Conversations with Bill Kristol

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I. What is Bidenomics? (0:15 – 43:23)

KRISTOL: Hi, I'm Bill Kristol. Welcome back to CONVERSATIONS. I'm very pleased to be joined today by my friend, Stan Veuger, the resident scholar and economist at the American Enterprise Institute. Also teaches at Harvard University and Tilburg University in the Netherlands. We've done two conversations. One, I think that stands up quite well. What? Early, middle of the pandemic where you, I think had a good forecast of what might be happening. But now we have a new administration, a new economic theory, allegedly, and we should talk about what it is, and what it means and what might happen. So welcome, Stan.

VEUGER: Thank you, Bill. Good to be back. Thank you for having me. I look forward to this.

KRISTOL: Yeah, me too. So Bidenomics. Everyone's talking about it. I don't know, it's funny. No one expected there to be a Bidenomics, even when he was elected. It was going to be, “oh, custodial residency,” show us how much things can — “transitional,” now it's transformational. Shows how much things can change quickly due to various events, I guess winning two Georgia Senate seats among others. But what is it? I mean, as he's laid out his plans here, how should we think about it? What's the magnitude? Is it a massive thing? Is it more of the same? Is it incremental? Just give us some sense of the quantities and then the different aspects we can go through of what Bidenomics looks like it wants to be.

VEUGER: Well, so I would say it is incremental in the following sense, that a lot of what the administration has proposed really does build on existing elements of the federal government and the activities it carries out. On the other hand, it is quite radical, I think, in the size of some of those increases of existing activity. So a good example is the Child Tax Credit, which has existed for a while, but the administration would like to expand quite dramatically. It is true for the involvement of the federal government in family policy more broadly, in education policy. It's all things where the federal government has long played a role, but pretty significant expansions are being proposed.

To give it a more quantitative interpretation, the current budget of the gederal government is about $4 trillion. A lot of that goes to Medicare, Social Security, the military. And so all of these programs are in the other part of the federal budget, and yet they will add about 10 to 15% to the size of the federal government. So the parts of the federal government that are not in the categories I just listed will really be expanded quite dramatically. And so, I think that is a good way to think about it. Existing programs. So no new agencies, no industries that are being nationalized, but a pretty dramatic expansion of the scale of the federal government, more so than the scope. I think that's a reasonable —

KRISTOL: Yeah, that's interesting. I hadn't really thought of it that way. So if you take out what's called the entitlement programs, the big ones, Medicare, and Social Security and add defense, that's probably, I'm just guessing close to half of the federal budget.

VEUGER: A little more.

KRISTOL: Little more even, yeah. So when people say, well, it's a 15% increase, it's really a 30% increase of the, let's call it discretionary domestic programs, not maybe strictly discretionary, but sort of the big ticket domestic items. So that's a pretty hefty increase in size. And I guess one question is, how much does the increase in quantity effect — Well, so what does one think of that? I mean, how does it affect the overall economy, debt, taxes? Assuming most of it happens, I don't know that we think all of it will happen. And then we can talk about some of the particular areas, perhaps.

VEUGER: Yeah. So working on the assumption that most of it will happen, what we'll see really is in many stages of life, I think the government will really step in and provide families with support, from childcare, from family leave on actually all the way through college, the federal government would really provide support to anyone who is not very high income, and to the people who I think the current policymakers think cannot themselves save or spend in a way that allows them to make it through those years of life comfortably. So that's a lot of different elements of people's lives, especially when they are young. And so it's very focused on children and their parents. Now, I think what that does, is it first of all, it blunts a lot of incentives.

Because if you don't need to save yourself, if your children will still be able to go to childcare, to pre-K, to community college, even if you cannot support them financially, but that makes being able to support them financially less important. And so I think that's, on the spending side, that's an effect that may reduce economic growth a bit. What the administration would say is that down the line, when those children grow up and when they start working themselves, they'll be more productive. They won't get into trouble the same way they would be in the absence of these programs. And so they believe that that's a sort of pro-growth effect of the agenda. But of course, that's relatively far out, and it relies on a lot of these policies actually working and actually adding to existing human capital, as opposed to simply crowding out the efforts of families and the institutions that they rely on now. So that's on the spending side. Now, of course, the programs are to a reasonably large extent financed with new tax increases.

KRISTOL: So let me just ask one more thing about the spending side, because I think that's interesting and helpful way of putting it. And then we can talk about the taxes, which a lot of anti-tax, a lot of conservatives would say, well, that's really where you're going to pay the economic growth price or whatever, and then there's debt. But before we get to those, if all this happens, or almost all it happens, most of it happens, how close are we from going from an American style, safety-net type welfare state to what is conventionally viewed as a maybe European, north European style, kind of thorough going kind of quite beyond a safety net type of welfare state?

VEUGER: Yeah. So I think we wouldn't be all the way there, I think, but we'd get closer. So many more people would send their children to a public pre-K. Lower income families would get a significant amount of money from the federal government if they have children, even if they do not work or do not work that much. The federal government's role in financing higher-ed would be stepped up even more. And there would be things like family leave, much more money for disabled care, for elderly care. All of those things do exist in Europe.

On the other hand, many of these programs will be means-tested, and so that makes it a little less clear what the participation would look like. There would probably still be a wide array of competing private sector institutions in all of those sectors. And so, obviously in some sectors you have that in Europe, but not in all sectors, not in all countries. And so, I think there would still be certainly a difference between the U.S. and Europe. In part that is, I think because the U.S. American voters, American society is just not interested in having the kind of levels of tax revenue that you see in Europe. So we'll talk about the tax increases in this program —

KRISTOL: Oh, let's go to that now. So yeah. So what would that look like?

VEUGER: Yeah. So the tax increases that will finance many of these new programs are very concentrated in corporate taxation and the taxation of the very wealthiest. So depending on the type of tax, people who have family incomes of over $400,000 a year, or even a million dollars a year. And so that is really a qualitatively different revenue raising model from what most European countries have. So for example, in the Netherlands, the top marginal income tax rate is around 50%, and it kicks in at $68,000 a year income. So that really is still a world apart from where we are in the U.S. On top of that, most European countries, including the Netherlands, have very high Value Added Taxes. So that's an additional 20% on consumption. And so, the scale of all these different programs is you're still going to be a little more limited in one way or another, and so there will be much more space for private alternatives. And of course, households will keep much more of their own money, and so they will have much more money to spend on private alternatives to those programs. So I do think it is important to keep in mind that we're not going to be at that European scale.

KRISTOL: Even including state and local taxes —

VEUGER: Yes, even including state and local —

KRISTOL: — the total government share. I don't know what it would be then and what it is in the U.S. exactly.

VEUGER: It would remain around 30 instead of 50. Obviously, it depends a little bit in how you do the calculation, because a lot of these programs that the Biden Administration wants to expand are tax credits, and so in the different government statistics, they aren't counted as spending, they're counted as reductions in revenue collected. And so, you can play around with that a little bit and maybe get the numbers slightly above 30, but it won't be much above 30.

KRISTOL: Thirty is federal or —

VEUGER: Both.

KRISTOL: Federal, state and local.

VEUGER: Yeah. Well, yeah. It's something like that. It won't be much more than that.

KRISTOL: So two thirds of America would still be, so to speak, private sector —

VEUGER: Yeah, that's right.

KRISTOL: And a third government. And in Europe, it's a little more 50/50, is that?

VEUGER: Yeah. And in the U.S., a lot of what would get counted as government spending is transfers still. That's obviously true in Europe too. But I do think that's an important distinction to keep in mind, that direct provision by the government is really quite different from just redistributing money through the tax code and the like, so that families spend the money themselves. And so, I think that's also important to keep in mind when we talk about the size of the government relative to the economy.

