

**This is an unedited transcript of the interview**

Peter: I'm Peter Robinson. By the way, please be sure to join us on Twitter at <https://twitter.com/uncknowledge...> <https://twitter.com/uncknowledge>. A fellow at the Hoover Institution and a professor of economics at Stanford, Michael Boskin served as Chairman of the Council of Economic Advisors under President George H.W. Bush. A fellow at the Hoover Institution and a professor at the Stanford Business School, Edward Lazear served as Chairman of the Council of Economic Advisors under President George W. Bush. Mike and Ed, welcome.

Mike: Good to see you here.

Ed: Please to be here.

Peter: On a scale of one to ten...one representing not a chance and ten representing it will happen for sure – how likely is it that the United States of America will become another Greece? Mike?

Mike: Two to three.

Peter: Oh really, I'm encouraged. Ed?

Ed: Two.

Peter: Okay, second one...spending more than we bring in...couple of statistics here...by January President Obama will have increased the Federal budget...the Federal deficit more in two years than President George W. Bush did in eight. He will have increased Federal spending to more than 25% of our gross domestic product...the highest proportion in American history, with the exception of WWII and he will have raised the annual deficit to some 1.4 trillion, more than three times the previous record set while you were Chairman of the CEA in 2008. Ed, why does this matter?

Ed: Well it matters for two reasons...first of all right now we are talking about a very large deficit and that tends to be the focus...when people in Washington talk about the budget...they tend to focus on the deficit. The deficit matters because it tells us how much we are borrowing and since we save less than we invest, it means that we borrow from abroad. But more important what we really need to be focused on is not the deficit, but the level of spending.

Peter: Okay.

Ed: And the reason for that is that ah...even if we closed our deficit and that would mean that we raised taxes...we would still be not helping the economy. Taxes hurt the economy...deficits hurt the economy. So, once we've declared that we are going to spend at very high levels, we're really between a rock and a hard place. We don't have an easy way out.

Peter: Mike, let me quote to you, Nobel Prize winning economist – Paul Krugman – this is Paul Krugman writing last year, “Deficits saved the world. In fact we would be better off if governments were willing to run even larger deficits over the next two years.”

Mike: I think that's silly. First of all there are two components to the deficits. One happens automatically in a recession. Receipts fall, especially if you have a very progressive income tax, they fall a lot. Some unemployment compensation goes up and some other transfer payments go up. But taxes fall a lot more than income, so disposable income falls less than before tax income and

**This is an unedited transcript of the interview**

that helps cushion the economy. That was actually twice as large, maybe three times as large in effect as the discretionary stimulus. The discretionary stimulus both the modest one in 2008, which President Bush and Congress did in the spring and President Obama's eight hundred and sixty-two billion-dollar...

Peter: Trillion...

Mike: Eight hundred and sixty-two billion-dollar so-called stimulus bill passed in early February 2009, helped the economy hardly at all. There was no big multiplier if you plot consumer spending against when disposable income changed there is very little effect...

Peter: Can I just add...

Mike: ...very small effect.

Peter: This is not saying that the multiplier was mistaken sort of uhm...ex-ante...the figures are in, you've looked at the data. This is purely empirical now, it just didn't work.

Mike: I think it's fair to say. You can't go back and re-run the economy.

Peter: Right.

Mike: So you've got to suppose what the counterfactual was, with the Federal Reserve would it have done exactly the same thing...what would have consumers have done, etc. So, in a wider ray a sense of the models it turns out that multipliers tend to be pretty small. And that the number that most serious economists work with are number between a half and one, not well over one as the Administration assumed. And they happen to be larger for tax cuts, especially those that tend to be longer lived and especially those that tend to be on marginal rates than much of spending...a fact that was demonstrated in the research of Christie Roman, Obama's own economic advisor.

Peter: Okay, we'll return here.

Ed: Okay, let me just follow on that, because I think Mike makes a very important point and one that I agree with. Probably the best evidence that we see from 2009, as far as the stimulus and it's affect...is if you look at what caused the economy to turn around and it did turn around in 2009, no doubt about it...in the first quarter of 2009, GDP fell by six percentage points. That's big, that's huge. In the fourth quarter it rose by six percentage points. So, that's a swing of twelve percentage points. Now, if you ask what cause the difference...the difference was all on the investment side. It was not on the consumption side, so investment fell off a cliff in the first quarter of 2009. Investment fell by 50% and we knew that at the time.

Mike: We knew that investment was dropping much more sharply than consumer spending.

Ed: That's right. And then after the fourth quarter of 2009, investment picked back up. Now why is that? Well I would argue that much of that had to do with the end of the cause of the recession. The cause of recession was the financial crisis that occurred primarily in the autumn of 2008. We didn't know it at the time, but the financial crisis...the crisis per se was probably over by the end of that quarter...by the end of autumn of 2008. That didn't mean that the financial markets had

**This is an unedited transcript of the interview**

recovered, they surely hadn't. But in terms of crisis and in terms of the kinds of things that we were worried about back in September, those were gone.

