EconoFact Chats: The U.S. Economy - A Look Back, and a Look Ahead

Binyamin Appelbaum (New York Times), Scott Horsley (National Public Radio), Greg Ip (Wall Street Journal) and Heather Long (Washington Post)

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Michael Klein:

I'm Michael Klein, executive editor of EconoFact, account effect a non-partisan, web-based publication of the Fletcher School at Tufts University. At a EconoFact, we bring key facts and incisive analysis to the national debate on economic and social policies, publishing work from leading economists across the country. You can learn more about us and see our work at www.econofact.org.

Michael Klein:

It's now been about 11 months since the inauguration of President Joe Biden. During this time, we have seen some encouraging developments. On the economic front, employment seems to be recovering, although the number of employed is still about four million less than just before the pandemic hit, but about 18 million more than at its nadir in April 2020.

Michael Klein:

As for the pandemic, there have been almost 50 million cases of COVID and more than 770,000 of our fellow citizens have died. But almost 60% of the population is fully vaccinated, although the percentage varies widely across states. For example, vaccination rates range from 41% in West Virginia, to more than 70% in five of the six New England states. And worldwide, vaccination rates are markedly lower in low-income countries. However, the emergence of the Omicron strain has raised concerns and led to a new spate of travel restrictions. Over the past few months, the big economic story has been disruptions to the supply chain and an inflation rate that is the highest we've seen in three decades.

Michael Klein:

Perhaps the best way to characterize the current situation is that things are complicated. To help make them a bit less complicated, I'm very pleased to welcome back to a EconoFact Chats for the fourth time, a panel of distinguished economic journalists; Binyamin Appelbaum of the New York times, Scott Horsley of NPR, Greg Ip of the Wall Street Journal, and Heather Long of the Washington Post. Welcome to each of you.

Scott Horsley:

Thanks Michael.

Heather Long:

Thank you.

Scott Horsley:

Good to be with you.

Binyamin Appelbaum:

Thank you.

Michael Klein:

Let's start with the pandemic since this is the underlying cause of so much that's happening in the economy. All of you cover economics, not epidemiology, but I would guess that because a pandemic is so important, you have some insights about the progress of the fight to contain it. Since the last time we spoke, I've taught in person, albeit while wearing a mask and having weekly COVID tests. My wife and I have taken a number of plane trips and celebrated our son's wedding with 180 other people, none of whom got COVID from the event. It seems to me like we had been returning slowly to some type of normality, but now with the omicron strain, are all bets off? Greg?

Greg Ip:

Obviously, there's a lot about Omicron we still don't know, but I think we can say a few things. First of all, while we don't know the magnitude of the impact of the new variant on the economy, I think we do know the direction. It's going to be negative. To be sure, probably not as negative as the initial or even subsequent waves of the virus because businesses and workers have learned how to adapt their behavior to the restrictions and the risks that crop up with this. Businesses can switch very quickly, for example, to remote working. Consumers can switch very quickly from in-person to online shopping and so forth. That said, we can probably predict that it will have a negative impact on certain types of demand, especially for travel and things like eating in restaurants and so forth.

Greg Ip:

We did see that with the spread of the Delta variant. Even more problematic, I think there are going to be the impacts on supply. We've seen that even when the United States itself is not severely impacted by the virus, when you have our partner countries like in Southeast Asia or China, shutting down activity in order to deal with outbreaks, that creates severe supply disruptions. And finally, we know that a big reason so many workers have not returned to the workforce is that they're concerned about COVID, or that there are other COVID related problems, like having to look after family members; that are keeping them out of the workforce. Another wave of the pandemic would likely make that worse as well.

Michael Klein:

Binyamin?

Binyamin Appelbaum:

It's been interesting to see the way that the economy adjusts to each wave of this pandemic, and what we saw in the Delta wave, even more pronounced than earlier waves is a shift in spending from services to goods. And it seems likely that to whatever extent this new wave causes people to reconsider, it's likely to produce that same effect again, which is one of the reasons that we've seen such port congestion and supply chain congestion here in the United States. And the other thing I'd say about it is that the longer this goes on, the more likely it becomes that some of the disruptions begin to ossify and become permanent. There's still roughly 10% of workers who have not returned to the office.

