>> Peter Robinson: Welcome to Uncommon Knowledge. I'm Peter Robinson. Dr. John Taylor holds degrees in economics from Princeton and Stanford. He served as a staff economist on the Council of Economic Advisors under President Ford, and is a member of the Council of Economic Advisors under President George H. W. Bush. Under President George W. Bush, he served during the President's first term as the Undersecretary of the Treasury for International Affairs. Dr. Taylor is the author of a number of books, including Global Financial Warriors: The Untold Story of International Finance in the Post 9/11 World, in which he describes his experiences as Undersecretary of the Treasury. John Taylor, thank you for joining us.

>> Dr. John Taylor: Thank you Peter.

>> Peter Robinson: Segment one, the crisis. Barrack Obama, "I think everybody knows we are in the worst financial crisis since the Great Depression". Is the President Elect correct?

>> Dr. John Taylor: It is the most unusual crisis, and by some measures the worst, no question. And as financial here, because sometimes people are quite financial with the whole economy and that's not happened so far. We've had a financial crisis with interest rates rising to unprecedented levels, in spreads - that is the risk that people are experiencing, the markets unprecedented levels. But in terms of the overall economy, we haven't seen anything even close to the experience of the Great Depression. The GDP fell by 20 percent and unemployment to double digits, and I don't think we're gonna get there quite frankly, but on the financial side quite unusual.

>> Peter Robinson: Alright let's put the current crisis aside for just a moment. For awhile we seemed to be doing pretty well, consider a couple of sets of statistics between 1890 and 1945. The economy contracted 7 times, twice by almost 10 percent, and twice by almost 15 percent. Contrast that piece of American history with the period from 1983 to 2007, when we have a long sustained expansion interrupted by only a couple of very shallow, very brief recessions. 83 until effectively it seems, the day before yesterday, a quarter of a century of sustained economic growth. What did we learn that permitted that sustained quarter century of growth to take place?

>> Dr. John Taylor: I think the most important thing was to have a steady monetary policy that kept the economy from the booms and busts, whether it experienced all during the period that you mentioned. But somewhere in the early 80's, 82 is the time I say, the beginning of that long 1980's expansion, right through 2007; 25 years as you say, it had only 2 mild recessions and long expansion and you saw inflation low, remember that's a monetary phenomenon as Dr. Freedman always emphasized. So you kept an enormous amount of stability by having monetary policy focus on low inflation and really making sure it didn't cause booms and busts.

>> Peter Robinson: Tax policy is less important?

>> Dr. John Taylor: Tax policy and regulatory policy, more important for the growth rate being strong, that is the progress over time being so dramatic.

>> Peter Robinson: So you're drawing a distinction between stability and growth?

>> Dr. John Taylor: Yes, and your question was that way too, about ups and downs, but absolutely the stability is more on the monetary policy side of the things and the steady growth and those low tax rates, and improved regulatory policy.

>> Peter Robinson: Alright now here is the question of the hour, and in one way or another we're just beginning our conversation, but in one way or another this is the question that runs through every segment of this conversation today. Has the current crisis proven that the lessons we thought we learned are invalid?

>> Dr. John Taylor: Absolutely not. In fact to me, they reinforce. This experience reinforces the lessons because we deviated from those policies that were working well. First in the 2002, 2004-5 period, interest rates were held to unprecedentedly low levels. That causes excesses, almost all booms and busts are caused by excesses so that was not following the policies that I mentioned work so well for the period you're talking about.

>> Peter Robinson: Greenspan's Fed was too loose.

>> Dr. John Taylor: For a period... for most of the period the policy, as you indicated, that period was dramatically stable. So it's only towards the end actually, and that's really why it ended in many respects.

>> Peter Robinson: Okay, now let me quote to you, Alan Greenspan is a friend of yours I believe?

>> Dr. John Taylor: Absolutely.