Mike: If you were to look at the four things that really affected the economy and were the proximate cause of the turnaround...the first is natural business cycle dynamics of the economy. A large part of this was inventory adjustments. The second part...the second thing would be the Fed's actions...monetary policy in some part of it's other extraordinary measures helped some in the commercial paper market. Some other things I thought were ill-advised, but unbalanced the Fed and helped a lot. The third would be the automatic stabilizer and then last at the bottom of the group and not worth the eight hundred and sixty-two billion dollar cost and a vast increase in taxes in the future that are going to apply...was the stimulus. Now, you could argue that a sensible stimulus might have been effective. Many of us argued that throughout 2008 and 2009, they maybe should have had a partial payroll tax holiday, which would have changed the calculus for firms and make how many workers they needed to lay-off to become profitable again, for example. And that works under a variety of macroeconomic theories and it even works under the Keynesian theory, which these guys seem to empower now and seem to buy, which most modern macroeconomists reject, other than for a very small short period of a very modest Keynesian in the short term. It works under a variety of other economic models and my own colleagues have at Stanford \_\_\_\_\_(00:07:17) his colleague at Rochester, Mark Bills estimated that might have saved three million lay-offs. That would have been a very wise thing to do. But what they do is that they outsourced it to the Congress. The Obama Administration outsourced it to the Congress and we had the left of the Democratic party become the barons of all committees and they have been out of power since the first years of the Clinton years, since the 1970s...so in thirty years they have been able to do very little of their agenda. They just lard it on a bunch of social engineering and pork. And whatever good you think my comment on spending on green...you know weatherizing schools and all that sort of stuff...doing that in 2011 and 12 is not going to stop lay-offs in 2009. So, it was particularly poorly thought out.

Peter: Segment Two money. You've already started this Mike. From President Obama and the Obama Administration and fiscal policy to Fed Chairman Ben Bernanke and monetary policy...financial crisis autumn 2008...from that point within a relatively few months, the Fed engaged in an unprecedented increase in the money supply. This is the tightest statement of it I have found, this is economist Arthur Laffer, "The percentage increase in the monetary base," this is Art Laffer writing in 2009, "is the largest increase in the past fifty years by a factor of ten. It is so far outside the realm of prior experiential base, that historical comparisons are rendered difficult, if not meaningless." Huge liquidity into the economy and the Fed continues to keep rates so low that mortgages just dropped below 5%. Is this the right thing?

Ed: Well, I would say two things on that. First, I think that Laffer's statement is bit of an overstatement in the following sense; first the Fed has a new instrument that is available to transmute instability and that is the ability to pay interest on reserves. So a large fraction of the money that was printed is soaked back up into the system...into the Federal Reserve system. That said, uhm...I think that this is an issue more for the long run than it is for the short run. And the concern that I have...ah is that when it comes time and the Fed is already starting to unwind some of the program that it started...when it comes time for the Fed to unwind, there will be tremendous pressure on the Fed to avoid doing that. In large part because sometimes it will have to unload...in particular the mortgage-backed securities and will have direct effects on political very sensitive variables, like mortgage interest rates. And so, I think is going to be the pressure in the future...right

**This is an unedited transcript of the interview**

now, it pretty hard to argue that there are strong inflationary pressure in the short run. I think most of the evidence suggests that there isn't. But, again I think the concern is in the long run and not the short run.

Peter: Mike?

Mike: I agree with that. I think we can break this up into three episodes. Part one, some sizable...far from all, but some sizable – far from all – but some sizable fractionary responsibility for the crisis comes from excessively loose monetary policy earlier in the last decade. The economy by 2003, was growing at 4.5%. We had a recession in 2001, a slow recovery in 2002, and then the economy started to boom. And the Fed kept it's target short-term interest rate, so called Fed's Fund Rate, below the rate of inflation for the next three years. So what we had was negative real short-term interest rates. So people could borrow a dollar and pay it back in ninety-eight cents later.

Peter: So to some extent, the housing bubble is...

Mike: It's not just housing. The housing bubble, ah low starter teaser rates on mortgages were enabled by this, home equity lines of credit, auto loans, credit cards and their receivables, private equity, all those things financed...all of this was financed at the short end. People were borrowing short and lending long...making money as long as that continued, as long as strong growth continued and there was a steep yield curve with negative real interest rates or close to zero real interest rates at the short end. Then when that changed and people couldn't continue to borrow short-term...that's when things really froze up. That's number one. So, they deserve some of the responsibility for the crisis in the first place. That said; the response lowering rates down close to zero and then I think you have to think of it as a series of experiments that they did because they weren't sure exactly what would happen. There was some history in the depression and some history in Japan in their loss debt...the so called quantitative and continuing to expand even though you couldn't lower interest rates any more because they were close to zero or at zero. There was a series of experiments. I think some of them were beneficial and some not. I think it was unfortunate that they started by long-term treasuries. I think that raises the specter of politicalization of the Fed's activities in the future and be unable to... So, giving them higher marks, good marks for their response and then as Ed has said, the real issue is how they unwind. And that is the thing that has beguiled the Fed in the past, when they've had to start raising rates early before unemployment got down a lot. There is a lot of pressure on them not and I know that is Bernanke's intention.