Binyamin Appelbaum:

They're concentrated in high profile jobs in major cities. It feels to many people in my world like it's more than that, but it's a small fraction of the workforce. But the longer they're out of their offices, I think the more likely it becomes that some of those forms of work never return to quite the way they were before. So, each wave of this I think increases the likelihood that some of its effects are truly enduring.

Michael Klein:

Heather?

Heather Long:

And I would just add that one of the interesting takeaways from the Delta variant experience earlier this year was poll after poll showed that it was vaccinated people who were most worried when these variants come along, and that they were the ones who were canceling travel plans and canceling birthday parties and pulling back on spending. I think it's a little bit unclear how the Biden administration is going to be able to reassure the vaccinated people that things are okay and they can keep going out. And I just returned from Europe, and it's such a stark contrast there. I couldn't even go into a restaurant without having a pass scan that showed a QR code that I had to carry around to show that I have proof that I was vaccinated, to even go into a restaurant.

Heather Long:

I think the consequences in the United States are still not as high as in other parts of the world if you aren't vaccinated. It was interesting to hear President Biden say that he is not so far in favor of say requiring vaccinations to get on a domestic airplane flight. It'll be interesting to see if those restrictions go up if this gets worse.

Michael Klein:

Yeah. I was in New York this last weekend and unlike Boston where I live, you do have to show proof of vaccination in New York and not so far in Boston. Scott, your ideas on this.

Scott Horsley:

Well, I think the reason that this pandemic has humbled so many economic forecasters is that the path back to something resembling normalcy, or some new normal has not been a straight line. It's been two steps forward and one step back, and you've probably experienced that maybe in making plans for your son's wedding, for example. Maybe you make the plans thinking it's going to be one situation and by the time the wedding arrives, it's something very different. I think all of us have lived through that over the last year, and it's why economists from the White House and The Federal Reserve have had such a challenge in trying to map out the path that this is going to take, even before we get a curve ball like Omicron.

Michael Klein:

As I mentioned in the introduction, we're seeing a recovery in employment, although we're still below the pre-COVID levels. And some of this shortfall is no doubt due to demand still being below trend, but this period is also seen the labor force participation rate falling, as we've been discussing just a minute ago with COVID. The most recent data puts it at 61.6%. Whereas just before the pandemic, it was 63.4%. And this 1.8 percentage point differential represents about three million people. What do you think are the sources of what's being called the great resignation, and what are its broader economic implications? Heather. I know you've been focusing on this a lot. What's your view on this?

Heather Long:

Yeah, I have. First of all, I think when we think about that three million who are still missing, it's important to divide it by gender. It's 1.5 million women and 1.2 million men roughly speaking. This is just so unusual because we did not see such a big decline in women's labor force participation in any other recent recession that we've had in this country, and it really goes to the heart of these ongoing child care issues. And I'll admit that I really thought once schools reopened broadly in September that things would improve. And we've seen a little improvement, but it's become really clear the disparities in this country when, you look at like when the labor department household survey asks people why they aren't returning to work or actively searching for work.

Heather Long:

Black women are about two times as likely to mention child care issues as white women are right now. And I think as I've called around and tried to talk to different women, it's become very apparent to me that even though schools are reopened, a lot of after-school programs have not, or those bus driver shortages make it hard for the kids to be taken home after their sports or after school programs. And that's particularly acute in communities of color. I think some of that is still going on in addition to fears of going back to work because of COVID, but I would just take a step back and say, the framing of the great resignation is nice, but I think it's too simplistic.

Heather Long:

And you have to pull back and think about not just people resigning from work, but we also have higher than normal retirements going on. We have some of the biggest new business formation going on in about three decades or four decades, depending upon how you dice up the government data. And we have a lot of situations where one spouse is going back to work, but the other spouse is not yet, for child care, for other issues that are going on. I've been calling it the 'great reassessment' of work. I think that there's just been this probably the biggest impact on the labor market since World War II, in the sense that, almost everyone was impacted around the world by this.