>> Peter Robinson: Alright let me quote to you Alan Greenspan, testifying before congress this past autumn, "The crisis has turned out to be broader than anything I could have imagined. Those of us who looked to the self interests of lending institutions to protect shareholder's equity including me, Alan Greenspan, are in a state of shocked disbelief". Something happened that I, Alan Greenspan, could never begin to foresee. Are you also in a state of shock, disbelief John?

>> Dr. John Taylor: Surprised that it's been as long and as drawn out as it has been and as severe, but I think again, I told you why it ended, why I think it ended - the good times. I think the prolonging of the crisis and it's increased severity also is due to policy and government much more than to the market place, and I would point to an early misdiagnosis of the problem a year ago, and then plus policies which were ad hock and confused the markets more.

>> Peter Robinson: I do want to get to... so give me one sentence, I'll read you one sentence and I want your one sentence answer. French President Nicolas Sarkozy, again this is just a couple months ago, the all powerful market that is always right, that's finished.

>> Dr. John Taylor: Absolutely not. No, again I think that if you look at this carefully, don't be ideological about it, don't be political about it, look at the facts; you see a crisis that was caused, prolonged, and made more severe by government policy, not by values of markets.

>> Peter Robinson: Segment two; let's go through in some detail, your analysis of what exactly has happened. In the Wall Street Journal on November 25 you wrote, "The economy has been pulled down by a housing slump, a financial crisis, and a bout of high energy prices". Let's take each of those in turn and you explain to this layman what each of those three items has to do with the crisis we're not experiencing, the housing slump.

>> Dr. John Taylor: The slump in housing followed a boom. Again, that was caused by monetary excesses. But once you have a slump or if prices are falling, it makes it much less likely that people are gonna be able to keep up their mortgages, the mortgages that were made go into default and delinquency of foreclosure, and that affects the banking system. If a bank is holding those mortgages it's balance sheet is much more risky than it was.

>> Peter Robinson: Alright so let's zoom out one level. You've mentioned a couple of times now the housing boom is caused by a period when in your judgment, the fed was too loose.

>> Dr. John Taylor: Voluntary excesses, yes.

>> Peter Robinson: Monetary excesses, what was Alan Greenspan thinking?

>> Dr. John Taylor: He was concerned I think, for good reason quite frankly, about possible deflation like they had in Japan. And it was not too long after 9/11 as well, so when you go back now and someone like me, you're asking me the questions of what went wrong, you gotta recognize policy makers at the time were trying to do what they thought was best. And I just say at this point, looking back you see there were excesses and I think that's the reason for both the boom and the bust.

>> Peter Robinson: Alright, and the housing slump essentially is a contraction? How do I put this, I'm trying to remember my... what I once understood in monetary policy, monetary theory. You've got prices... velocity, it's a shrinking in velocity of money, people aren't spending as much. Isn't that right?

>> Dr. John Taylor: Well the bust in the housing came because we have a boom, the excesses, prices get so high, they get above what would be a natural level base without the excesses, and then they collapse. By the way it's not just the United States; we had

some similar effects in other countries brought on by similar monetary policies, perhaps influenced by the U. S.

>> Peter Robinson: Okay now, the fed is too loose with money, that helps to create the housing boom. The federal government, particularly in the person of Barney Frank, Democrat of Massachusetts, Chairman of the House Financial Services Committee, leans on Freddie and Fannie to make loans; in effect to invent the market for subprime instruments, he's pushing to get lower income people into homes that we now know in many instances, they couldn't afford. That strikes me as the same old story that Milton Freedman would have told. If you see an economic wreck, the government is likely to be involved somewhere. But here's a piece that I'm not so sure fits the puzzle, or fits that narrative. One other aspect of the crisis is that a lot of very highly paid bankers in New York carry these instruments on their books, and we now know they couldn't value them, that they had no notion what to do if this boom - which everybody understood at the time, you could read in Fortune, in Forbes, in Business Week, everybody said this is a housing boom. Everybody knew this couldn't get... or to quote the great Herb Stein, the economist who was chairman of the economic advisors under Nixon, "if something can't go on forever it won't". Everybody knew this wouldn't go on forever and yet they were totally unprepared for what would happen when the music stopped, and that's not a government failure that's a market failure. Right?