Peter: Okay, so could I ask you – layman that I am...I can construct an argument for either worry...inflation or deflation. So, the argument for deflation, which you've already touched on is that there is just so much money sloshing around and it is going to be very hard...the Fed knows how as a technical matter...to scoop that excess money or what will become excess money, but it will be under intense political pressure to do so slowly and to do so. So inflation is a problem. On the other hand, mortgage rates are down below 5%, the housing industry is still lagging, surely that has to be at least in part because people are expecting prices to drop even further. So, it's...you could argue, I think that there are deflationary expectations already built into segments of the economy and Bernanke is very correct to be worried about that.

Ed: I would say this is a short run versus long run phenomena. And again, I think the major problem goes back to what you were talking about earlier...it has to do with our budgetary pressures. So, remember where you started – you talked about the very large growth in the deficits,

**This is an unedited transcript of the interview**

the high increase in the debt to GDP ratio – we're talking about something over 70% by the time we hit 2013. Those kinds of numbers mean that the US Government will be spending in the very near future, more on servicing its debt than it's spending on national defense. And the concern for us, I think at that point becomes what do we do? Do we start raising taxes and raising taxes dramatically, or do we essentially default on the debt through higher inflation. The US is never going to default on the debt, that's simply...so the way we would do that would simply be to say; are we going to have a very high rate of inflation...at a rate of inflation that essentially renders that debt worth much less to the creditors than it was in the past. I think that's the big concern.

Mike: It's a legitimate concern, but we've – the government has moved so much to short-term financing of its debt. The duration...the average duration is around four years, so you don't get a lot out of inflation...it rolls over too fast. So, you can't – it's the long-term debt if you can fix nominal rates it's get hit when there is a higher inflation rate.

Ed: Going back to longer terms.

Mike: So very slightly so far. So, if they start moving back quite a bit and there is a lot of pressure to inflate, then we will wind up with a lot of chaos in the markets and a lot of pressure. I want to come back to the debt and deficit though. Because the way to think about it when the government borrows a dollar – that means in the future it's going to pay back that dollar plus a series of interest payments. So the present value of all that is the dollar discounted back to today. So if it fixes the level of spending...every dollar borrowed today is a dollar, plus interest of taxes in the future. So, the reason people worry about big deficits and debt is they look at it that if we don't get spending under control, large tax increases. If you look at episodes in history, episodes around the world...recently and throughout time...we can look at two episodes...one with high debt ratios and one with high taxes. If we look at the last quarter century before the crisis, you could rank the major large economies exactly in inverse order the size of their government sectors. The ones with the biggest taxes and spending...Germany and France...grew the slowest. Britain in between the United States, with the smallest...grew more rapidly. Now there is some causality. There are many other factors, but there are some people...and I think it's much of the reason, but it's not all. That's number one. Number two, you look at debt ratios. The IMF believes that every ten percentage point increase in the debt ratio will slow growth by about two tenths or a quarter of a point. Ah...another thirty or forty points that Obama is adding or more...into the future would wind up slowing growth by three quarters of a point let's say, which is roughly half of our long-term per capita growth rate. So, there are big, big issues...big, big issues and when you look at when countries have gotten into the debt crisis's, it tended to be when the debt GDP ration started to approach eighty, ninety, or a hundred percent in the gross debt. That's a technical term because we have some net debt costs of Social Security holding some and we're headed there by the end of the decade. So, that's typically been a time where there have been big problems. And we have some other issues...we borrow in dollars, which is the world's reserve currency so that may give us a little break with the largest most liquid capital market. But the notion somehow that we're invulnerable to any of things is a foolish one. The math is the same for everybody.

Peter: Segment Three, where we stand. Ed you talked about the swing by the end of...the GDP dropped six percent...give me the quarter...first quarter?

Ed: Oh, 2009. The first quarter 2009 and fourth quarter...

**This is an unedited transcript of the interview**

Peter: Fourth quarter 2009, it recovered by 6%, so there is a 12% ...alright.

Ed: For a quarter. This is annual rate for a quarter.

Peter: Annual rate for a quarter.

Ed: The economy would have had to have dropped six percentage points for four quarters to have actually fallen 6%.

Peter: Okay, got it, got it. Thank you very much. That actually is quite important. Alright, so again layman's question...since the end of the second World War, the general rule seems to be the deeper the recession, the sharper the recover, right? So, having just gone through the worst recession since the end of the second World War, we ought to be feeling a rocket rumbling underneath this economy by now. The Dow is monkeying around, around ten thousand and has for some months. May jobs report shows about 450,000 jobs created, but only 41,000 of those are in the private sector, the rest accounted for entirely by Federal hiring. So what's going on? This is not a roaring economy. This is not a sharp recovery, is it?

Mike: Well you have to distinguish GDP growth from labor market growth.

Peter: Alright.

Ed: So GDP growth has been pretty strong in the past half year. In fact, when I left CEA in 2008, we had a forecast and we said what would it look like in early 2010...and we said 5% and everybody thought that was ridiculous. Well it turned out it's 4.5% over the past six months. Unfortunately, it's backwards. It was 6% in the fourth quarter of 2009 and than 3% in the first quarter of 2010. So, that's not such a great sign. The problem has been that the labor market has not responded very quickly. And I don't think that any of the gimmicks...any of the so-called job creation techniques that the government has attempted to use, have been effective. Unfortunately, we only know one way to create jobs...and that is to make sure that the economy grows and grows rapidly. The best prescription for that is keeping tax rates low and making sure that they low into the future. As you know, 2010 is a key year. It is the year during which many of the taxes that went into effect under President Bush's tax cuts are going to expire. Capital gains, dividend reductions, as well as the highest marginal rate will most likely change. Those are impediments to investment. They are impediments to growth, and they are impediments to hiring.