Heather Long:

And what we're seeing is when you look at resignations, some people say to me, "Well, but it's not every single industry." No, but it is every in-person shift-work industry is either at a record high, or near record high. So, not just retail and hospitality, but also manufacturing seen near record high and of course, education and health care. I think we have to understand that when I call and talk to workers, yes, many of them are resigning because they want higher pay, or because they're just done, and want to retire and enjoy life now that their home value went up, or their stock market portfolio went up, or their stimulus payments gave them a little bit of an extra boost, but the vast majority of people that you talked to mentioned mental health issues, mentioned burnout.

Heather Long:

They mentioned just "this whole experience for the first time in my life made me pause, look in the mirror and say, "What is my life really about? What am I doing right now"?" And I think that's going to have lasting ripples and impacts that are not going to be solved in just the next few weeks or months.

Michael Klein:

Heather, do you think some of the gender and racial differences are accounted for by compositional differences of over-representation of certain racial groups, or women in jobs that are higher risk?

Heather Long:

I mean that's certainly the first wave explanation of what's going on, but I feel like that was the story of 2020 and early 2021. I think again, the story is a little bit more complex now and in terms of we're going back to these disparities in resources; I was looking at some of the analysis of the K through 12 school re-openings, and their staffing is still down 10% in day cares across the United States and 4% to 5% in the K through 12 education sector, but that's the average. If you actually look across different school districts, it's far worse in a lot of urban school districts, particularly serving communities of color.

Heather Long:

I think that's where the situation is now that yes, some of it is people, the types of jobs they were in, but it's also what they're seeing in their own community in terms of how easy it is right now to get back to work, or get their life back on track.

Scott Horsley:

Certainly women are over represented in some of those in-person, face-to-face industries that have been the most sensitive throughout the pandemic and each subsequent wave, we've seen that play out again. We saw hospitality actually lose jobs during the Delta wave period. So, I do think that's part of the explanation for the gender breakdown, along with the care-giving responsibilities that Heather was talking about, but the reassessment is very real and it's not just employees, but employers too. I mean I talked to a bartender not long ago, who's not gone back to her bartending job. She's a former bartender I guess I should say. She may go back at some point, but she was saying, "It's just really nice not to get yelled at for being slow to draw a Budweiser."

Scott Horsley:

And I also talked to a restaurant owner in a resort community in Oregon who lost out on a lot of business this summer, because he didn't have the staffing. He had to cut back to four and a half days a week. He lamented those lost sales, but he said, "you know look, I got to go river rafting with my family for the first time in years. We're always too busy serving tourists to take advantage of those tourist attractions ourselves." I think people on every rung of the ladder are doing that kind of reassessment.

Michael Klein:

Greg?

Greg Ip:

Yeah, two other specific sources I think of the labor shortfall just to touch on quickly. One that Heather didn't mention was, immigration is down a lot. We started to see legal immigration flows decline in a noticeable way at the start of the Trump administration that has continued. It got worse last year, because of many of the border closures and the suspension of admissions for temporary workers. There are certain areas especially like construction and agriculture which are really suffering from that loss of labor supply. And the other Heather mentioned this and I wanted to expand on it a bit, and that's retirement. Numerically, roughly half of the shortfall in labor force today is people who have retired early, 55 and over, especially 65 and over.

Greg Ip:

There are several reasons for this. Heather mentioned for example some of these people had big increases in their stock market and home portfolio, and they can afford to retire and they want to retire. Other people were laid off at the start of the pandemic, and they just decided it was too difficult to get back into the labor force and this was a logical time to start collecting Social Security. They may not have chosen this as their way out, but circumstances are what they are. And finally, COVID is a disease that laser-like targets the elderly. If you had any concern at all that being at work was putting your life in danger this was like perhaps the final nudge to push you out.

Scott Horsley:

And the retirement effect I think is especially troublesome, because what we know is that people once they retire, they almost never come back. It is possible that some of these other factors we've been discussing, like the child care issue, the reassessment issue, even the immigration issue that with time could reverse. The retirement issue is not going to reverse.

Michael Klein:

Yeah, that's a very good point and on immigration, my wife's an immigration attorney. And she's telling me that even trying to get a visa, a lot of the consulates in other countries are not accepting applications because they're so short-staffed, and so that's a real issue as well. Well, one implication of the decline in labor force participation seems to be pressure to raise wages, and the standard economic idea is that if something is in short supply, then its price will rise. In this case, increase in prices, that is wages, especially of lower wage workers may help those at the lower end of the income scale. Do you see this as a durable trend? Binyamin, what are your views on that?