KRISTOL: And just before we get to the taxes and debt, which are the two ways, I guess this could be funded. I mean, we've stressed the welfare state, let's call it safety net, side of the expenditures. There are also big infrastructure proposals, which is a different kind of government expenditure to some degree, and some overhaul of the energy sector, I suppose. Maybe those are the two other big things, I'm thinking off the top of my head, that Biden's proposing.

VEUGER: Yeah. The infrastructure is what they called the American Jobs Plan, and there's a good chunk of that, I think about $600 or $800 billion, depending on whether you count electric vehicles and the like as infrastructure spending. That's a good chunk of that program. I think Republicans would be willing, in some scenario where the two parties come to agreement on a major bill of this kind outside of a crisis moment, would be willing to spend a similar amount allocated slightly differently across programs. But there's a proposal of Senate Republicans that is maybe $600 billion or so, and the Biden Administration would like more, something more like $800 billion. And so, there you could maybe see some agreement. I find it somewhat puzzling that that is the element that people are most excited about. I think many of the things that are included in these infrastructure bills are kind of classic, private goods in the sense that they are excludable. You could finance many of them with user fees. I think Republicans would be more interested in that. But if you take that logic to the next step, you'd say, well, if it can be financed through user fees, why do we need the government to do the spending in the first place because the private sector should be able to do that? And so, I think that part, I'm a little puzzled by its popularity. It's not clear to me that it will lead to the kind of productivity increases that people often claim will flow from those kinds of investments. I think what sometimes gets conflated is that some of those types of programs have high fiscal multipliers during a downturn in the sense that they are direct government spending, and they will put people to work building the projects that are to be built.

That doesn't mean, of course, that they will add to the growth rate of the economy down the line. So I think those two notions of stimulus sometimes get conflated. That it's one thing to stimulate aggregate demand during a downturn, it's very different to increase the level of productivity in the overall economy and growth rates with that. And so I think I'm not as excited about that as other people are.

KRISTOL: But I suppose from a sort of political economy point of view, limited government versus very expansive government, I mean, they build a whole bunch more off-ramps from highways, and a whole bunch of railroad lines, and a whole bunch of new airports in medium-sized cities and so forth, and bridges get fixed up. And that happens and either is or isn't a very useful expenditure at the margin. But I suppose leaving aside the question of how we pay for it, which we'll get to in a second, it doesn't change things that much. I mean, it's sort of in the sense that it's not a federal takeover or anything really, it's just funneling more money into existing programs, most of which already have pretty big federal contribution, I guess, or at least government contribution.

VEUGER: No, that is fair.

KRISTOL: And that's why Republicans, I think are less allergic to it. It's sort of like, hey, even Eisenhower was for that. So it's like, highways, airports, whatever. I don't know.

VEUGER: Yeah, fair enough.

KRISTOL: — from a strictly, from a real economic and even equity point of view, there were some real questions to raise about it. But it is also less —

VEUGER: I think that is true. So it goes back in a way to how transformational is the current administration's approach? And so, I do think that even dramatic expansions of existing programs are not seen as threatening or revolutionary in the same way that entirely new programs would look like. You could have an administration that would spend a lot less money, that would expand the federal expenditures a lot less, but that would try to introduce a single payer system in the healthcare industry. I think the response to that would be entirely different, because that would be seen as really a qualitatively different approach to the government from what we're seeing.

KRISTOL: Yeah. The people who want to say, I'm slightly on this side, I suppose that it doesn't seem as transformational. But the qualitative changes aren't just transformational as the quantitative changes, with the caveat that quantity at some point can change quality. I would say, yeah, there's no Medicare for all. There's not even Social Security for people who are 60. It's just patches, greater subsidies for Obamacare, which exists and which doesn't affect most Americans, honestly. I mean, most of us would get our health insurance the way we get it. We'll get it three years from now the way we get it today, and it's not going to be very different, either in cost or character. There doesn't seem to be a heck of a lot of trust busting right yet. Maybe there will be some more aggressive antitrust. You can talk about that if we want. There's no government takeover of anything much. We're not in 1946 Great Britain —

VEUGER: That's right.

KRISTOL: There's no wealth tax. I mean, all the kind of big ticket, left Democrat, not quite socialists, but let's say real qualitative changes in the way we run the economy. A lot of those don't seem to be involved.

VEUGER: That's right. So I think you have a few other models sort of from the left to the center left that we've seen in the west over the past 50 years. You mentioned you have the UK approach from the ’50s to the ’70s — before they were liberated by the European Union — which is very focused on nationalization and quite a bit of direct provision in the healthcare industry in particular.

KRISTOL: Didn’t Mrs. Thatcher have something to do with that liberation?

VEUGER: Correct. Correct.

KRISTOL: This is a very pro EU account of it. [Laughter]

VEUGER: Yeah. So that is one approach, and this is what the Biden Administration is doing is not that. You will have, what we talked about earlier, a Northern European approach with a public sector that is sort of over 50% of the economy as opposed to 30, 35%. So going from a third to half, and that's not what they're doing either. As I said, I think because they're shying away from the kind of tax increases on the middle class that you would need for that. And I think that was very explicit in the campaign. And I think they are really concerned about not giving the impression that they're raising taxes on middle class. And so they're not doing that.

And then you'll have the sort of Third-Way model from the ’90s, which is sort of a more of the triumph of some liberal ideas of using the market mechanism and the price system, and complimenting that with subsidies, and transfers and the like. And so, I think that is, in a way, what they're doing. But I think a crucial difference with the ’90s is that they are much less concerned about balanced budgets, and about deficits and about the debt. And so that allows them to spend on a scale that the Clinton administration did not. And so that really, I think, is what sets what we're seeing now apart from what we saw in the ’90s. And so, in that sense, I think it's its own different model, very different on the macro policy side. But more on the micro policy side, it does really still fit into that mold, I think of a blend of free market and technocratic elements that the sort of post Cold War center-left embraced.

KRISTOL: No, that's very helpful. So then what about that? I mean, how much of it is paid for by tax increases? And we should talk a bit about maybe how worried one should be about what those tax increases, what cost in just economic growth and other things we will pay for those. And then how much of it is debt? And how come we suddenly think we can run up all this debt that the Clinton administration, and even to some degree the Obama administration, wasn't quite as cavalier about running up?

VEUGER: Yeah. So let's talk about the second point first, about the people's willingness to tolerate a larger deficit. Because I do think that that is a view that is shared pretty broadly across the political spectrum, that there is a little more fiscal room than people had assumed previously. And it's not just a sentiment on the left. I think there, of course, you have the modern monetary theorists who see taxation really only as a way to combat inflation, not something you do to fund government activity. That's a pretty extreme position, but that is their view and that does certainly, given where inflation is right now, where interest rates are, that gives you a lot of space. More on the right, you have someone like Ed Conard, who you've had on the show before, who really believed that there's just a glut of risk averse capital, and what do the owners of that capital want to buy? They want to buy Treasury bonds. And so, that just means that the government can issue more Treasury bonds, and they'll get bought up without you running into financial distress.

So I think that's a left-wing view, a right-wing view. In the center, you have views like that of Larry Summers, who you had on a few months ago who believes that there's just an ongoing shortfall in aggregate demand, then the government should step in to remedy that and in addition that there are more productivity-enhancing investment opportunities in the public sector than in the private sector, and so the government should also step in for that reason.