Mike: Let me go back to this issue of the growth. I think it's likely that when the recession is dated, it will be dated as having ended in the summer of 2009. If we date since then, one quarter earlier than the numbers Ed did, we have averaged 3% growth since the recession ended.

Peter: \_\_\_\_\_(00:19:29)

Mike: ...which is three quarters. In the other two comparable large deep recessions, 1974/75 and 1981/82, when unemployment got to 9% and 10.8%, higher than this time around by the way, respectively. The economy grew between 5 and 6% for three years. So, this is an anemic recovery and it's poor in job growth and it's modest at best in GDP growth, in my opinion.

Peter: Mike, listen to George...

**This is an unedited transcript of the interview**

Mike: Part of that is Obama's...the prospect of higher taxes...but also Obama's policies have been very anti-business...very anti-jobs...very anti-investment...a lot of uncertainty has been created. A lot of increased costs of labor are being piled on.

Peter: George Weil writing in June, "Investors and employers are uncertain about when interest rates will rise and by how much..." That's a Ben Bernanke question, but now here comes a Barack Obama question. "They do not know how badly the economy will be burdened by the expiration of the Bush Tax Cuts. They know the costs of Obamacare will be higher than advertised, but not how much higher. They do not know the potential costs of Cap and Trade. They do not know how the financial sector will be altered and impeded by the many new regulatory rules and agencies." If you are an employer or a venture cap...why would you hire people right now? So I guess what I am probing for here is...actually two questions. One question is, you both are ah...came of age and you studied your academics during this period, but how bad does what we went through...how bad is it by comparison to the late 70s, say? Is this just a repeat of a cyclical something or other we should expect every twenty to thirty years?

Ed: I think in terms of the effect on the economy, it's quite comparable to the late 70s and the early 80s. I don't think this is any worse.

Mike: I agree.

Ed: However...yeah you know when you have 20 to 22% interest rates...when you have 10.8% unemployment...the difference is a new path was chartered for economic policy in the early 1980s, which had lower taxes, more sensible and less regulation and the like, okay? Lower inflation, better monetary policies...

Peter: So Clinton in effect, validated it making it bipartisan. So there's real stability and certainty, right?

Ed: Yeah, we argued over a point or two of GDP and taxes and so on back and forth subsequently, but Clinton started from the center of left and move to the center. Obama started more from the far left and we will see if he moves to the center left. However, I do want to make one other point about what happened in this period - which is that the financial crisis...ah was much more severe this time...I had to help clean up the previous financial crisis with the third world debt problems, the money center banks, and the savings and loans. Which were problems that started in the late 1970s through the early 1980s. We wound up cleaning them up in 1989.

Peter: Right.

Ed: And so they had problems that had been sweep aside for some period of time and we cleaned them up and the economy had a sluggish couple of years because of that. So, I think part of this is the financial crisis and part of it is Obama's policies and the uncertainties of the policies, but if Obama got his policies through the way he wanted them, it would be worse than uncertainty because than we have a certain poor set of policies.

Peter: A last question about how weak or how strong the economy is right now. Uhm...one more reference to Arthur Laffer here, who wrote in the Wall St. Journal in June and made the point that

**This is an unedited transcript of the interview**

the tax cuts...all kinds of tax cuts are said to expire on January 1<sup>st</sup> and made the point that human beings respond to incentives, so individuals and enterprises are shifting...realizing as much income as they can this year to beat the tax hikes next year. There is income shifting going on and in fact the economy looks better, because of that than it's likely to. So, here's the money quotations, "When we pass..." this is Art Laffer, "when we pass the tax boundary of January 1, 2011, my best guess is that the train goes off the tracks. If you thought deficits and unemployment have been bad lately, you ain't seen nothing yet." In other words, the economy looks stronger in some way today than it really is. Do you buy that?

Ed: Well, I buy it a little bit. Everything that he is talking about is anticipated. So, this is not like something that is going to come as a big surprise to us. It's also a little bit difficult to substitute from the future to the present. It's not the case that people are working very hard today because they know their tax rates are going to go up in the future. I don't think there is a lot of evidence that that's the case. In fact, one of the things that is different in this recession and a bit in the previous recession in early 2000/01...uhm...is that the labor market has responded somewhat differently. The cut in the number of jobs is much more dramatic than it was in previous recessions. Productivity growth has remained high, which is unusual for recessions, at least historically. It used to be that during a recession what would happen is labor would stay on, productivity would go down, and then as the recovery came on, productivity would increase. In this particular recession, unfortunately from worker's points of view...the lay-offs, the amount of job cuts has been much more significant and employers have gotten much more savvy about reducing their costs.

Peter: So productivity goes up and employment goes down...is close to the same thing. Productivity is just a measure of output per worker.