>> Dr. John Taylor: Well you mentioned at the beginning of this Fannie and Freddie.

>> Peter Robinson: Yeah.

>> Dr. John Taylor: And those are government sponsored enterprises.

>> Peter Robinson: But the government didn't cause their sterns or layman, to hold too much of this garbage did it?

>> Dr. John Taylor: Obviously there were mistakes made by people in charge who should have known better, and that's not unusual in history right? Not everybody makes the right decisions, but in terms of your question about government, you have to add Fannie and Freddie to the mix. And also there were people who tried to pull it back. I mentioned Alan Greenspan again, he argued they were too big and they needed to be pulled back, and you had legislation proposed in 2005 to pull them back and put them in better control, but it wasn't passed and so they expanded and added to these excesses.

>> Peter Robinson: Okay. You also mentioned the housing slump, financial crisis, and then the bout of high energy prices as a contributing factor.

>> Dr. John Taylor: Yes. You remember we had in the beginning of the crisis back in the summer, fall of 2007, oil prices in the 60 - 80 dollar range.

>> Peter Robinson: Right.

>> Dr. John Taylor: But then as the crisis began prices went up to over 140 dollars a barrel. I think a lot of that actually can be caused by a very excessive cut in interest rates at that time, which weakened the dollar, would weaken the dollar, tends to make oil prices high.

>> Peter Robinson: Ben Bernanke, chairman of the feds, sees a crisis developing and he pushes liquidity into the markets, lowering interest rates and how does that affect the price of commodities?

>> Dr. John Taylor: Well first it affects the value of the dollar. If you cut interest rates, makes the dollar less attractive so the dollar falls, and it fell quite dramatically during that period. And then oil is priced in dollars, so that almost always causes the price of oil to rise.   So I think that a part of that increase in oil prices was also induced by, they say, a bad diagnosis of the problem. But Peter, your main question is, why that was a factor in the crisis?

>> Peter Robinson: Yes.

>> Dr. John Taylor: Because obviously very high prices led to very high gasoline prices, which cut into sales of vehicles which hit the automobile industry and hit Ohio and Michigan hard, and so that was the element...

>> Peter Robinson: To the extent that the financial crisis has spilled over into the real economy, the mechanism was high energy prices.

>> Dr. John Taylor: And housing as well.

>> Peter Robinson: Of course. Alright, multiple choice. The housing slump, the financial crisis, high energy prices - you take them all together and the crisis of recent months has been A, the result of bad government policy. This is multiple choice, you just get the answer that fits the best.

>> Dr. John Taylor: Okay.

>> Peter Robinson: A - the result of bad government policy, B - the result of market failures, inherent flaws in capitalism, or C - an act of God, that is to say, once a century economic disaster, as impossible to predict or to prevent as a hurricane or an earthquake.

>> Dr. John Taylor: I think the first part A or whatever you want to call it, is government induced in terms of extending this beyond it's original part, absolutely. And again I think a misdiagnosis of this... as you just described it, the problem in the housing market made risks higher at the financial institutions. A lot of our policy makers address that as a kind of a liquidity problem, more people need more money, let's give them a check, let's provide more funds and liquidity to the banks, let's increase the money supply, and that really wasn't the problem.

>> Peter Robinson: Alright. Segment three; we're from the government and we're here to help. We'll turn in a moment to what you believe the government should do. I don't want to... next segment will be John Taylor's prescriptions, but first let's talk about what some people who are actually in power seem to think ought to be done. Let's begin with the federal reserve. In the last 6 months, the Federal Reserve has expanded the money supply by more than 11 percent, and in the last 3 months by more than 9 percent. You take the expansion of the money supply in the last 3 months and it works out to be an annual rate of 37 percent. As best I can tell, that represents the most massive increase in the money supply in American history and certainly, since the establishment of the fed almost a century ago. Necessary, sufficient?

