing on the unemployment rate. There's been some cooling in the labor market and vacancies, but basically this idea of a sacrifice ratio, which is a very solid concept in macroeconomics that says you can't have that, you can't get the disinflation you need in a situation like this without giving up major points on the demand side or higher unemployment. And, in fact, the sacrifice ratio quantitatively is the number of points of unemployment you have to give up to get lower inflation. That ratio has been about zero. So, the first point is, yes, it's been pretty remarkable.

Now, I actually think there's a hint in that scatter plot to answer your question of what's happening. I take a close shave with Occam's razor on this one. The U.S. is a 70% consumer spending economy. Europe is 55%. China is 40, 45%. And, you know, I talked a little bit about consumption suppression. The fact is that when the American consumer is economically healthy, either because she has fiscal and monetary support, or as the excess savings from that period, which you've documented, burned off, the labor market came up behind. We've now had real earnings gains, that is wage growth beating price growth for 13 months in a row, year over year for middle-wage workers. That's been a bit of a baton handoff from savings to earnings. Strong job growth in tandem with real wage gains and a 70% consumer economy equals a steady, stable growth trend. So I think that's, you know, at first blush, a pretty straightforward explanation.

MARK ZANDI: Okay, now the blemish – inflation. So core consumer expenditure deflator inflation, which is the measure the Fed target is traveling just south of 3%. Of course, the target is 2%. And like last year we were making a lot of progress here, with that inflation number coming in very gracefully. It hit, early 2024, first quarter, not so much. In fact, it backed up. I think annualized core PCE was up 3.7% annualized. That's not good.

And, of course, it's created a lot of changes in expectations around the conduct of monetary policy, interest rates, that kind of thing, and what's going on in financial markets. So the key, kind of critical question here is what's going on? You know, why is inflation kind of stalling? Did disinflation kind of stall out here? And how do you feel about things going forward here with regard to inflation?

JARED BERNSTEIN: I think the disinflation in the second half of '23 is largely explained by unsnarling of supply chains, improvement in that part of the economy that delivered that inflation in the first place, as I've mentioned. Demand was strong, in part with fiscal and monetary support, but it was the collision of demand and constrained supply, particularly as consumer preferences shifted towards manufacturing goods. So we have some normalization of forces that were very much associated with the pandemic that got us a lot of disinflation. The goods share is still elevated. The goods share of consumer spending is still somewhat elevated relative to pre-pandemic, but it's been coming down.

And most importantly, the indexes of supply chains, the New York Fed tracks one, are back down to where they were pre-pandemic. We found in work that we did at CEA that 80+% of the disinflation through the fourth quarter of last year was due to either supply on its own or supply interacted with demand. So that explains the lion's share of what we had. That leaves us with the question of what happened in Q1 where disinflation decelerated. We have less disinflation in Q1 than we had in the second half. To me, it looks like a, this question is still unanswered, and, you know, the Fed is scratching its head, so we're still scratching ours. You might even be scratching yours. And, you know, it looks to us like a combination of top-down and bottom-up.

I think the punch line, and I said this in an article in the *Times* yesterday about this. And interestingly Goldman Sachs has been doing a very nice job of tracking this at a very granular level. They said the same thing in a report from yesterday, a paper by David Mericle who is one of their chief economists there, that the forces that were driving the disinflation, this normalizing of things that drove up inflation in the first place, looked to us like they're still in play. They haven't gone away. They've been temporarily suppressed in Q1 in part due to, as I said, I think a pretty strong economy from the top down, which you and I just talked about, and a set of anomalist components from the bottom up.

Starting with those, I mean the classic example is auto insurance in the CPI went up 22% year over year. That's not going to stick. I feel quite confident. Medical services, there's a technical thing that we wrote a blog about if you want to see it. You know, CEA does have a blog. How many people here have read the CEA blog?

MARK ZANDI: It's quite good.

JARED BERNSTEIN: One. Molly...oh, is that you who answered...okay. So please read the CEA blog. We have a piece on the medical services contribution to the CPI. It doesn't have much to do with actual out-of-pocket spending. So at any rate, you know, housing, housing we all think, and I defer to you on this, if you disagree with this, tell me so and I'll change my view. I think we all think that the shelter component of CPI is going to roll over as market rents have rolled over at least in terms of the rate of inflation. So we think that those will come back to life.