Ed: Per worker.

Peter: So, to what extent...so to what extent as to what we are watching a ratification of the technology revolution? Employers are using this moment to shift into technology and shift out of \_\_\_\_\_(00:25:10)...

Ed: I don't think it's quite that. I think technology and people are compliments, not substitutes. So, as we look to the future, technology is not a bad thing for workers. Technology is a good thing for workers. The problem is the business cycle affect on workers and unfortunately, this has been a periods when we have seen very significant lay-offs relative to the drop in GDP. So, I agree with Mike, if you look back and you say, "Gee is this the worst recession?" You know, people always say this is the worst recession since the Great Depression. First of all, it's a lot different from the Great Depression. It may be the worst by some measures, it may not be worst by others, if you look at the unemployment rates in the early 80s, they are a bit worse. But the point is, this is a very bad recession along the lines of the kind that we have seen in the past. What's different is that the job picture is, I think less promising as we move into the future and that's unfortunate.

Mike: And I think a big part of that has to be laid on the prospect of a much higher cost of labor, because of the Obama agenda.

Peter: Okay, Segment Four, economics, a brief history of the profession. Mike, I am going to quote you. This is you writing in 2008, shortly after Barack Obama defeated John McCain. Quoting Michael Boskin, "Those of us who supported the other guy, hope Mr. Obama succeeds..." very

**This is an unedited transcript of the interview**

gracious. And now here's something even more gracious..."We like his top economic appointments." Oh?

Mike: Yeah, I think they're capable economists, however, it turns out what seems to have happened to the Obama Administration is that all the calls have been political and there has been very little sound economics.

Peter: Okay, so here's what President Obama's Chair of the Council of Economic Advisors...you're a successor and you're a successor...Christina Romer...doctorate for MIT. Taught at Princeton and Berkley, Director of President Obama's National Economic Council, Larry Summers, former President of Harvard University...these are serious people. What are they thinking.

Ed: Well I would say, you know I don't want to criticize the people who are in office right now. I think they are trying to do the best they can and we all know these are not easy jobs. I think they have a different view of economy than Mike and I probably do. Larry is a terrific economist...a great person and I think someone who is trying to help the economy, but he...

[Multiple speakers talking over]

Ed: I am going to tell you...from my point of view, I think he believes in Keynesian Economics much more than I do. I think he believes that the stimulus has worked to a much greater extent than I do. Uhm...unfortunately the stimulus doesn't work in large part, not only because the multiplier might be below one, but also because it is very difficult to get the money out there. We learned that and I learned that directly from the tax rebates that we did in 2008. When we did those tax rebates and by the way the tax rebates are somewhat different from the stimulus, because the tax rebates at least give the money back to the people. It's not additional spending...

Peter: Right.

Ed: ...government spending. So, there's a bit of a distinction there. But still, I have to confess in retrospect...when I look back from the evidence from that tax rebate, it was really underwhelming. The reality is that we spent about a hundred and fifty billion dollars, we figure we got maybe a third to half of that out into the economy over the first six months and it had really very limited effect on economic growth. I think the same has been true during the Obama Administration, unfortunately they didn't the lesson I think that they could have gotten from us. But, they believe in what they are doing, I simply don't believe that it works.

Peter: Mike, you spoke earlier about the 70s versus the 80s...again a layman's question – in the 1980s you have in this country, smaller government, lower taxes, less regulation, restrained consistent monetary policy...growth. At the same time the central planning is bringing Russia and Eastern Europe into collapse. I had sort of thought that between Milton Friedman and George Stigler and Gary Becker on the intellectual side and the actual lived experience of the 1980s and 1990s, your profession...economics...had gotten some place. Conclusions had been reached. Now, am I simply mistaken about that? Did the Keynesian big government spending stimulus model just simply continue...did it just kind of go underground for a while and now it has sprung back forth? Is it considered still a coherent alternative model to free markets?

**This is an unedited transcript of the interview**

Mike: Well describe...

Peter: Intellectual landscape.

Mike: There is something called "New Keynesian View." If we go back intellectually, Milton Freedman or Frank \_\_\_\_\_(00:29:45) were at Chicago MIT at the time, but both geared people to longer-term time horizons. Bob Lucas geared us toward people's expectations of future events and supply siders, myself and academically some others on a more popular basis, geared us toward incentives. And those things got incorporated into the main stream macroeconomics. But, there's was always...so the New Keynesians started to take a look at what happened when you did some of this, but still had what they thought of as a very sticky prices and wages, so the economy could get stuck and you might need a more activist government. So that's kind of the neo-intellectuals. On the intellectual side, if one the leading New Keynesian theorists, Michael Woodford at Columbia and in a paper that he just gave in Atlanta in 2010...says he can only get the multiplier up to one in extreme cases when the Feds is at zero interest rate, so we are expected to stay there for the duration of when the spending is done. So, I think intellectually it's kind of broken done. However, there is this political urge to do something and that's very powerful. And I myself, and many...most economists believe there is some short run wear in where an extreme environment in Keynesian Economics has some partial validity. But it's not large multipliers, but there's a very short time period.

Peter: So...