>> Dr. John Taylor: I don't think it's necessary, again I think it's going back to this misdiagnosis that it's not that there is not enough money out there. It's that there is this problem with the banks about not wanting to lend to each other. That's not gonna get fixed by creating more money. It's gonna be fixed by getting bad assets, these mortgages, and derivatives from mortgages off the bank's balance sheets and that's really what should have been done in the first place.

>> Peter Robinson: Well then let me... so the expansion of what Bernanke has done, it's not necessary. Is it harmful?

>> Dr. John Taylor: Ultimately it could be harmful. All these things, their harm frequently comes in the unintended consequences from them. And one unintended consequence is that there's this money and it eventually creates inflation and gets us in a worse situation like we were before these good times, in the 80's and 90's that you referred to. There's also the consequences that it will just create uncertainty, and uncertainty adds a lot of risks. Government policy, because it's been I think to ad hock, has created uncertainty. I'd say markets are clamoring for some clarity here about policy.

>> Peter Robinson: So for example, right now everybody knows Bernanke can't keep expanding at this rate, but nobody knows when he'll put on the brakes. That's a very big...

>> Dr. John Taylor: And then he'll actually bring it back out actually... reverse the direction.

>> Peter Robinson: From monetary to fiscal policy, brace yourself for a staggering number. I set out to add up all the numbers associated with the programs that the government has already enacted. I'm not talking about what President Elect Obama wants to do, I'm talking about what the government has already set aside to deal with this crisis. Add it all up. The bailouts of Fannie and Freddie, AIG bailout, the troubled asset relief program - there are about a dozen of them, and the present number is 5 point 6 trillion.

>> Dr. John Taylor: It's a mind boggling number, so big people don't really... can't get their arms around it.

>> Peter Robinson: How does that sit with you?

>> Dr. John Taylor: Well it's a reflection on the fact that there's been so many things, something doesn't work you try another thing, something doesn't work you try another thing. So I think it's a problem, it reflects a problem. Now to be sure you're adding a little bit of apples and oranges when you do this, because some of the increased debt is used to acquire assets. But the number is so big, it doesn't matter.

>> Peter Robinson: Right. Keynes' biographer, Robert Skidelsky, this is longish but again this is in the air today. "Keynes believed there was only one sure way to get an increase in spending in the face of extreme private sector reluctance to spend, and that was for the government to spend the money itself; spend on pyramids, spend on hospitals, but spend it must. Keynes' purpose was not to destroy capitalism, but to save it from itself. The moment has come to build a new structure on the foundations Keynes laid." What do you make of that?

>> Dr. John Taylor: I don't think it applies to the current situation at all, if it ever applied to any situation. In fact the first Keynesian like response to this crisis was to give people a check.

>> Peter Robinson: Economic stimulus package.

>> Dr. John Taylor: That's a Keynesian policy.

>> Peter Robinson: Economic stimulus package 2008 signed by President Bush last February. The last number I saw for that was 162 billion.

>> Dr. John Taylor: Yes.

>> Peter Robinson: And the effect was?

>> Dr. John Taylor: So far nothing, absolutely. If you look at... 115 of that 165 was basically a rebate check, a check sent to individuals and the theory was Keynesian, is that that would make people spend more and that would cause people to get more jobs and keep the economy going. It didn't work. People didn't spend it, as people sense gained, like Norm Freedman predicted.

>> Peter Robinson: Well but what about John, you mentioned a moment ago the bankers won't lend to each other. People are sitting on their assets.

>> Dr. John Taylor: Yes.