Binyamin Appelbaum:

I think it's a really interesting and important trend, and I suspect that to some extent, it probably is durable. On the one hand, there are reasons, we've just discussed some of them why to some extent this labor shortage may be a temporary phenomenon. We may see some of the people who've left the labor force choosing to return. We may see immigration increasing going forward. There are reasons, and we already see employers dealing with labor shortages by trying to automate, or to reduce their need for labor. And all of these are factors that you would expect to work against the durability of wage increases, to reduce the severity of the shortage of workers.

Binyamin Appelbaum:

But on the other hand, the ways in which wages are being raised, some of them do seem likely to be irreversible. If you are a major retailer and you have announced a new benchmark for wages, you are not likely to be able to reduce it if all of a sudden more workers start showing up again. If to the extent that unions are taking advantage of this period to lock in contractual gains, those are not easily reversible. To the extent that this period has built renewed political support for higher minimum wage standards in some states, those gains would not easily be reversible, or for benefits for expansion of benefits, which is another form of compensation where we've seen workers making gains during this period.

Binyamin Appelbaum:

That too is not easily reversible. My guess is that we are likely to see some durable increases. To some extent, there's short-term pressure that will subside, but I think a lot of this is likely to be durable. The final thing I'd say about it is that relative to the scale of the problem, I don't think this pressure is particularly significant. There's this huge trend over time in which workers have been receiving a smaller and smaller share of their productivity in the form of compensation. This is a very minor reversal of that pattern in the grand scheme of things.

Michael Klein:

I guess also what's important is that these increases in nominal wages could be eroded by inflation, and we know that there's downward rigidity on nominal wages, but not necessarily on real wages when you take into account inflation. Heather, your view on this.

Heather Long:

I would just put it really simply that I used to think that by the corporate CEO mentality that probably there would come a point when this would not be durable and the labor shortage situation would shift, but I think I've really revised my thinking. And I would say it's going to be durable for the 15 an hour and under wage pressure, because you can just see there's so much data now from all these different job sites that pretty much the first screen that low-wage workers are doing is jobs that pay at least 15 an hour. They do not even look at something that pays less than that. It truly is the new bottom benchmark that's going on here, and I just don't see anything that's really going to change that going forward.

Michael Klein:

Scott?

Scott Horsley:

Well, I do think there's a big difference though in saying wages won't go backwards, to saying wages won't continue to rise at the 5% per year rate, or whatever we're seeing. It could be durable in the sense that there'll be a new normal where 15 is the new threshold for example, but that doesn't necessarily [inaudible] continue to see the kind of upward pressure on wages that we've seen in the last year.

Michael Klein:

We talked a little bit about a possible reason for the decline in labor force participation. Another reason that's cited is generous government programs that help people avoid the most dire economic consequences of the pandemic. And for that reason, maybe many people thought that there would be less of an urgent need to return to work. I myself am not so sure about this explanation, because if it were true we might have expected to see a spike up in labor force participation when these extraordinary unemployment benefits ended in the summer. Scott, do you have a view on the role of unemployment insurance on people's willingness to work?

Scott Horsley:

Well, as you said at the outset of the podcast, it's complicated. I think there was a reasonable expectation that the end of the more generous unemployment benefits that Congress put in place early in the pandemic would push people back into the workforce, but we conducted this big national experiment over the summer, where about half the states ended the benefits early and half of them left them in place. And there really was not a big difference in the workforce participation in those two groups of states. So, the picture is clearly more complicated than just being able to starve people back in the workforce.

Scott Horsley:

That said, those generous benefits have now ended nationwide. They ran out in early September, and we did see job growth which was pretty lackluster in August and September pick up in October. Now, is that because the benefits had gone away and people who have maybe banked a little bit of the benefits saw their cushion eroded and did have to go back to work? Or was that because the public health outlook was improving between September and October? Both of those things were going on, so it's hard to isolate the effects. I think it's pretty clear that there's not just a simple one-to-one correlation between the more generous benefits and people staying out of the workforce, but clearly, those benefits were a factor that gave people more options.