The top-down part is, you know, look, we need to see – demand has cooled. We've seen cooling demand in the labor market. It remains very strong, but the vacancies have come down and that's very clear, especially if you look at the vacancy data. The vacancies have come down so we've seen some cooling there. And most importantly, nominal wage growth has decelerated. Nominal wage growth has kind of slowed down and that should help in that regard as well.

So as long as the top-down continues to gradually cool, the bottom-up, the sort of anomalist categories kind of go back to where they were with regression to the mean that I think will occur, then I think we should get back to something like we were seeing in the second half of last year.

MARK ZANDI: Okay, so no hair on fire here. Just hold on, it's coming. We'll continue to see disinflation here. Okay. You know, when I talk to a lot of different groups around the country, the one thing that often comes up is deficits and debt. The argument is that it's the high deficits and debt that's powering the economy's growth, that it has nothing to do with anything else other than that.

JARED BERNSTEIN: Yes, I don't think that's, I think that's quite easily disproved. And the best way to do that is to look at fiscal impulse. So fiscal impulse is this economic concept that answers that question. It's how much fiscal policy is contributing to GDP growth. And it's easily, most easily understood. It's not the level of your deficit but the change in your deficit, actually your primary deficit, so your deficit after you take out the interest rate payments, which don't really play that much of a role here.

And so the Brookings Institute, the Hutchins Center at the Brookings Institute keeps a very nice up-to-date quarter-by-quarter series of fiscal impulse. It was through the roof during the pandemic recession with lots of support from fiscal policy, as we've talked about. And it went very negative after that, and that's often the pattern when you see counter-cyclical responses. The fiscal impulse goes way up and then it reverses. And now it's neutral.

Now, I guess you could argue that, well, neutral is too much, it should be negative. But I think that at least as long as fiscal impulse is neutral – we've looked at this very carefully – it's just not contributing very much to GDP growth right now.

MARK ZANDI: Okay, okay, very good. That's the same answer I give, by the way. That Brookings, they have a nice chart that shows quarter by, and then break it down federal, state, and local. Okay, one last question and then I'm going to turn it to the audience, to the group. Here I might get a little too close to the sun, but you can tell me if I'm getting too close to the sun.

And this is about economic policy on the other side of the election. And I bring this up in the context of an article in the *Wall Street Journal* last week around Fed independence. I don't know, I'm sure most of you read it. I nearly choked when I read it. There's some conversations about how to, in my words, reign in, capture the Federal Reserve. So I don't know how you want to handle that or how you want to talk about that, but what do you think?

JARED BERNSTEIN: Well, here's what I can say. If you think about a policy agenda that's focused on mass deportation, on devaluing the dollar, and on taking tariffs up to sky-high rates, most economists, and I bet you almost everybody in this room would say that sounds like an inflationary agenda. But if you have the Federal Reserve in the background, at least you know there's a potential institutional offset to that inflationary agenda. If you then cut the knees out from the Federal Reserve, I think that is a very scary proposition. So that's what I'll say about that.

MARK ZANDI: Okay, very good. Excellent. Okay, let me turn it back to the group, to the audience. I think, Fred, you wanted to ask a question.

JARED BERNSTEIN: And there was somebody who, during the reception wanted to ask a question about fiscal debt, so I said we'd get to that person. But first, Fred.

QUESTION: How do we balance sort of jobs and employment and worker-centered and consumers when we're trying to come up with economic policy? Because there's, you know, on both sides there are people who feel we should do more for labor. There are others who feel we've drifted too far from worrying about consumers. And so how are you threading that needle? And then if you add in national security, it becomes even more complicated.

JARED BERNSTEIN: You know, Fred, I think one of the problems we get into in economics, and I came up with the same training that you did, you know, back in the Stone Age – nothing personal – and is that we're taught like people, there's this consumer section and there's this worker section. They're the same people. Workers are consumers. Consumers are workers. Even if they live in a household where somebody doesn't necessarily do labor market production, they're doing, you know, home production.

So I think we get into trouble when we split apart workers and consumers and think that there's some sort of competitive policies there. As you've heard from my comments, and I hope you know from my work in this area, when you have a full employment labor market, a lot of those problems get solved. As I answered to Mark, especially when you have a high percentage consumer spending economy like we do – 70% of nominal GDP – having a strong labor market means having a strong consumer. Having strong countercyclical policy in downturns means having a strong consumer. Having a strong industrial policy that creates value-added jobs means having strong employment and strong consumers. So I can tell you that in the mind of President Biden, that is a false dichotomy.