Mike: So this has been, I think, kind of exaggerated to make a political case and the politicians above wanted it. But more importantly...you know the President's economists wouldn't have designed the stimulus package the way it was. It was designed in the House. You can go on and on for all the variety of things that were done. I think if there was a case for it, the case was really for a partial payroll tax suspension or something of that sort. This was really very ill-timed, not much of it got out quickly, as Ed has said, and it's had a very, very small impact on the economy. One place it's probably done or prevented some lay-offs was in the State and Local sectors, because there were large subventions to State and Local governments, which helped them financially when they were running deficits.

Peter: So when it comes down to it, again the layman's question. I watched the Obama Administration and clearly there are intense political pressures. Clearly, Nancy Pelosi and Henry Waxman and the liberals who have descended into the chairmanship of both important committees in the House had a huge...but than there is Larry Summers and there is Christina Romer, so overwhelmingly, it's politics and you with your deep vow of professional curtesy to these folks, but what's really going on is they're trying to impose on what is essentially a political set of events, some intellectual coherence and some...is that right?

Ed: I think that's a little too strong. I would say...

Peter: You too?

Mike: I partially agree and than it gets exaggerated in the political front.

Ed: I think that the economics profession, despite the evidence that we have for macroeconomics over the past thirty to forty years, decided in 2008, that we were going to believe the Keynesian

**This is an unedited transcript of the interview**

model, but we needed something to work. I think it was more hope than it was based on evidence, but unfortunately that was what was going on. Not only in the Administration, but I think that was going on throughout most of the economics profession and I hear it constantly. When I watch the Business Press, Business News...many very distinguished economists will talk about the effect of the stimulus, how the economy has rebounded, not only in the United States, but in Europe in large part because of government action. China is another case in point. I just don't believe it. I just don't think we have the support system.

Mike: Let me give you an example of how outrageously exaggerated this is. President Obama often says something almost exactly like the following, "It largely because of the stimulus bill that we avoided a second great depression."

Peter: Right.

Mike: If you go back to Christie Romer and Jared Bernstein's analysis of the stimulus, they said for three quarters or so, we are going to have a one percentage point lower unemployment because of the stimulus. Okay, now they were probably talking about an eight rather than nine and it actually got up to ten, so maybe it would have gone up to eleven. But in any event, that's nothing like...so their own estimate of the effect of it was tiny compared to this kind effusive statement by the President and by many people in the political process. So that's what I mean by it gets exaggerated as it's told and then it got kind of distorted in the political process from something that might have been somewhat effective to something that was fairly ineffective.

Peter: I want to move on to the next segment, but just a kind of summary statement...basically what it comes down to is that Milton Freedman did not win a decisive and intellectual victory, as I had supposed. That is to say there is still a Neo-Keynesian view...there is this notion that stimulus can be effective, that government must step in a dramatic way...that still lives on in respectable ways within the profession.

Ed: I would say that lives on, but I would say that if anything I would take the evidence of the past couple of years as supporting, not contradicting Milton's view. Markets have worked and they have worked remarkably well. If you look at how badly markets have punished the players who got out of line, it's dramatic. Now, people will say the bail-out saved this guy...for the most part people got killed by that action and if anything, the market over reacted. So there was a period. I remember being on Wall Street with my former boss, President Bush, when he said, "You know you guys got drunk and we're all feeling the hangover." And the problem is that's true, but there was a period for a couple of years where people wouldn't even drink water. So, there were even very good loans, very good things out there that could have been done and the market was simply unwilling to do that, because the market is a ruthless task master and in fact, I think when it comes to punishing, the market doesn't variate.

Mike: I think one thing that needs to be dealt with and disposed of...is kind of the strong hand that some, particularly some on the left point out as conservatives or Freedman or people who kind of are...believe in a lighter hand of government that we want no regulation. One thing that clearly failed was the regulatory system...regulatory apparatus. It was ill-designed...there were gaps...people were asleep at the wheel from the New York Federal Reserve to the FCC to so on and so forth. So, while we're probably over doing it now, the fact of the matter is that we didn't have perfect market reactions. We had indeed, a lot of people who were driven to make profits and they

**This is an unedited transcript of the interview**

saw gaps and they took advantage of it. That got expanded into the IGs and in the extreme case Fannie and Freddie and cases of that sort. To President George W. Bush's credit, he tried to reign in Fannie and Freddie and didn't get anywhere. I tried to raise that on top of the S & L's when I was the CEA Chairman and was told that you will never get the S & L's, which were essentially Fannie and Freddie.

Peter: Okay Segment Five...where do we go from here? Governor Mitch Daniels of Indiana..."What we've seen in the past year, what I call shock and awe statism...has put the American experiment at risk. For the first time in my life, the country faces survival-level issues." A little dramatic or accurate?

Ed: I think it's accurate. If we continue on this path and this path means fiscal irresponsibility, very large increases in expenditures, not dealing with the entitlements problems that we have...Social Security and Medicare and Medicaid being the most important obviously...the new health bill is not going to bend the curve down. I don't think anybody believes that. Even if you believe that the...

Peter: Bend the curve of costs?