A little more on the center-left you have this view that over the past couple of decades, for a number of reasons, including developments in emerging economies and demographic developments, that there's just a ton of demand for safe assets and only really the US can satisfy that. Maybe Germany, but Germany just isn't as large and it doesn't issue as much debt. I think some of that is influenced thinking in the EU too, where they're now borrowing much more at the central level.

So, all four of those approaches really speak for more borrowing, more of a fiscally loose policy. I think it's risky to go down that route as aggressively as we're doing. I think all four of those approaches point in a direction but without much of a quantitative sense of how far we can go. And what we've been doing over the past year is we added five, six trillion dollars of emergency spending with no tax increases. Now, the two plans that the Biden administration has proposed would add an additional four, four and a half trillion dollars in spending over the next decade. While some of it is offset by tax increases, not all of it is. So I think maybe a trillion and a half is not. And in addition, I think the tax increases are, the estimates of the revenue they will bring in are fairly optimistic, right? They assume, for example, that those tax increases will be permanent. They assume that people will continue to realize capital gains in the way they have so far. So, I'm a little nervous about that. I think we've gone a little too far in the direction of, we can borrow as much as we want to. I think it's safe to say —

KRISTOL: Trillion dollar deficits as far as the eye can see is not a sound fiscal policy.

VEUGER: That's right, because this all comes in addition to underlying trends that would have generated larger deficits over the next 20 years as things stood. Just if we kept current levels of taxation and we just let Medicare and Social Security and the like evolve as they are currently set up, we would have already accumulated significant additional amount of debt. So to add to that, I think, is risky, but I do think the intellectual environment is such that people aren't as concerned.

I think you can see that from the lack of pushback from Republicans too, who have been focused on anything but really these large spending plans that the Biden administration —

KRISTOL: Just on that, I mean, you say you're more worried maybe than conventional wisdom is. I mean, but how would we see that manifest itself? I mean, how would we know that the appetite for US Treasury bills is starting to diminish and that interest rates start to go – So, you can get in a pretty nasty spiral, can't you if interest rates start to go up, start to go up and the cost of financing the debt starts to go up?

VEUGER: Yeah, so the risk is —

KRISTOL: Then the Fed has to tighten because of inflation and then you get et cetera.

VEUGER: Yeah. So that is the concern, right? So, interest rates would start to go up. You can't just finance those new interest expenses through the Federal Reserve because that may create inflation, and if we're back to the inflation target, we wouldn't be able to let that happen. So, you'd either have to cut spending, or you'd have to raise taxes. If we were to cut spending, we would probably cut the spending that is most dearest, I think, to you and me, which is spending on national security, spending on research and development, spending really on the core federal government public goods. I think those ultimately, in part because of how appropriations work, those would be the first ones to come under pressure as they were over the past 15 years with the concerns about fiscal sustainability after the financial crisis. So, we would see that, I think, before we would see significant tax increases on the middle class or cuts to Medicare, Social Security, and all the various family programs that are being introduced now.

KRISTOL: I mean, just who knows, right? But when do you think you would see this kicking in?

VEUGER: But I think the answer —

KRISTOL: I mean, are we talking a year from now? Are we talking five years from now?

VEUGER: Well, I would think five years from now more than a year from now, and 10 years from now more than five years from now. But the problem is, I do think here the point "who knows?" is really important, because I don't think we have good quantitative estimates of when that will happen. That's precisely why it's so concerning, right?

I think it's reasonable to have spent large amounts of money now during the crisis, because obviously we have to keep people afloat. It's really the kind of emergency in which you want the federal government to step in. I think at the same time, we should have taken measures to bring us a little closer to equilibrium in the long run, and so I think the "who knows" is important to hear in the sense that it should make us adopt an attitude that's a little more prudent, a little more cautious than what we seem to be doing now, which is to just assume things will be fine. It's a lot easier to carry out a program of fiscal consolidation if you're doing it 20 years out than if you have to do it on the spot once interest rates are going up. So, I think that is the concern.

KRISTOL: And on the tax — Yeah. That's interesting and worrisome, and I guess Larry Summers was worried about a version of that, or at least that you would crowd out other public spending that you wanted to make three to five years from now. What happens if we actually have a foreign policy crisis, and we have to spend more money on God knows what to do with China or cybersecurity or whatever? Right?

VEUGER: Yeah. I mean, to be clear, I'm not thinking that — The US will be able to borrow in its own currency and the like. I'm not talking about this scenario like in Greece. It is more that we will start taking these measures, and they'll gradually crowd out important programs.

So, now part of the new spending, of course, would be financed by tax increases, so that creates a different set of concerns that the taxes are on corporations and on high-income families. The corporate tax changes are — The big picture is that they are a partial reversal of the corporate tax changes in the Tax Cuts and Jobs Act. So, the corporate tax rate would go from 21% to 28%. It used to be 35%, so that is an increase. But it's well within bounds of what we've seen over the past 20 years, right? It's still below where it was at the beginning of the Trump administration.

Then in addition, we revert to a system of worldwide taxation of the profits of US corporations. The way you can think about it is we'd be taxing domestic profits at 28%, overseas profits at 21%. And that brings in, say a trillion and a half, over the next ten years, maybe a little more. Then on the individual side, basically all the rates go up to the highest they've been in a generation, and then capital gains go up more than that. Right? So, that is pretty significant, but it really is on a small group of households. So, there you really see the constraints of taxing only affecting only the very rich. It's a little bit in line with what Elizabeth Warren and people around her for a while now have been saying about how really the big problem in American society is income inequality that sets the top one percent apart from the other 99% of the income distribution. This is the taxation form of that, but without a wealth tax. Right? They haven't been willing to go that far.

The individual rates are where they were during the Clinton administration. The capital gains tax is higher, and a lot of the money is supposed to come from the capital gains tax. I think the administration's much too optimistic there. They think that raising the capital gains tax from where it currently is to the regular income tax rate, so 40-something percent will bring in hundreds of billions of dollars in revenue, because they think people will just continue to realize their capital gains at the same rate, basically, in part, because they want to step up the basis on which people get — They will end the stepping up as a basis on which people are taxed if they inherit capital gains. So, they think that will make it less valuable to hold your capital gains till death, and so people will just realize them beforehand. I'm a little skeptical. I don't think the US tax system is reliably permanent enough for people to not just think, "Okay, I'm going to wait it out. They raised a capital gains rate to 40%. Next time the Republicans are in power, I'm going to realize my gains because they will cut it again."

So, I think that that will produce a big dent in the amount of revenue that they expect to raise. I want to work this in. I want to make sure people hear this. It points to a bigger problem with US tax policy, which is that it just fluctuates. It's been fluctuating pretty wildly now over the past five to 10 years, and I think that's only going to get worse the way things are looking now, where you get one administration that really goes to the highest level we've seen in a generation. Then the next generation will go to the lowest levels we've seen in a generation.

That makes planning difficult, but it also, I think, has created a number of very perverse incentives. So, I talked a little bit about why you would want to delay realizing your capital gains. It also is harmful on the corporate side. We've had a 21% corporate tax rate now for a few years. That kind of rate combined with the expectation that the rate will go up is horrible for investment, because it means that you deduct your initial investment at the low rate, and then you're taxed on your profits at the high rate. So, that makes it less attractive to invest than if you just had a permanent, constant 28%. So, that kind of uncertainty really is quite detrimental, I think, to growth in investment, which is ultimately what these policy are meant to induce.