I think where it has more relevance is in the trades space, which you've written about, and which I tried to speak to here. And there the idea is that we need to be mindful that people are both consumers and workers so that if something helps consumers and hurts workers, we probably shouldn't do it. But there's ways, and I've spoken extensively about this, if you want to go on the CEA website and see some of my speeches. I've given two speeches on this exact topic, this both/and trade policy. Ramping up the benefits to consumers from trade while maintaining a worker-centered policy framework.

MARK ZANDI: Who was the person who asked the question....

JARED BERNSTEIN: Well, I remember it if you don't. Somebody asked the question – I don't actually see him here. Oh, there you are. Okay go ahead.

QUESTION: Thank you for coming today. What is your view about the national debt, in particular the national debt at the current elevated interest levels, the interest payment on that debt? As a percentage of GDP, I'm told it'll eclipse all other line items except entitlements. What does that mean for our nation and future generations?

JARED BERNSTEIN: I think we have to be mindful that lines that just go straight up forever are unsustainable, and I think that's just common sense. I think about this very much in near-term and longer-term perspectives. I think over the near term – and again Louise Sheiner from Brookings did a very nice piece on this recently – I think over the near term, we can handily finance the debt that we have, even at higher interest rates. A good way to look at that is how are Treasury auctions going and look at bid-ask spreads. And I think we still, by dint of our unique economic position in the world, our reserve currency, we can still finance our debt.

In fact, one of the things we look at is the debt service, not debt to GDP, but debt service as a share of GDP. And that's well within historical realms. Historically, that's stayed between 1 and 2% and what's where it is now. So we can finance our current debt in ways that don't look economically stressful to me. But if we don't do something in the long term about the structural imbalance between receipts and outlays, we're going to have, I think, a lot of problems.

And that's why, you know, in our budget the President has $3 trillion in deficit reduction. And so it's not that simple, I mean this is...I mean it's not that complicated, this is arithmetic. And so we have quite significant revenue enhancements, higher taxes above $400,000. And one of the problems there is that we have some very wealthy people in this country who pay a very low effective tax rate. So President Biden calls this, you know, investing more fairness into the tax code. We fund the IRS so that they can close the literally hundreds of billions, $500 billion, $600 billion tax gap between what people owe and what they pay. So that's tax evasion. And that's very much concentrated at the top of the scale. So that helps close that gap. And that's our budget.

And then, of course, we cut costs. It's not just tax revenue. We cut costs, especially in healthcare. In fact, some of that you've seen – insulin costs, prescription drug costs. I mean that's a winner for both inflation and the budget. So I don't think it's that complicated. We have a plan to get there. We need Congress to work with us. Look, when one-half of Congress, or whatever the ratio is, says I will never, ever raise a tax, we can't get there from here. So there has to be compromise.

MARK ZANDI: How are we doing on time, Barbara?

PRESIDENT BARBARA VAN ALLEN: We have a few more minutes.

MARK ZANDI: A few more minutes. Good.

QUESTION: Jared, thank you for all, it's been great. We talked a long time ago, for a long time about the income inequality aspect of what you've been addressing, and I think a lot of your policies are going in the right direction on that. But another thing we've talked about in the past, and it follows on in a bunch of ways, but even on the deficit and stuff, is demographics, in that we have such a big decline in the working-age population as a percentage of our population. The primary way we tax people is through their earnings, if you look at all our measures of taxation. And at the same time, we have a global economy where every major economy has declining working-age populations. So how do we think about that?

There's a lot of aspects, but just on the part, I believe in your new budget you have some, you know, going after people of higher, paying more for their Social Security, etc. But once you've retired, you're not paying. And so how do we think about the burden, not just on rich versus poor, but old versus young of paying for the deficits that we've already run up before we got old? And one question on that just is that I think every other OECD country has a VAT or some form of consumption. And is there any thought about that as one of the ways that if I'm wealthy and retired, I will consume more? Is that one way to look at taxation?

JARED BERNSTEIN: I don't think I've ever gone to a tax meeting where the question of a VAT hasn't come up, so it's a well-understood alternative. Now, look, President Biden has been unequivocal and said this hundreds, if not thousands of times. He's not going to raise taxes on anybody under $400,000. That is a view that he has espoused since he was running for office, and it is a line he will not cross.