Ed: The costs. I mean even if you believe...even if you believe that this budget deficit neutral or even reduced deficit, you have to remember that it's still an increase in spending of a half trillion dollars. So, it's only deficit neutral because it comes associated with large tax increases. All of those things, I think are prescriptions for an economy that is going to grow much less rapidly in the future. The problem is not just at the level of government, when the economy grows less rapidly obviously that puts fiscal pressure on us because it's harder to balance the budget and it's much easier to create an environment where you stay with low deficits when the economy is growing, but the main thing is the standard of living. If you just look at individual standard of living and you ask where will our children be relative to where they could have been had we maintained the low tax, high growth, open economy policies that we had in the past...I think it's going to be quite different.

Mike: We are at serious risk. We have wide swaths of the economy under state control and direction and there has not been a clear exit strategy enunciated by this Administration for many of them. I think that's deeply unfortunate. Even if they think they are going to take time to lay out an exit strategy...its going to take eighteen months or something like that...lay it out in tiers or something of that sort. I think it's a major, major problem and they seem to be bullying every sector that tries to do something in the normal course of business. Now they are going after...

Ed: BP.

Mike: BP...and now the insurance companies, etc. BP deserves some attention...they may have done some things that they shouldn't of and certainly there is an ecological diaster and they should be held accountable. On the other hand we have the large fiscal issues and so if you can think of...there is no worst time to be expanding the government...

Ed: Right, right.

Mike: ...than as we are heading into the baby boomers retirement and we are going to have the extra demographic pressures on top of the rising cost pressures in healthcare and the rising real

**This is an unedited transcript of the interview**

benefits for beneficiaries in Social Security. So this Administration, I think has been basically and the Congress has basically treated resources as free, but they are not. Every dollar we borrowed, all these trillions of dollars, that's gonna get paid back in higher taxes in the future and that's going to be a big drag on the economy. There is no doubt about that over say a ten or twenty-year period. So I think in that sense, it's a big issue. Even if we just go halfway to a European Social Welfare state that would be such a big change from where we were and it's likely that that would slow growth considerably.

Peter: Two basic remaining questions...only two. As a matter of pure economics, what should we do? And as a matter of practical politics, how can we get it done. So, Ed give me a nice tight summary statement of what we ought to do.

Ed: I would say two things. One, is we need to reform our tax code and two, keep our taxes low. So, when I say reform our tax code, there's an issue of what should be the appropriate kind of taxes that we have. We're far from the optimal tax structure. Mike spent much of his career studying taxes. I was on the President's Tax Panel before going to the government and there are many things that we could to reform that would be very beneficial to the economy. The second thing is keeping taxes low. And there is only one way to keep taxes low. You can't keep taxes low when you have spending high. If spending grows there will be natural pressure to raise taxes and close the deficit gap and that's going to be a reality. So, what we have to do is we have to get control of our budget...I will let Mike talk about the politics on it...

Mike: Well let me just say that I generally agree with what Ed had to say. I think it's substantially much easier than they are letting on. All these new programs...all these this big expansion...I think we should reverse much of that. I think that any change in the healthcare system should be narrowly targeted...

Peter: Right.

Mike: And I think our attention should be on controlling the rising healthcare costs. In Social Security we can index the initial benefits by prices rather than wages. Nobody's benefits would go down, everybody's benefits would be at least at the current real level of benefits and that would solve all the Social Security long-run problems. We should be getting much more rigorous in our evaluations of these programs and the government should be scaling back and partly for emergency reasons...we've got a whole slew of things from education to infrastructure to a variety of other things that have been justified as if resources are free and their not.

Peter: Okay.

Mike: And those things should be ended. They should be phased out in a sensible way and we should be putting limits on spending, we should be...and remember there are three sets of conservatives in the Republican party and around the country. Those who want to keep taxes low, those who want to keep spending low, and those who want to balance the budget. You basically need to do all three within appropriate measures within the budget.

Peter: Okay. At CEA you are working in the White House, which means this is not pure economics. You are paying...you are at least aware of...intensely aware of the surrounding politics. Let me to you two strains of thought, alright? One is noted by Mike from a writing in February, you

**This is an unedited transcript of the interview**

write, “Mr. Obama’s programs increase the fraction of people getting money back from the government...more money back from the government than they pay in taxes...almost 50%, just as the demographics on an aging population will drive it up further.” Argument...we’ve already passed a tipping point, roughly half or more than half of voters have already been turned in effect into clients of the Federal government and once that happens, you’re as a political matter, you’re not up yet, but as a political matter, it is really hard to reverse – viewpoint one. Viewpoint two, Governor Haley Barber of Mississippi, who was the Republican National Chairman in 1994, when republicans recaptured the House, says “This is the best moment...” not long ago, “since 1994.” Former Governor Jeb Bush of Florida said he senses that people would be willing actually to undertake to permit cuts in entitlements for the first time perhaps in his entire political career. The Tea Party Movement, the election of Scott Brown from Massachusetts...for the first time Gallup shows...for the first time in years Gallup shows that more people call themselves republicans than democrats...there is this strange coexisting strains of real pessimism about what has already happened in the country with enormous hopefulness that there may be a decisive movement against the welfare state, seventy years after the new deal...how do you read it? How do you read the current situation there?

[Multiple speakers]

Ed: So, first of all I think it's very dangerous for society to get into a position where more than half the voters get more back from the government than they pay in taxes.