KRISTOL: So all in, the combination of hiking rates on the wealthy, hiking rates quite a lot on capital gains, the step-up, getting rid of the stepped up basis, which means that death — I mean, how much of a disincentive are we creating to capital investment and to savings, I suppose, for that matter? How worried are you that this is anti-growth in the classic kind of —

VEUGER: I am somewhat worried. So, I think the most optimistic way of looking at it is you say, "Look, the US is an open economy, and capital will flow in from abroad to take advantage of new opportunities." I think that some of the models that people use to estimate the effects would lead you to believe that.

A more pessimistic view is sure, interest rates are very low, if you look at the federal funds rate. that doesn't mean that there is abundant capital for riskier investments. There's different interest rates for different types of projects, and it's not obvious that we have a surplus of capital in these other areas. So, I think that that is a little bit concerning.

Some of the empirical evidence that I think the administration relies on for not worrying about these increases of capital income taxes is a little more narrow than they would want to tell you. So, there is a pretty well-known paper by Danny Yagan, who's now the chief economist at the OMB, who studied the dividend tax rate cuts during the Bush administration and finds basically zero effects. Now, those effects are within firm. So, he compares firms that benefited from the tax rate cuts — or where the shareholders benefited from the tax rate cut — to firms where they didn't. And what he sees is that the firms where shareholders benefited do not invest more. Now, you can explain that logically, right? So, on the one hand, the projects within the firm become more attractive because the dividend tax rate has gone down. On the other hand, handing money back to your investors is also become more attractive because they now pay a lower tax rate on those dividends.

That is all fine and good, but I think it misses the broader picture a little bit, which is one) after the increased dividend tax payments investors will have less money left. Two, the firm comes from somewhere, right? And you can't just only look at existing corporations to assess the effectiveness of a policy like this, because one big concern is that people will *not* start new companies and will not think starting a new project is worthwhile precisely because a larger share of the returns is captured by the government. So, I think they're a little too optimistic there that the negative effects will be very limited.

KRISTOL: It sounds to me like that would be worrisome about riskier capital investments. I mean, they're taking for granted that there's this infinite desire to risk a lot on unproven drug therapies or new computer companies or whatever or anything like that and other things too, not just tech stuff —

VEUGER: Yeah. I would agree with that, though to be fair, the canonical way in which public finance economists think about this, and Marty Feldstein liked to emphasize this, which is that if you increase the taxes on capital income, people can just compensate for that by taking on more risk because now the government is their partner. If the government takes 50% of the gains or 50% of the losses, you just double the riskiness of your investments and you are as well off as you were before. I don't know that we want to rely on that logic too heavily, especially because the treatment isn't symmetric, but there is a school of thought that says that, that there is a reach for yield if you increase capital income taxes. I am skeptical that works at this kind of scale and [inaudible] equilibrium but there is that line of argument for what it's worth.

KRISTOL: But it does seem that if you think it's important, if people have been too short-term oriented, you want to encourage long-term investment, long-term risk taking, innovation, this doesn't seem to think, at least, this set of tax increases seems to think that you can do this without endangering all of that.

VEUGER: Yeah. I couldn't agree more. I mean, there are some glaring, I think, contradictions in the preferred policies and the diagnosis of problems of the people who are worried about short-termism and about a lack of investment domestically. I think those concerns, I think, would point you toward other policies than the ones that are proposed here.

KRISTOL: I mean, I suppose the one sign, though, it's funny the Biden administration's, both the scale of what they're doing for better or worse, but also the lack of willingness to do something qualitatively new, which would look, I mean, ironically different. They don't want to say they're — They're happy when people say it's transformational, because who wouldn't be. It's flattering. But actually they seem to have gone out of their way not to be transformational.

What does transformational mean? New agencies, whole new categories of spending and Medicare type thing. Or new categories of taxes, income tax. But of course they rejected the wealth tax, the Elizabeth Warren thing. And they've rejected the one tax that I think an awful lot of economists left and right, assumed would be part of a revenue-raising package at some time in the future, which is some form of carbon tax, whether at the border or not. It's ironic. I mean, it shows in a way how conservative with a little “c” they are, that, “Okay, let's raise taxes. What should we do?” Raise income taxes for the wealthy back up to what they were five years ago. Raise corporate taxes about halfway back up to what they were five years ago, do a little bit of a hit at the wealthy on the estate tax, step up question, maybe lower the —

VEUGER: And capital gains. Yeah.

KRISTOL: And capital gains, right, which is mostly for the wealthy they would say, I suppose. Right? I mean, it's a very conventional, in a certain sense, set of tax hikes, which I suppose means that Congress can also chop some of the hikes in half and reverse some of them in a year or two, which also means, however, then the debt comes back in, right?

VEUGER: Yeah. So, that's why I'm skeptical about some of these revenue projections, because it does seem like these rate increases would not last for an entire decade. That just seems hard to imagine.

On the carbon tax, I agree with you that it comes with pretty broad support, I think, among economists. It would conceivably raise a lot of revenue. Of course, a lot of that revenue would come from households making under $400,000 a year, so I think that's why the administration does not want to do it.

On climate policy more broadly, they've gone a very different direction. Right? So, there you've really seen a shift where they tried to do Cap and Trade during the Obama administration. Then I think there was talk of carbon taxation throughout the end of the Obama administration and during the Trump administration somewhat as well. But now they're going much more in the direct subsidy model with significant spending on things like electric vehicles and on research and development, all kinds of manufacturing initiatives, some of which will point in a green direction.

So, that really is a very different approach from the previous two. I think it requires — So, this really is, I think, a departure a bit from the model of governance that we talked about earlier with subsidies and tax credits for households and then it figures itself out. Here it's a little more in the industrial policy arena. I think in part, as you're saying, for political reasons they don't want to tax class the middle class. By doing it this way, they get to say that they've created jobs. Labor unions probably approve of this.
It's always a little hard to tell where industrial policy shades into special interest politics. I think there's probably some of that here. There's probably some of that in the education sphere too, but so, I think that is a little different. There you do have to get it right, otherwise the emissions won't come down, right? The carbon tax is perhaps a little more foolproof.

KRISTOL: I mean, I suppose though, if you don't — Let's talk about that. If you don't get it right — Let me put it back up and say this, do you agree with the following formulation that occurs to me, which is in a funny way, they bent over backwards to avoid socialism, to avoid too much micromanagement, a Hayekian fatal conceit of central planning, setting up new agencies, telling everyone — it's not the NRA from Roosevelt or something. Basically, they're throwing a ton of money at a lot of institutions, ranging from families to some businesses, some business sectors, education, state and local government, and so forth.

Let's just say it's profligacy It's profligacy, it feels to me like, more than socialism or hyper-government control. You can pay a price for profligacy, I mean, a pretty big price, right? But I don't know, but maybe it's more politically palatable, and maybe ultimately less — I guess the worries that come from that are it's ineffectual: creates some perverse incentives, the usual kind of critiques of big government liberalism. I guess it's funny, so much is big government liberalism, even when you start talking about interest groups. And of course the teachers, the education sector does well because the Democrats like it, and I mean, maybe there are other reasons why they deserve more money. And that is just kind of Ted Lowi, I don't know if you know the political scientist from 50 years ago, interest group liberalism just kind of on steroids basically. Which is not what one would have predicted, I don't think, 20 years ago that the 21st century was going to —that the transformational economic policy of the 21st century is going to be this? It's sort of The Great Society a little beefed up. I don't know.

VEUGER: No, I agree. And so then the concern really does become, how good are your choices you're making? And —

KRISTOL: And can you afford to make them in the first place? At some point —

VEUGER: Can you afford to make them in the first place, that's right. Right. Because you could end up with a much worse fiscal picture and an ineffective climate policy.