Scott Horsley:

And let's face it, that's not a bad thing. The fact that unemployed workers had a chance to look around for a better job, a better fit, ultimately should make for a more productive economy than people who simply had to grasp at the first job that came along in order to keep the lights on.

Michael Klein:

And happier workers who can now take raft trips with their families. Binyamin?

Binyamin Appelbaum:

Yeah. Look, I think this story it basically has its unstated premise is that workers are shirkers, and that as soon as they get to a minimum level of compensation, they're going to pull out of the labor force and go

sit on their couches and be lazy do for nothings. In the first place, it's not at all my experience of my interactions with American workers. And in the second place, as Scott points out, we have a fair amount of evidence that that's not actually what has happened during this period. It just doesn't fit the facts basically.

Binyamin Appelbaum:

The reality is that many people have used this additional compensation to improve their lives and their opportunities. To move, to seek additional training, to pull out of the labor force temporarily in pursuit of a better job, to use it as leverage to secure better terms from their employers. So, it goes both ways. It's not at all clear to me that the balance of the way that it goes is toward people being less willing to work. People in general want to work and are going to be inclined to use this... To consume or to seek better opportunities. It's a pretty bleak view of people to think that the effect of this would be to reduce labor force participation over time.

Michael Klein:

Well, as an economist, I have to say we do take a pretty bleak view of people, although we understand now that a more subtle better rounded view is probably more appropriate. Heather?

Heather Long:

Yeah, I'll just said quickly Scott and Binya did a great job covering the issue, but one of the neat quirks here is my colleague Andrew Van Dam at the Washington Post got a hold of the Social Security data. And actually, it does appear that government aid played a role in the early retirements, giving people a cushion to retire early, and actually people applying for Social Security is way less than normal in the last year and a half. And the Social Security administration itself attributes this to the generous government aid payments, especially the stimulus checks. So, they may have played a role in that early retirement trend.

Michael Klein:

Well, moving from workers to prices, we've already mentioned inflation a couple of times and of course, it's a major concern now. The question is, 'should it be?' There are different views on this. Some people are on 'team transitory,' and other people are on 'team permanent.' Which team you're on is likely a reflection of your views on the sources of current inflation. Neil Irwin, Binyamin's colleague at the New York Times has a recent article in which he says that the large government response in 2020 was partly motivated by the memory of too small a fiscal response to the 2008 crisis. So in a way, we were fighting the last war.

Michael Klein:

Some people think that this large fiscal response is an important source of current inflation since it led to a big increase in demand, while other people point to supply bottlenecks due to the pandemic. And then a third view is that the loose monetary policies of The Fed are an important source of inflation. And then a fourth view is that we're seeing price gouging and anti-competitive behavior. None of these potential causes are mutually exclusive of course, but people weigh them differently. Greg, what are your views about the sources of current inflation, and how do these views inform your ideas about appropriate policy responses?

Greg Ip:

George Bernard Shaw apparently once said that to get an economist, all you have to do is train a parrot to say supply and demand over and over again, and that is really the story of inflation now. On the demand

side, it is definitely the case that the very aggressive fiscal response to the pandemic and the very aggressive monetary response has elevated demand well above the trends we might have anticipated otherwise. And that is to echo something that Scott said with respect to the unemployment insurance program, that's a feature, not a bug. We wanted that fiscal relief in place, so that all those people who'd lost their jobs or couldn't work because of the pandemic didn't suddenly have to withdraw from the economy because of lack of income.

Greg Ip:

We did something that is nothing short of miraculous. We actually recovered the pre-pandemic path of GDP growth within a period of less than two years, something that took many... we never actually achieved after the global financial crisis, but we probably overdid it. The last round of stimulus was probably unnecessary. But it wasn't just that. Thanks to the very aggressive response by The Federal Reserve, housing demand has been off the charts. We've got household wealth driven primarily by stock values of something like $8 trillion from before the pandemic. And if you run that through traditional models of how much of that wealth we tend to spend, that could be boosting consumption by anywhere from 1% to 3% per year.