Peter: That’s real...that’s a serious problem.

Mike: Some of that is...a lot of the temporary stuff that Obama did. So if we can end that, we can get back down to around 40%...so I think we have a window and that window is maybe the next few years...five or ten years, if we can get this under control. We will then get well into the baby boomers retirements and it would be very, very difficult to start curtailing Social Security and Medicare growth, not the levels, but the growth per beneficiary. So, I think there’s an opportunity. Second of all, I think people are ingassed and I think Obama badly misread the country. He thought that this was an FDR moment...that everybody would move left because of the problem...they would want and welcome this government with open arms and people ingassed at the things that have been done from the bail outs to the spending to the deficits and they are very concerned for their future and their children’s future and I think that there is an opportunity to channel that into a constructive, more moderate, more modest, but much effective government. Because a successful society needs an effective government, whether you have an oil spill...whether that’s in the military...whether it's the local police...whether that’s decent schools...whatever it happens to be, but we are trying to get the government to do too many things...it doesn’t do many of them well. It does most of them very inefficiently and it costs too much. We need to do for example what Major Giuliani did in New York...which was eight years Giuliani spending less per capita spending, but he improved on almost every service in various ways. Some of that is being emulated by cities around the country. We need somebody to go in and do that for the Federal Government – reduce, eliminate, withdraw, and than where the government really has an important role to play – make sure it's effective, nimble, and not so bureaucratic.

Peter: Mike sounds pretty chipper...

Ed: I would say I am even more optimistic than Mike...

**This is an unedited transcript of the interview**

Peter: Are you really?

Ed: In the long run, I am. I have...

Peter: You are the opposite of Keynesians in the long run...in the long run things will work out.

Ed: I have a lot of faith in the American people to have long-term wisdom and while people panic in the short run there is no question that this was a period during which panic was rampant...I think that over the long haul that people will realize that the United States has been successful primarily for one reason and that is that we encourage individual effort...we encourage people to go out be entrepreneurs...we encourage people to find their own way and we help them when they need help, but we don't do that to excess. I think people understand that's the right formula for the United States. I think people will push back in that direction. I hope that President Obama will in the second half of his term understand that in the same way that President Clinton did in his later years as President. I think that he...as Mike said earlier...President Clinton moved to the right and he did so wisely, because he understood not only the mood of the country, but he also understood that that was the way to successful economic growth.

Mike: Yeah...

Peter: Two last questions.

Mike: ...I think it would be good for the country and very good for him politically...he easily won reelection once he moved to the center.

Peter: Uhm...we have an election coming up in the November. Is the economy going to improve markedly between now and then or even note...it won't feel different?

Ed: No.

Peter: Okay, so there is no swing between the democrats...

Ed: Anybody who says they know what it will look like on the eve of the election is far too sure of themselves, because there are wide possibilities.

Mike: We know...what we do know...hang on a second...

Ed: Can I please finish...

Mike: What we do know...well you just contradicted my statements so...what we do know is unemployment is going to remain very high.

Peter: Over 9%?

Mike: Well, somewhere around 9% at a minimum. And what we do know is that right now, people have about one-third as high a chance of finding a job today, as they did in 2007, that hurts and that's gonna be felt at election time.

**This is an unedited transcript of the interview**

Ed: So, I don't think we disagree...I am just saying it's unclear what will happen over the next six or seven months. What is clear is that the economy will not be in good shape. It's likely to be a little bit better than now, would be a base case...that's about it.

Peter: Okay, last question. So that's between now and November...now let me ask you twenty-five years from now...I am trying to get sort of your sort of body temperature on optimism versus pessimism...twenty-five years from now, will historians look back at the first two years of Barack Obama's Administration as the moment when the country moved decisively in the direction of the European style welfare state. Or, do you feel there's a real rejection. Is something decisive taking place now. Mike?

Mike: I think that remains to be seen. I think if there is a big reaction in the polls in November, either President Obama will move to the center and if it continues or he will not get reelected in 2012, so either he has to change or somebody else has to be making the policy. I think there is a decent chance of that. I would twenty-five years looking back to now, I would say it's fifty/fifty.

Peter: Ed:?

Ed: I agree with Mike. I think that again, if you look at the first two years of the Clinton term and look how disastrous that was for President Clinton. You know, he looked very similar to President Obama in those first two years. You had the Republicans take the House in 1994...it made a huge difference in terms of his policies and I think we look back at that term very differently now than we would have had that not happened. I think the question will be whether President Obama moves with the country after this election.

Peter: Okay, so even the wisest of men have to wait and see what the American people do at the polls and then have Barack Obama respond to that.

Mike: One big difference is that Hilary Care lost.

Peter: Yes.

Mike And that actually in my opinion...I think the proper lesson from that is that it saved Clinton's presidency. It is not very different from what has happened now, so there is a lot of contention about the roll out of health care reform that President Obama has to look at.

Peter: Ed Lazear...Michael Boskin, thank you very much.

Mike: It's a pleasure, Peter:.

Peter: I am Peter Robinson for Uncommon Knowledge and the Hoover Institution. Thanks for joining us.

Unidentified Male: You guys are pretty smart, you know?