KRISTOL: Right and family policy. And it affects education policy.

VEUGER: That's right.

II: Debt, Trade, and Immigration (43:23 – 1:22:38)

KRISTOL: So talk about that part a little bit then. What is the real economy we're dealing with such that all this money is being flowing out into? I mean, how much of it's necessary? How much of it's going to be simply pointless? Which, okay, you can tolerate that some if you're a very wealthy country, right? How much of it is going to actually be worrisomely counterproductive?

VEUGER: Yeah. So I think you could good sketch a good case scenario, a bad case scenario, and a steady as we go scenario. I think the bad case scenario is one that we briefly touched upon earlier, which is the spending overheats the economy, the Federal Reserve steps in, we enter a recession. Right? That's a short run, bad case scenario. Secretary Yellen hinted at the risk of that kind of scenario earlier this week. Though, of course, she was pretty worried I think in 2016, 2017 as well. And I think turned out to be overly cautious then. Let's hope the same mistake isn't made now. So the longer term bad case scenario is the other one we talked about earlier, with increasing interest rates crowding out certain things. So I think the first one in particular would be, I think be politically inconvenient for the administration, because it would mean a recession in the relatively near future after —

KRISTOL: Those are the macro scenarios.

VEUGER: That's right. That's right. But they're related to the micro scenarios.

So the good case scenario is one where all of these policies work as intended. So the family policies make it so that female labor force participation goes up dramatically, a new generation of children is stronger, happier, and more productive. And that creates just massive expansion on the supply side until you can see much faster economic growth. That is then coupled with a successful industrial policy that attenuates climate change, not just by having effects within the US, but because the US develops all kinds of technologies that can be deployed worldwide. And climate change is solved as well, right? That would be the long-term good case scenario.

I think a realistic risk is more of a mid-case scenario where we end up with higher debt. We send a lot of money around the middle class mostly, and people spend a little more. Maybe they de-leverage a little bit, but they realize that at some point taxes are probably going to go up a little bit, and so they don't adjust their behavior that much, they're not that much happier. Lower income families receive a bit more money, and so child poverty goes down a bit, but not as much as people were hoping for. Because it turns out that quite a bit of the reductions in child poverty that we've seen came from sending out check after check after check. And so nothing really fundamental changes. A lot of the new subsidies run into supply constraints, right? So you send out money for housing construction, it just drives up home prices in other parts of town because you can't build anything new anywhere.

So that I think would be a very disappointing scenario. And one that wouldn't even have run into any of the macro constraints. Right? So I think really the bad case scenario would run into macro constraints. The middle case scenario, if you want to call it that, just not much would change because you run into micro constraints. And the good case scenario, you really fundamentally change the supplies out of the economy through family policy and industrial policy. I'm skeptical that the extreme version of the good case scenario that I sketched will actually materialize, but I think that's what the administration is hoping for.

KRISTOL: I mean, I suppose one could say, if you could get an in-between scenario where you actually reduce — leaving aside whether it ultimately leads to higher growth or not — if you actually reduce child poverty rates, you actually improved healthcare outcomes, if you actually helped the people get educated a little better, maybe ultimately it doesn't really change your GDP growth. I mean, that's a separate question. But that would be a good thing.

VEUGER: No, no. Sure. It would be a good thing, but I'm saying it wouldn't revolutionize outcomes.

KRISTOL: Right. And also, to get to the point you hinted at though on the supply side. But you can also write a scenario where you double spending on, I'm making this up obviously, on higher education, all in. And it doesn't, it just — we have doubled spending on higher education, I believe, over the last 20, 30 years. And I don't know, it just means more money sloshing around into higher education, and tuitions go up, and administrative costs go up. Healthcare, I think, has notoriously not been responsive necessarily to simply having more spending flow into the system. And so —

VEUGER: And housing, which I highlighted is a good example.

KRISTOL: Yeah, that's a good sphere too. Right. So you end up with a situation where, again, it's not the worst thing in the world to just have more money sloshing if you could afford to from a macro point of view. But do you get the micro — I mean, how much have people thought about the supply side, if you would? Constraints, I guess, behavioral constraints also that maybe make you wonder if this money is really going to do what they want it to? That's sort of the classic neo-conservative critique of the late ’60s programs. Not so much that we couldn't afford it, that was part of it. But more that they had a poverty program and poverty didn't go down. Right? I mean, they had a massive education expenditures at the federal level and education didn't get that much more accessible to people, or much better, and et cetera.

VEUGER: Yeah. So I think that distinction you draw is fair, right? That you could have not a dramatic macro change, but you could have within that growth rates remain the same. You could have slightly better outcomes in certain areas or slightly worse ones. And so in there I do think that the supply side issues are very important. I think people have thought more deeply about them in some areas than in others. And I think in some areas they're just quite intractable.

So I think housing is a good example there, just not totally clear what the federal government can do. There's some elements in their proposals that would try to reduce supply restrictions, but it's just been very difficult. It's a lot of local decision makers in a lot of different places that all have, I think, political incentives in most places to just say, "No, we're not going to build anything new around here." And so while a lot of thought has gone into it, it's just hard to think of how to deal with it.

In childcare, the proposal pays some attention to the supply side, [inaudible]. You know, you want to train better childcare workers. But it's not clear to me that they're really thinking about expanding capacity dramatically, or they just want to make sure that people in that industry, workers in that industry are paid more, right? Which is also a supply side issue, but obviously wouldn't be effective for the kind of changes that we would like to see for the actual users and for financial burdens on family.

I think the area where the current team in the administration has probably focused the most on really growing the supply side of the economy is in family policy and in early childhood education. And I think they are just deeply convinced that that's where you can make a pretty large difference with the kind of programs that they are pushing for. I'm not sure — That presumably would change quite a bit for children who grow up in low income families and for the parents, especially women who would enter the labor force. I don't think that kind of change would have that much of an impact on all the other households in the economy. And so it's a little different from programs like making housing more affordable, making childcare more affordable, and the like.

KRISTOL: It be nice to help childcare providers, might be a good thing to be paid better. But of course that could just be done by, well — Yeah, but that doesn’t necessarily deal with the bigger problems.

VEUGER: That would certainly make the childcare workers better off, but it wouldn't necessarily make anyone else in the economy better off. That is, I think, the distinction I would draw. You just increase prices, right? This is what we do with healthcare.

KRISTOL: Right the money has to come from somewhere. So —

VEUGER: Yeah, yeah, no, for sure. I mean, to be clear, people aren’t always made better off when the prices for providers go up, right? This is what we see in healthcare. You and I occasionally work in the higher education industry, obviously if people want to give us more money that is fine and welcome. But that’s not — The government can just do that by sending us a check, you don't have to go through the industry necessarily.

KRISTOL: Right. And the students don't necessarily learn any more —

VEUGER: Exactly. No, precisely. Precisely my point.

KRISTOL: So I guess a lot of this does depend on what real world economy, and society, this is all being injected into. And so it would look different if we were at 20% unemployment, I assume, than 3% unemployment. And where are we in that in terms of the current growth and how damaged by the pandemic, labor markets and so forth? I mean, we're doing a pretty big injection of money, maybe a profligate one. There might be times for that. Is this the conventional economic theory say this is the right time to do that? Or some of it —

VEUGER: Yeah, I think we may be overdoing it a little bit. I don't think the dramatic aggregate demand stimulus that we saw in the American Rescue Plan was entirely necessary. Another round of checks, quite a lot of money for households that didn't really need it. So what we saw is that the personal savings —

KRISTOL: You were a strong advocate for the initial big injection —

VEUGER: Oh, for sure. Yeah, yeah, for sure.