Greg Ip:

So, that demand is clearly playing a role here, but if you look at traditional economic models, that demand alone is not enough to push inflation from 2% to 6%. Inflation is just too sluggish. So, what explains the rest of that increase? Well, it's the supply side, is that the pandemic didn't just... it actually severely disrupted our ability as an economy to produce goods and services. Initially, that's because governments closed establishments. But even once those establishments reopened, there were severe disruptions to the availability of certain parts. Binya spoke earlier about how we saw this big skew in demand towards goods from services.

Greg Ip:

That meant that certain inputs to goods, most prominently semiconductor chips were not adequate to go around. And we've had severe shortages things, like automobiles. Shipping has been severely strained, so that you have to wait six months instead of six weeks for that new couch that you've ordered, for that new house that you've decided to buy. And finally, the shortage of labor that we've all just been talking about. The reason we have bad inflation isn't demand or supply, but elevated demand interacting with constrained supply. Whether this is a persistent or a transitory phenomenon depends entirely on where you expect those two phenomena to go. Right now, it looks like there's still enough money in people's bank accounts and from wage income to keep demand going pretty healthy for a while.

Greg Ip:

If the new Omicron variant sustains this bias towards goods buying as Binya was positing earlier on, that will sustain some of this upward pressure on goods prices. If workers are not coming back into the service side of the sector, that will do the same thing to wages. So, there's a number of reasons to expect that the risks to inflation are all on the upside. The main reason not to be too worried about this I think is that we've had inflation of around 2% or lower for now, 20 or 30 years. And I don't see convincing evidence that people's psychology, what we call their expectations have shifted in a permanent sustained way towards high inflation.

Greg Ip:

I'm not yet convinced that just because employers felt they had to raise salaries 5% or 6% this year to deal with the pandemic-related shortages, that they think they'll be doing that every year for the next 5 to 10 years. But that's the sort of thing that we'll only know with any certainty with passage of time.

Michael Klein:

Yeah, it's very important to remember inflation is a rate of change of prices, and you can have high prices and no inflation. Scott?

Scott Horsley:

Yeah, I would just say as Greg points out, it's this mismatch between supply and demand and in particular demand for goods. I mean I think when we talk about the supply chain challenges, we do have to remember that we're buying more stuff than ever before. And while there are absolute shortages of some things, like new automobiles because of the semiconductor shortage, most of the supply chain challenges are because we're trying to just push a whole lot more stuff through the existing transportation network. When you see all those containers piled up at the port of LA and Long Beach, that's because we're just buying a lot more stuff, partly because we can't go out to live entertainment, and take vacations and spend money on services the way we ordinarily would.

Scott Horsley:

The other explanation you threw out there for inflation that is that it's price gouging or greedy businesses jacking up the prices, Heather's colleague, Catherine Rampell had a great column the other day, where she said businesses didn't suddenly get a lot more greedy in 2021 than they were before. The notion that they're suddenly gouging prices now when they weren't doing it for most the last decade, when we had inflation running below 2% is telling.

Michael Klein:

Binyamin?

Binyamin Appelbaum:

Yeah, I guess I actually want to push back a little bit on that last point because I think that for years, I would talk to corporate executives who would complain about their lack of pricing power. That in a flat inflation economy, it was just very difficult to drive price increases, to sell price increases to the market. You really needed to expand profit margins by cutting costs, by holding down worker wages. We heard this for years and years and years. And it seems clear to me that one of the things that is happening in this period is that at least temporarily, a lot of companies have found that they have the power to raise prices again. And they're doing it aggressively.

Binyamin Appelbaum:

They're doing it to compensate for wage increases. They're doing it to compensate for increased supply costs, but they are also doing it to expand profit margins. And we've seen in industry after industry that profit margins have fattened during what is ostensibly a very difficult period for these companies. You've got your shipping companies reporting record profits, and your home builders reporting record profits. And these are industries in which they are able to take advantage of this supply and demand situation, which I think is the dominant explanation for what's happening by far to drive up prices. And the interesting question to me is whether that becomes ingrained, whether they can teach customers to expect price increases.

Binyamin Appelbaum:

That's where inflation becomes dangerous is when expectations start to shift as Greg said earlier. I don't see a lot of evidence of that, but that's certainly the thing that to me is the difference between short-term disruptions, and a bigger long-term problem.

Michael Klein:

Greg.