I think the budget gives you our answer to that question. It may not be as fulsome as your question suggested in terms of going into different areas and going into different parts of the income scale where, you know we're not going to go. But I think when you propose, you know, literally trillions of dollars of deficit reduction, and adding fairness into the tax code by going after high-end tax evaders. You know, for every dollar you fund the IRS, I think you claw back something like $10 or $12. And if you're against that, you're for tax evasion. I mean I know; I'm not saying that as a partisan, I'm saying that as a very simple statement of fact. I would actually call, you know, underfunding the IRS is a shadow tax cut for tax evaders. That's true. I'll argue that all day.

And so where we start is a good starting place. It may not be a finishing place, but it's a good starting place. And I think the idea would be to work with Congress, which Biden has consistently shown he can pull rabbits out of hats and achieve the deficit savings that we've written down in the budget.

PRESIDENT BARBARA VAN ALLEN: One last question.

QUESTION: Thank you for this thoughtful conversation. I wanted to see if you would, especially from two chart nerds, which was also very interesting, I wanted to ask if you would get a little bit more specific in your predictions for the rest of the calendar year as to the inflation rate, how quickly it may go down more, and interest rates. How and when and how often we might see interest rates coming down?

JARED BERNSTEIN: Well, one of the things that is unique about my position is that Mark can make a forecast and get it wrong and, you know, somebody might, I might bug him. But he's not going to get slammed all over the newspapers and every time he goes on TV, and say, you were wrong, you were wrong. Whereas that will happen to me.

So let me just say, and I don't want to be completely evasive, and in fact, I'll be forthcoming in the following sense. We have a forecast. It's public. You can go see it. So in the budget, maybe this isn't the forecast that people go and look at all the time because it's quite late relative to market forecasts. It's a little stale. But you can look at our budget and look at the economic assumptions. And CEA, working with Treasury and OMB, comes up with a ten-year forecast where we forecast inflation and interest rates, and you can go see what they say.

When it comes to the next year, I would just cite the market shops that I follow, and Mark's work, which I follow closely, and he's got as good a track record as anybody I think. And, you know, the idea is very consistent with what I said before about deflation, returning maybe not back at the same pace we saw in the second half of last year, but that the road back to the target should get underway in the remaining quarters of this year. And it will be, it will be bumpy and non-linear.

So I saw Goldman, for example, I think it was this morning or yesterday, was talking about core PCE. So this is not my forecast, this is theirs, talking about core PCE at the end of this year being, you know, well north of target, but between 2 and 3, maybe it was 2.5...

MARK ZANDI: 2.6.

JARED BERNSTEIN: 2.6, okay. And that by the end of '25, by the end of '25, being closer to target. I think they had 2.1. And so I follow them and I think they do a good job.

And you can look at them for prediction of cuts. So that's something I wouldn't say because that gets into a granular commentary on Fed policy that we don't do because, in reference to my earlier comment, we respect that independence.

MARK ZANDI: So the trick is to forecast often. That's the trick. Forecast often. And let me say, before I turn it back to Barbara, I had never heard this before, but this is a great phrase. Close shave with Occam's razor. That is so cool. That is so cool.

PRESIDENT BARBARA VAN ALLEN: Thank you both. That was terrific. And it was a real honor to have you here today, and it was fun too. So we do have many additional speakers ahead for the spring calendar. I'm going to zip through those really quickly because I know everybody's getting hungry that's here. And if you're virtual, you probably have other things you want to get to too.

On Thursday, May 2nd, we will host the Founder and President of HistoryMakers, Julieanna Richardson, for a webinar. We have Garry Kasparov for a luncheon on May 6th. We have Dr. Ed Yardeni for a webinar on May 21st. And our very own Chair, John Williams, the head of the New York Fed, will be speaking at a luncheon on May 30th.

We have Glenn Hubbard and Larry Summers joining us remotely June 4th, again, by popular demand. Strauss Zelnick, the Chair and CEO of Take-Two Interactive, the gaming company, will be here June 17th. And then Lisa Cook will come back to visit us again from the Federal Reserve on June 25th. As the presidential elections approach, we'll be inviting both the major party candidates after their conventions to also address the Club, separately of course. And there are some other great speakers that I'm not going to announce yet that we're in the middle of confirming. So keep track of our website please. We try to keep it current, so you can watch for those dates.

And as always, I'd like to take a minute to thank those of our 375 members of the Centennial Society joining us today for their contributions because they represent the financial backbone of the Club and make our programming possible. So thank you all for attending today. We look forward to seeing you again soon. And for those in the room, please enjoy your lunch. Those digital, we'll see you soon I hope. Thank you.