KRISTOL: You're not doing this from a dogmatic, “the government never has to do anything —"

VEUGER: Not at all. I think a lot of the spending was very helpful. But we did something like $800 billion of spending on the PPP program, $700 billion or so on healthcare policy. You have all kinds of types, I think fighting the public health crisis was very important. Yeah, almost $800 billion on unemployment insurance, which I think was money well spent.

The question is, do we still need as much going forward? How do we want to design that? But for sure that was very necessary last summer and last fall. We've sent almost a trillion dollars to state and local governments, that was probably too much. But the other components I've been pretty supportive of. I think the most recent package was probably a bit larger than necessary. I mean, but I think the context there is important, right? Former President Trump proposed a new round of checks, then the Democratic Senate candidates in Georgia adopted that idea. And that's how we ended up with it. I don't think we otherwise would've seen an additional round of checks.

But anyway, as a consequence the savings rate in the past quarter, in the first quarter of 2021, was very high. It was over 20%. So it's something like $4 trillion in savings. That money will presumably at some point get spent. But that does mean that households are, in the aggregate, are in very good shape. We saw a very high annual growth rate in the first quarter, it's over 6% in annualized terms. Inflation picked up a bit, but nothing, I think, particularly concerning. Personal incomes just up, something like 60% on an annualized basis, right? Really dramatic increases in all those income and growth metrics.

Then a second element is the labor market, right? So I think there, and there we're basically back in terms of real GDP where we were before the crisis. Right? So we're not quite back to the trend growth level yet, but we're back to the level that we were at before the crisis. So that's going pretty well.

The labor market is healing, and there there's still quite a bit of damage. So yeah, unemployment rate is now 6%, that's down from the last time we talked when it was more like 14%, right? So that's been very good. It is still higher than it was before the crisis. And in addition, a number of people have dropped out of labor force. So we're still about eight million jobs down from where we were. A good chunk of that, probably 35 or so percent is in leisure and hospitality. But that means that a majority of the jobs in other sectors, right, education and professional and business services, all industries have suffered to some extent.

So the healing isn't quite complete yet there, but then of course that is in part just because there are ongoing restrictions, people don't feel safe. Obviously conventions and the like have to be planned pretty far ahead of time, and so those haven't fully bounced back yet.

But things are looking quite good, I think certainly in the US. And importantly, they look a lot better than people expected. So in part, thanks to all of the government interventions. In part, because we developed a vaccine, I think at a pace that has been miraculous.

So if we go back to June last year, the IMF projected for the US that the economy would shrink by about 8% in 2020. Instead that became -3.5%. And expected growth for 2021 of only 4.5%. Right? So the IMF projection was that even by the end of this year we would still be well below where we started out before the crisis. Instead, we've already gotten to the point where we were before the crisis, and growth is expected to be higher than they expected this year. Even though last year we did better than they expected too. So that's going pretty well.

It's not going as well in Europe, but it's going reasonably okay. There's a few other countries that are really struggling. Latin America, India and South Africa did really poorly in 2020, and I don't think are going to be able to come back fully. But the US has really exceeded expectations tremendously. And I think we're in a good position now to go ahead.

And so I think it's important to keep in mind that the American Jobs Plan, the American Families Plan as they called them, the new Biden proposals. Those are really not needed from a macroeconomic perspective, right?

KRISTOL: I think that's a very important point though. I mean, normally these things get introduced from a macroeconomic Keynesian perspective, you need a giant shot in the arm for the economy. And then of course you get to do it in the way that you prefer based on some ideological or other considerations for what you think is important to do. But there is something that feels a little bit like the mid ’60s, as Larry Summers kind of warned about. “Well, I don't know, we just could afford to do it so we're going to do all these things.” Even though it's not obvious you've —

VEUGER: Well, but yeah — I mean, it's in part also why they combine it with the tax increases, right? And so here you really do see different impulses the administration has. Because I think some people do think that we should overheat the economy a little more, and that there's not much risk there. I think others, I think Janet Yellen is the prime example probably, is much more cautious on that front. But she just wants these programs done, right? She just wants to reduce inequality and do all these various family and education programs, and is less worried about the negative growth consequences of tax increases, and the like. But also not convinced that we need a much looser fiscal policy for another few years.

KRISTOL: I mean, you've emphasized several times, I think it's a good reminder how much the Biden administration has gone out of its way to avoid or look like they're avoiding increasing taxes on the middle class. Pretty broad understanding of the middle class up to $400,000 family income. I mean, one thing one could say —

I talked to someone the other day who's — anyway, a sort of non-Trump Republican thinking of running for office who was very hostile to the Biden plan, even though she voted for Biden. I think running for Congress because she so disliked Trump. “But this is what I'm worried about,” [she said]. And I said, "Really, why is it that bad?" “It's not going to stick at $400,000, they always say it's going to be on the wealthy, and then it's going to come down to the middle class.”

That is a pretty common sentiment, and not without some basis in history, of course, in reality. I mean, do you think that one way they could resolve, when they see the revenue shortfalls, is expand the taxes? Or do you think that they're dug in just psychologically on that, not letting the Republicans have that issue of a tax increase on people making $150 or $200,000?

VEUGER: Yeah, I do think they're very committed to that. And in fact, they're pretty dramatically reducing taxes on households under $400,000. Right? By expanding the child tax credit, by expanding — It's not the marginal rates that I would like to see them reduce, but they are reducing the total tax payments of a lot of lower income, middle class households. The child tax credit expansion, that is a big program. That's something like half a trillion in 10 years. That's a quarter of the net tax decrease in the Tax Cuts and Jobs Act. Right? And all that money is going to those families. So—

KRISTOL: But it does top out, doesn't it? Around —

VEUGER: No, no, but that's going to the bottom 99% of the income distribution is what I'm saying. [—

KRISTOL: The bottom 75 or 80% —

VEUGER: I see. So if the concern is it may creep down from $400,000 to $250,000, that's possible. I'm just saying, it seems inconceivable to me that they will do broad-based tax increases on the entire income distribution.

KRISTOL: No. Well, that's a very important point. I mean, from a political point of view you could argue that the people between $200,000 and $400,000 —I'm making this up, I haven't looked at the studies — is a particularly important political class. There are people who really vote, who make their voices known, who were influential in their community. And if they suddenly feel net, net, they're pretty obvious losers rather than at least neutral, as this whole thing happens, that would be an interesting question I suppose.

VEUGER: Yeah, but that hasn't happened yet. And I mean, I think, if anything Democrats are more likely to eliminate the cap on state and local tax deductions than they are to raise taxes on that group of people. I think that's a good indication of where the politics are on that issue.

KRISTOL: So it'd be funny if, yeah, they don't turn out to be a big tax party at all. Or they turn out to be more redistributive, I guess, than one expects. The knock on then that they'll come and tax the middle class won't turn out to be true, but the knock on the deficit —

VEUGER: Yeah, it'll be a problem for them if interest rates do go up, if it turns out that you run out of fiscal space, that's when the hard choices will arrive. That will be a problem. But for now, I think they're happy to —

KRISTOL: Two things we haven't even mentioned, which are kind of important in overall economic policy, are immigration and trade. Which I think we've discussed both on-air and off-air many, many times. Kind of nothing there. I mean, if you came down from Mars and said, what could you do to help the economy? I think immigration or trade would be pretty, may not be number one or two on the list, but they'd be pretty high in the list of five or six things you should think about. Are they not doing any harm at least? Or would you wish for more?