>> Peter Robinson: Isn't that the Keynesian liquidity trap? There's plenty of money but no velocity, people aren't spending it? That's not a Keynesian problem?

>> Dr. John Taylor: The banking problem, since the interest rates have come down close to zero, some people call that as a liquidity trap but until then knows, is simply a problem of credit risk and bad lending; garbage on the books, yeah.

>> Peter Robinson: Democratic congressman Barney Frank of Massachusetts, chairman of the House Financial Services Committee, in a recent interview, "At this point..." by the way he is now one of the most powerful figures in America and arguably the most powerful figure in government policy as it concerns finance. "At this point", says Barney Frank, "there needs to be an immediate increase in spending, and I think this is a time when deficit fear needs to take second seat. This is a time for a very important dose of Keynesianism, later on there should be tax increases. I think there are a lot of very rich people out there whom we can tax at some point down the road, and recover some of this money."

>> Dr. John Taylor: I think it's a mistake. If you raise taxes, now or even sort of signalish you're gonna raise taxes soon, that's a depressant economic activity. How do you create jobs? You create jobs because businesses hire people. If you raise the taxes that he's referring to, you're gonna increase taxes on businesses - small businesses. Roughly speaking, 50 percent of business income will be taxed more under that kind of a policy. So I think it's a mistake to be raising taxes at this point in time, and with respect to big spending programs, we should spend what we need to spend for the growth and the health of our economy and infrastructure, but to think that that's gonna bring us out of this I think is a mistake. People compare the Eisenhower road building. Well no one thinks of Eisenhower road building as something that led to a big boom in the 1950's.

>> Peter Robinson: When you say people think of the Eisenhower road building, President Elect Obama explicitly compared his proposal to; he called it the largest infrastructure project since the building of the interstate highway system in the 1950's. Let me give you President Elect Obama, "Investing in an infrastructure program, in roads and bridges, rebuilding our schools, making sure that we're investing in electronic medical records and other technologies that can drive down healthcare costs, all those things are not only part of an immediate stimulus package, they're also down payments on the kind of long term sustainable growth that we need." John Taylor?

>> Dr. John Taylor: With respect to the long term, if he thinks that and he works with the congress and the people, if that's the kind of thing that we need fine. But it's not gonna be the short term stimulus. We shouldn't fool ourselves. You can't take a road building project, you gotta develop, you got the environmental reports, you have to get the contracts, get everything in place, so it's not something that's gonna help this economy get out of the deep recession we're in right now.

>> Peter Robinson: Alright. Segment four; what should be done? In your article in the Wall Street Journal in late November, you proposed four specific measures. Let's just take them in turn. "First make a commitment, passed into law, to keep all income tax rates where they are now affectively making tax rates permanent."

>> Dr. John Taylor: That will be a powerful stimulus, because there is tax increases on the books right now. If you look at the code, we're gonna have tax increase.

>> Peter Robinson: The Bush tax cuts are set to expire.

>> Dr. John Taylor: Exactly, all over the place. Dividends would increase, dividend tax rates, capital gains tax rates. So a firm commitment not to raise those taxes, I think would be beneficial to the markets and beneficial to business - give them more certainty too as well, even more predictability. So that's a very important part of it.

>> Peter Robinson: Second, I'm quoting you, "Enact a worker's tax credit equal to 6 point 2 percent of wages, up to 8,000 dollars, as Mr. Obama proposed during the campaign, but make it permanent."

>> Dr. John Taylor: Absolutely. Again, the permanence is for the same reason, to give people the expectations this is not gonna just be a one time thing. But also to mention this, it's another example of tax cuts right? To stimulate the economy, making them permanent, but it's also something that could be represented as kind of bipartisan. You got the point one, which is keeping those tax rates constant, that the Republicans will favor, and you got this new proposal of the President Elect which he favors. So it's a way to move things ahead.

>> Peter Robinson: Twice now, in your first suggestion and your second, you use the word permanent.