Greg Ip:

Just to make one quick point, I think it's true as Binya said that companies are indeed getting back pricing power, and this has delivered very fat profit margins, but that in itself is not proof of anti-competitive behavior or price gouging, which would generally be indicative of, for example, oligopolist or collusive behavior. It's much more likely the case that you just have situations where demand is far out-running ahead of supply. You go to your car dealer a lot. If there's only three models, instead of 10 models available on the car a lot, of course, the dealer is going to charge full price and perhaps make you get those like the nitrogen filled wheels and the extra trunk liner that you really didn't want.

Greg Ip:

Once the shortage and once the artificial restraints from the pandemic go away, I think you would see normal competitive behavior return. And at that point, we'll know whether or not there was so-called price gouging going on.

Michael Klein:

One of the concerns is that if inflation stays high, the fed will have to raise interest rates which will cause a recession; a replay of the Volcker recession that began with The Fed raising interest rates in October 1979, which then led to the deepest downturn at that time since the Great Depression. President Biden recently announced that Jerome Powell will continue to serve in his role as Fed Chair and Lael Brainard who served as a governor will become vice chair. Paul Krugman wrote, "President Biden faced a difficult choice. Should he reappoint Jay Powell, a monetary dove who believes that the current inflation spike is probably temporary, but might revise his views in the light of the evidence, or should he nominate Lael Brainard, a monetary dove who believes that the current inflation spike is probably temporary, but might revise her views in the light of the evidence?" Krugman was saying there's really no difference. All of you I think at some point covered The Fed. Do you agree with Paul Krugman that there's really little difference between Jerome Powell and Lael Brainard at least when it comes to the conduct of monetary policy, if not regulation? Heather, you want to go first?

Heather Long:

Sure, I'll dive in first. I mean on a basic level, Paul Krugman's probably right that on their monetary policy views right now, there's very little difference between them. People who care more about climate change or who care more about regular bank regulation, or who care more about even the fate of cryptocurrency or digital currency, you might see more of a divergence between them. Powell has certainly been a little bit more hesitant to move rapidly on a lot of those areas. But to me, the biggest difference between them is really that I think Chair Powell's legacy, he'll have many legacies, but one of them will be he is refreshingly willing to admit he's wrong, or that the entire economic profession is wrong.

Heather Long:

And he's willing to alter his views and has proven multiple times so far that he can alter those views or shift the direction of the committee, the FOMC without losing confidence of the market. And that's really hard to do. That's where I think the Powell choice was probably pretty shrewd here. A lot of people of course look at what he did in March of 2020, and the rapid reevaluation of what was needed in this crisis, but I think people forget that even in the trade war in the summer of 2019, he cut rates three times in 2019 in the second half of the year, as he was readjusting and recalibrating where he thought the committee should be. And that they probably did get too high at the end of 2018.

Heather Long:

Anyway, I think that's really to me the main difference is more that style and credibility difference. And it's not that Lael Brainard couldn't get it. She obviously has a long and distinguished career in DC, but I think Powell's... I remember we all wrote articles when he first got on. We were worried that he wasn't an economist, but in some ways him not being an economist has proven to be his strongest asset in these times.

Michael Klein:

Yeah. We have an interview with Jeremy Stein who's this very prominent finance and monetary economist at Harvard, and he gives Powell and The Fed a great of an A in their response in March 2020 when markets start to seize up. So, an A from Jeremy stein at Harvard is a pretty good grade. Binyamin, what do you think about this?

Binyamin Appelbaum:

I think a friend of mine was circulating on Twitter the other day, the article I wrote when Powell's nomination was announced, his first nomination to be Chair of The Fed. And it was an article quoting a lot of people wondering whether he would have not just the courage of his convictions, but basically whether he would have sufficiently forceful convictions in the face of an economic crisis, because he was not an economist and might not have a theoretical grounding sufficient to give him confidence in the course that he needed to chart. Well, that turned out to be completely wrong. Whether or not you think he charted the right course, he certainly hasn't lacked force and confidence.