VEUGER: So on trade, and it's frustrating that both parties are in a place where they are unwilling to engage in efforts to liberalize trade. I think just because presidential politics is so important for when it comes to considering trade policy options. And there's obviously the 400,000 voters who everyone thinks of as the most important people in the country, care a lot about trade policy and immigration policy. So, I think that's why they're a little cautious on trade.

They haven't undone all the measures the Trump administration took. They haven't undone measures, not even against traditional US allies. So, there I had hoped for a little bit more.

On immigration, same thing. They haven't rolled back even some of the more draconian restrictions that the Trump administration imposed. Maybe that will get a little better by the time the pandemic is really fully over here in the US, but I don't think they're doing this for traditional populist reasons. I think it's more of a *popularist* approach where they don't want to adopt policies that are relatively unpopular. If you look at the polls, a lot of relatively obvious immigration measures are quite unpopular, and so I think that's driving some of that.

KRISTOL: Do you agree, though, that if in fact you didn't have any political constraints, some of what one could do with immigration, both maybe especially high-skilled or maybe all-skilled, is really among the best things you could do, for economic growth.

VEUGER: I totally agree. I think it's one of the best things you could do for economic growth, both with high-skilled immigrants on the innovation and the entrepreneurship side of things.

With immigration overall, I think you can really grow the country's geopolitical political strength too, so even outside the more narrow economics of immigration. I think if there's one big advantage, the US has over the EU to some extent, but certainly over China, is that it's capable of attracting significant numbers of immigrants, including some of the most talented people from a lot of countries around the globe.

I always find it genuinely frustrating that some of the people in Congress who present themselves as the biggest China hawks are also the most committed anti-immigration activists. Really, it's not a very convincing combination of views to hold.

And then thirdly, obviously the immigrants themselves in many cases benefit tremendously. I think, letting that potential come to full fruition is very important in and of itself as well.

KRISTOL: But there seems to be not much political impetus on trade or immigration, so we'll muddle through, I guess, with the current policies.

VEUGER: On trade, I think some of the same geopolitical considerations apply to TPP most obviously, but I think more generally. I think building a web of allies, especially in east Asia, it seems like something you'd want to do.

KRISTOL: No. I know. If you're serious about the competition with China, the two obvious things to do are have some version of TPP, I would think, and as you say, build the web around China of our allies, mostly democratic ones. And especially, what we've done in the past, which has helped us certainly in World War II and in the Cold War, which was attract an awful lot of qualified immigrants to help us out-compete them and out-innovate them. But that seems not to be — Maybe that'll come at some point.

Finally, maybe we should — This has been terrific, and for me, very clarifying, I think, in thinking about the whole question of what Bidenomics is. What about the world? I mean, it is a global economy. Isn't that something we were all taught for the last 30, 40 years? "You've got to break out of that looking at each country alone. You've got to think of it internationally." So, where are we globally? How much does this stuff get dissipated? What effects does it have globally and so forth?

VEUGER: So, the US and the EU, I think, are on track to recover quite well. China has done okay throughout the crisis, I think, at least in that narrow business cycle sense of the term.

Latin America and Africa, I think, have really struggled to gain access to vaccines, excepting a few smaller countries. And so that's very concerning.I would hope that the US would make an effort to make sure that everyone in those countries gets vaccinated as soon as possible, both for the obvious humanitarian reasons, but also to make sure that those countries can revert to their growth path soon, that the governments won't get destabilized in the middle of a major public health crisis, et cetera. So, I think that's important.

Then one thing I would highlight in Europe is that we've seen pretty dramatic developments there since we did our conversation on the European Union a little over a year ago now. So, since then, we've really seen pretty significant steps toward further integration on the macroeconomic front. So, as most of our listeners will know, Europe went through a very deep crisis and a sovereign debt crisis after the global financial crisis. Big issue there was that some member states just weren't allowed to engage in much deficit spending. Did some of that, almost inevitably just because in the middle of a crisis you lose a lot of tax revenue, then had to engage in dramatic austerity measures to remain within the bounds of fiscal policy that the EU had set for its members. Faced a lot of market pressure, increasing interest rates. So, that requires even more belt-tightening, and you get into this vicious cycle.

This time, I think, the EU really learned its lesson. It, I think, had pretty convincingly signaled that it would back the sovereign debt of its member states. So, that wasn't really a concern, but that would still leave, of course, member states with the restrictions to 3% of GDP maximum deficit rule that the EU imposes. It would still leave countries with those restrictions, if those rules weren't loosened. So, those rules were were loosened for the crisis. Then you run the market risk again to some extent.

So, instead what the European union has done now has set up a central fund where it raises money that is backed by all the member states, and then will pay it out to the member states based on how hard they were hit, based on their income levels, so that they can use that for the recovery. Right?

It's a little reminiscent of how the US federal government plays this role in a crisis. State and local governments in the US have balanced budget constraints, and so they can't do countercyclical spending. So, instead the federal government steps in and sends them checks. Maybe in the current crisis, it sent them money in too generous of a fashion, but it does play that stabilizing role.

So, what we see now in Europe is that the commission, the central fiscal authority, has adopted that role a little bit. I think it's important because the EU really did come under quite a bit of stress in 2014, ’15, 2012 to ’15 actually. So, moving in this direction of more of a central fiscal authority that can step in, at least when there is a deep crisis, I think, is very helpful, both to the member states involved themselves, but also through the sustainability of the whole framework.

KRISTOL: Yeah. So many people, and I was one of them, thought the whole thing could just fall apart eight, nine years ago, and now it seems somewhat — Britain's out, I guess — but it seems stronger than it was, not weaker.

VEUGER: Yeah. I agree. Of course, the vaccine purchase program hasn't been as successful as people had hoped. Some of that is bad luck just because of which vaccines came to be developed first.

But, otherwise I think more on the macroeconomic side where really the concerns were five, six, seven years ago. There, I think, there's been a ton of progress, and I think that's helpful for the US as well, because I do think it serves the US well to have a strong community of allies there.

KRISTOL: So, you think the EU goes back a little more slowly, and once they get the vaccines distributed adequately —

VEUGER: Yeah. So, now that we have seen —

KRISTOL: So we end up with an adequate — For all the, I mean, terrible price we paid for the pandemic, it does sound like you're saying that, bracketing even the Biden programs for a minute, that mid of about a year from now, we have economies that are not that far behind where they would otherwise have been it sounds like?

VEUGER: I think that's right. That's right. Yeah, exactly. So, we're now back at the level that we were at, but growth is prognosticated to be a little faster than it would have been in the absence of the crisis for the rest of the year. So, that should let us catch up to the trend, and I think that's about right, which is, I think much better than what people expected in May, June of last year.

So, I think that really is a testament to the public policies that have been implemented since, and, of course, to the pharmaceutical companies that really very quickly developed this vaccine. What does it take, 48 hours and then 10 months of FDA approval?

KRISTOL: Yeah. And if I can sound a little more right-wing, to the resilience of free-market economies which have all these pharmaceutical companies and all these ability to adapt in ways that are much —

VEUGER: Exactly. Yep. That's exactly right.

KRISTOL: Amazon can hire hundreds of thousands of people who get laid off from hotels and cruise ships or whatever.

VEUGER: Absolutely.

KRISTOL: So, it is impressive just that flexibility of the labor market and so forth. It turns out to —I wonder politically if — I will close — but a year from now, if we are really chugging along with 5% growth and our four, four and a half percent unemployment or something, I guess that's not impossible or something like that?

VEUGER: No, I think it is possible. Yeah.