>> Dr. John Taylor: Yes.

>> Peter Robinson: Why is the permanence so important?

>> Dr. John Taylor: Two reasons: first of all if it's something temporary, it wouldn't affect people's behavior. Just like this tax rebate, remember we spent 300, 600 dollars a family and people just pocketed it, they didn't go out and spend. So it didn't jumpstart the economy. But if it was permanent, they'd say ha - I got a permanent reduction in my taxes, this is something I can bank on.

>> Peter Robinson: Income has permanently gone up.

>> Dr. John Taylor: Yes. So you can spend more, plus if it's at marginal rates, that is rates on additional income come down, then you have more incentive to take a job and firms have more incentive to hire people.

>> Peter Robinson: Third, again quoting you, "Recognize explicitly that the automatic stabilizers are likely to be as large as 2 point 5 percent of GDP this fiscal year, that they will help stabilize the economy and that they should be viewed as part of the overall fiscal package even if they do not require legislation." What on earth are the automatic stabilizers?

>> Dr. John Taylor: People always ask me that question. Automatic stabilizers is a jargon term, it simply reflects the fact that when the economy slows down it goes into a recession. Tax receipts to the government automatically go down, and some of our transfer programs like Social Security or Unemployment benefits, go out so that increases the deficit and that is, cut having tax receipts going down and spending going up, is stimulative...

>> Peter Robinson: And that's in the law, and it was going to happen, it is happening even without Hank Paulson and Ben Bernanke and everybody else running around, saying the sky is falling.

>> Dr. John Taylor: And it's a big number.

>> Peter Robinson: 2 point 5 percent of GDP. What's GDP, 13, 14 trillion?

>> Dr. John Taylor: Yeah, so it's gonna be over 300 billion. Consider that along with...

>> Peter Robinson: So calm down because those of you who believe in Keynesian stimulus, a little bit is gonna take place anyway, right? Okay. Fourth, your fourth and final point, "Construct a government spending plan that meets long term objectives, puts the economy on a path to budget balance, and is expedited to the degree possible without causing waste and inefficiency." Government spending that's sensible?

>> Dr. John Taylor: Yes. This is maybe the hope here, is you don't want to put in some things... you mentioned building pyramids or something like that. You don't want to waste money.

>> Peter Robinson: They're saying it doesn't matter what the government spends money on, just that it's spent.

>> Dr. John Taylor: That is the wrong philosophy. You do things that you think are needed the best we can, we have a Democratic system in our country where we use that to decide on what we're gonna do. How about ruling out earmarks in this process, so you have the most sensible thing you can possibly get. Put that in place, and if you can bring some of it forward fine, but don't think that that's gonna make all the difference. The best thing is to have... we know what we need. Do we need more roads? Do we need to fix the roads? Do we need to have an electronic grid? Yes, let's do that.

>> Peter Robinson: John, you said, you've said several times now though, that the financial... the credit crisis is a function of so many institutions having so much garbage on their books, instruments that they can't value properly and they certainly can't get off their hands. Now why in your four proposals here, didn't you include Hank Paulson's first proposal which he himself seems to have backed away from now, but this notion that the government is going to inject capital into the banking system by the very specific means of buying up bad paper, get it off their books, just dump it. There's a parallel to

the savings and loan crisis, the way we fix that problem in the 90's. The government took the garbage and then revalued it by auctioning it off over a period of time, an unpanicked period of time. It's a government intervention, you might be queasy about that, but it directly addresses the problem you've identified. Right?

>> Dr. John Taylor: This addresses a problem caused by government, and we have 700 billion dollars already reserved for that. This was about stimulus packages that people are proposing on top of all that. So I say yes, the 700 billion which is a large sum by any definition, used to be anyway, make sure you use that for the problems in the financial system. And the treasury has said they want to use some to get the toxic acids off the balance sheet, they're using some for equity, they could use some for mortgages directly, but use it the most effective way to address the problem of credit.