Binyamin Appelbaum:

And I think what it highlights for me is that it is very difficult to judge what a person is going to do as Fed Chair before they have held that job. So, anyone who looks at Lael Brainard and says with confidence that they know how she would behave as chairwoman of The Fed, I just have trouble taking seriously. We know broadly what her beliefs are. We know what she has said and what she has done in her current role, but I think there is an element of inherent unpredictability in the installation of a new Fed Chair. And for that reason, I think the Biden administration made a safer choice in sticking with Jerome Powell, because he really is a known quantity in a sense that Lael Brainard had simply cannot be.

Michael Klein:

Greg?

Greg Ip:

I think I agree with the thrust of what Heather and Binya were saying, which is that Powell and Brainard are both eminently qualified, very intellectually supple, able to adjust to the circumstances as necessary, open-minded about circumstances. If I were to say that there's a big problem or challenge facing them, it's as follows. Like Heather was saying, both I think Powell especially showed a willingness to challenge

some of the precepts of economics, and the manifestation of that was a fairly significant reworking of their entire approach to monetary policy that they made public in August of last year.

Greg Ip:

The two key facets of this monetary overhaul were number one, because the problem facing the US and most of the world for the prior decade had been inflation that was too low, they were now going to aim for inflation that was if anything above their inflation target of 2%. So that, over time it would average around 2%, and the US would not get stuck in this low inflation trap that countries like Japan were in. The second was to more or less reject the notion that there was any inherent trade-off between unemployment and inflation; a relationship that economists call the Philips curve. And this was borne out by the evidence of the prior decade that unemployment could get to extremely low levels of around three and a half percent. This was extremely beneficial to a lot of demographic groups who had not shared in the benefits of economic growth in the past; the disabled, people with criminal records, racial minorities, and yet we saw no inflation problem. The new framework said we're going to aim for slightly above 2% inflation because we think below target inflation is the big problem, and we're never going to look at a low unemployment rate as being an inflation problem. Unfortunately, facts on the ground have played a nasty trick on them, in that those precepts don't look quite as good today. We now have inflation that is well above The Fed's 2% target. And I think that almost everyone including The Fed would agree that above target inflation is a much more salient risk now than below target inflation.

Greg Ip:

And the other thing that the Philips curve seems to have come back to life with a vengeance. We are seeing low unemployment rates being associated with very strong upward pressure on wages, and some of those wages being passed through to prices. We don't know yet whether this is sustained, whether that process will continue and become the cycle of ever rising wages and prices that result in a sustained inflation problem and the type of interest rate response that was necessary in the early 1980s, but I will say that it will require both Jay Powell as chair, and Lael Brainard as vice chair to perhaps rethink and reassess some of the assumptions that they were making in the years up until the pandemic.

Scott Horsley:

Yeah, that new framework that was announced last summer seemed very reasonable to time after a decade of low inflation, and the experience of really strong job gains that weren't putting upward pressure on prices, but that framework is certainly going to be severely tested in the next six months or so. Both Powell and Brainard have been very explicit in saying they're not going to even consider raising interest rates, until we're back to full employment. One question is going to be what does full employment look like in a post-pandemic world. Given the great reassessment we've talked about. Does it mean we have to get back to the numbers that we had, we have to put all those three million people back to work? We have to fill the four million missing payroll jobs? Or is it something short of that?

Scott Horsley:

That's going to be a question that The Fed's going to have to answer with the pressure of high prices if that inflation rate continues. I do think another way that this was a shrewd decision by the White House is that having a Republican as Fed Chair, a fed chair who was initially appointed by former President Trump gives the white house some measure of political cover. Not that President Biden's going to not going to take a lot of arrows from Republicans for high inflation, but it does give some bipartisan sheen to this policy. And Jerome Powell has proven to be a very adept politician, who can sell whatever The Fed is doing on Capitol Hill.

Michael Klein:

Well, as I said at the outset, things are complicated now. And I think the four of you have really helped show not just that things are complicated, but that we can think through them, and at least give some conditional answers, and have frameworks for thinking about these things. For the fourth time, I really appreciate your coming on to EconoFact Chats and participating in a discussion that I found really interesting and enlightening. So, thanks very much to all of you for coming on to EconoFact Chats.

Scott Horsley:

Thanks for a good conversation.

Heather Long:

Thanks for what you do.

Scott Horsley:

Thanks for having us.

Binyamin Appelbaum:

Thank you.

Michael Klein:

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