KRISTOL: I mean, whether some of the impetus for some of the spending goes away, some of the people decide some of these tax increases look a little high and you get the Biden thing. I mean, because it is spending, doing so much more in the current structure, I suppose, it has that — If one had a serious opposition party, the serious opposition party could say, "Well, let's just get rid of this particular tax, and let's cut this one in half. Let's cut this spending. Studies have shown that this particular spending program isn't quite as necessary, and let's kill the last three years of it."

I mean, there are plenty of ways in normal politics, you might say, that you could end up with a sane adjustment of that. I mean, Reagan passes the huge tax cuts in ’81, and a third of it's taken away in ’82 when it becomes pretty clear that it's not really necessary, you might say, to get the economy going and it's been overdone. It doesn't feel like our politics is capable of something so sensible.

VEUGER: It's not totally clear to me what's in it for Democrats on a lot of these issues, because you can have a bipartisan infrastructure bill. I mean, that's something they can pass by themselves, too. I think in some of the areas that are more controversial, you know voting, which I know you've worked on, but immigration as well, there's just nothing Republicans are willing to offer as far as I can tell. On climate policy —

KRISTOL: I mean, even on the strictly economic, I guess what I'm saying is, I mean, you could imagine a year or two from now a healthy political system could say, "Look, Biden may have over done it in some of these areas. They just made up some numbers a little bit on the back of an envelope and decided it's a big round number. Let's do it." But these are mostly five or 10 year programs, right? I mean, they can be cut back in out years, not all the expenditures —

VEUGER: And some of them expire in 2025 when the Trump tax cuts expire as well. So, presumably that is when we will have that conversation. So on the pure economic side of things, I think, that's part of when it will happen. Presumably the next time Republicans have a majority, they will change tax policy back to the way they like it. I agree with you it would be better if we had some sort of more permanent compromise position, but I'm not sure —

KRISTOL: I guess the question is if the Republicans won one of, or both houses — this is way ahead though, so we don't need to dwell on this in 2022 — whether you could end up with a TEFRA-like situation. That was the ’82 compromise, that Reagan signed something that he wasn't happy about.

VEUGER: It's possible.

KRISTOL: Certainly the Jack Kemp types were very unhappy about it, but probably net at the end of the day, people think that was probably sensible. Or the 1990 budget deal. I mean, it does seem like that's another world politically. But I mean, one way you fix overly exuberant policies is to make them less exuberant in a year or two when the data is coming in that you don't need all the exuberance. But that seems like too rational a system for us.

VEUGER: But it is quite possible. Right? Now it's the year 2023. We start out with four months of a government shutdown. [Laughter]

KRISTOL: That's going to be great.

VEUGER: And then the child tax credit gets reduced.

KRISTOL: Yeah. Yeah. Yeah. On the tax side, final question, because that seems to be where the Republican opposition will be the most vehement, I should think. I mean, genuinely from a just economic growth point of view, which of them worries you the most? If Biden called you in and said, "You know what? I'm going to tool back some of the spending, and I'm going to get rid of some of the tax increases," which ones would you tell them to either get rid of —

VEUGER: I would probably get rid of a good chunk of the manufacturing subsidies, and a reasonable chunk of the infrastructure, and I would personally probably get rid of the child tax credit expansion, certainly for the middle class. You don't want to phase it out too fast, but I think that seems unnecessary.

KRISTOL: How about the corporate tax increase? Are you worried that takes us above —

VEUGER: On the tax increases side.

KRISTOL: On the tax side, yeah.

VEUGER: On the tax side, the corporate side, I mean, on the tax side, I'd probably try to dial back as many of them as I could. For the corporate tax system, I think that would be a good area for bi-partisan agreement. If you could get maybe the 28% rate, but maybe reduce the worldwide nature of the system a little bit more, some sort of international agreement to reduce tax avoidance, that would be a good space for bipartisan agreement. It's a little less controversial and a little less burdened with cultural disputes, I think, than some of the family policy issues. So, maybe that would be an area to focus on.

KRISTOL: And cap gains versus individual rates, which do you think? If you could only avoid one of the two increases, which would you, or parts of one of the two?

VEUGER: Well, I would cut the individual rates because the cap gains rates are tied to them. Then you get both.

KRISTOL: Well, that's true. That's right. Yeah. Yeah.

VEUGER: Yeah. I mean, I do worry about that a little bit, that we're phasing out all the programs that are between $250 and $400, and then we're gradually increasing those top rates by a lot because now you go from 37, 39.6, plus you now have to pay the Medicare on earned income tax on earned income as well. So, that's another four points. Of course, we got rid of the SALT deduction, so that's another five points in some places. It really does start to escalate on the top end of the income distribution. So, I think that should be a priority. I don't know that Republicans are as energized about that as they once were. I mean, it's ultimately the reason why those rates, I think, are so high is just because of fear of any kind of tax increase on the rest of the income distribution.

KRISTOL: But you don't think it's just special pleading when wealthy people, or people who work for wealthy people, say you're running some risk of really getting the overall incremental, the overall marginal tax rates on some of these people just too high to be healthy. I mean, that's not a ridiculous thing to worry about.

VEUGER: No, I don't think that's a ridiculous thing to worry. I mean, I think those are... No, I don't. I mean, part of it is that many of the people in those categories have many more margins along which they can adjust their behavior than people who earn a single salary from one employer and are very tied to a specific occupation. So, those adjustment margins are, I think, what matter for growth purposes, for efficiency purposes. I think it's pretty clear that those are more important at the very high end than anywhere else in the income distribution.

KRISTOL: Yeah. Biden's increasing taxes precisely on the people who can do the most tax avoidance and tax juggling which is the opposite of what you —

VEUGER: But not even in a negative sense. Not just... Yeah. Yeah.

KRISTOL: I don't mean that. I just mean practically they can — So that means your revenues don't come in where they're supposed to, which means you have higher deficits, which means then you do have pressure. You need to go down into the middle class.

VEUGER: Yeah. Or you choose not to do an additional thing.

KRISTOL: Right. So, it's not over. I mean, I guess that's one big, final, final, I keep saying. Yeah, but this is so interesting, I want to keep going, but one final takeaway from this is it's not as if you pass all this, and then everyone just goes home for three years and does nothing. Right? There'll be real-world consequences of all kinds, and real-world both— I mean, everything from mini scandals about some government subsidy or something to actual questions about how certain monies, are they doing what they're supposed to be doing?

VEUGER: Generally, there will suddenly be a lot of electric vehicles and all kinds of new train routes between towns you've never even heard of.

KRISTOL: But, I mean, there will be real-world effects. In a year or two from now an awful lot of people will start to say, "Well, this one isn't working the way it's supposed," or, "This one is working well." So, I do think that you —

VEUGER: Yeah. You can have revenue from the capital gains tax increase to be very disappointing.

KRISTOL: And that would lead to a rethinking presumably. Or similarly on the spending side, clean energy could work or not, or whatever. So, I think that's interesting that it's not over. I mean, maybe it's over for 2022. I mean, as I said, there won't be much stomach to do anything then, but it feels to me like you could have, even if there's no political change, the Democrats control everything, you could have a pretty big wave of policy again in 2023 based on what will have worked or won’t have worked.

VEUGER: No, obviously, a lot will depend on what happens in the midterm elections.

KRISTOL: Right, right, right. Okay. Well, good. Well that gives us a chance to have more conversations about the state of economy, the state of what's up with Bidenomics, if it's transformational or just profligate and so forth. So, Stan Veuger, thanks so much for spending the time with me today. And thank you for joining us on CONVERSATIONS.

[END]