>> Peter Robinson: So Hank Paulson was speaking more sense at the beginning of the crisis than he is now, because he was talking then about having conducting auctions for the large institutions to sell this garbage to the government, and now he said they're not going to do that.

>> Dr. John Taylor: I think all along he should have said they're gonna do several things, the three I just mentioned. He originally said he was just going to do one, and I think that misled people.

>> Peter Robinson: He was politically imprudent, but his fundamental impulse is correct.

>> Dr. John Taylor: Doing all of the mixture of all these is really what's appropriate.

>> Peter Robinson: I see, okay. The great forgetting. Again from your November article in the Wall Street Journal, "After years of studying debate, economists concluded that discretionary fiscal policy action such as temporary rebates", and I would insert, and such as most of that 5 point 6 trillion in spending that's already been enacted, "are not a good policy tool." And now the phrase that just lept off the page when I read that, was actually a dependent clause - "after years of studying debate". Do you have the feeling during this crisis that a lot of hard won intellectual progress, going all the way back to Von Mises and Hayek and Milton Freedman when he was writing the permanent income hypothesis, which I think was published in... we're talking about at least a half century, six decades. Do you have the feeling that this... nobody's refuting it, they're just ignoring it.

>> Dr. John Taylor: I do have that feeling, absolutely, and I don't know exactly why but there's fads that come and go and perhaps the... what fooled people was in 2001 when President Bush started with the permanent tax cut. He also did a first installment, if you like, which was a check and that seemed to help the economy at the time, and so perhaps that started to shift people's thinking a little bit that this could do some good. But I don't have a good explanation quite frankly. It's no question I feel it, absolutely, in the consensus that was there and the consensus that really led to this tremendously successful

macroeconomic period of 25 years. It's that consensus I think, that led to this success and now as we drift away from that, things are not looking as good.

>> Peter Robinson: John, let me read you a couple of quotations. You tell me if you think they're still relevant, and if so, how? Friedrich Hayek, "There would be no difficulty about efficient control or planning, or conditions so simple that a single person or board could effectively survey all the facts." He's addressing here the question of government control of the economy. But the constantly changing conditions of demand and supply can never be fully known by any one center. Under competition, and under no other economic order, the price system automatically records all the relevant data. Competition and prices.

>> Dr. John Taylor: Makes a lot of sense, makes a lot of sense, and we've learned a lot since then but that basic orientation I think, is still...

>> Peter Robinson: That is still 100 percent relevant. The development of high technology, the ability to... I suppose for example, if you're sitting in the Federal Reserve you get much better data, much more data, and data much more quickly today than you did when the fed was created in 1913.

>> Dr. John Taylor: Well there's much more stuff to keep track of, so even that improvement has not kept up with the greater complexity, and I think things change so frequently. Of course we have learned a lot about things like externalities Peter, where there's a need for government. There's no role for government by any means, but I think...

>> Peter Robinson: Give me an example.

>> Dr. John Taylor: Well we have of course National Defense and we have the basic one providing safety, the rule of law, providing the rules of the game. Hayek also spoke one way about the importance of rules of the game so that the private sector knows what the government is going to do, so government has the obligation to have rules or what's going on in the markets.

>> Peter Robinson: Alright, your friend and colleague Milton Freedman, this sounds so simple that it almost sounds simplistic so we need to remind ourselves in the audience that this is a man who won a Nobel prize in economics. There was nothing simplistic about this mind, but here goes. "Nobody spends somebody else's money as carefully as he spends his own. Nobody uses somebody else's resources as carefully as he uses his own. So if you want efficiency and effectiveness, if you want knowledge to be properly utilized, you have to do it through the means of private property."

>> Dr. John Taylor: Again, still makes a lot of sense. And I think he's seen in examples here where government has tried to do things better, and it hasn't worked out. So again, you don't want to say, and Milton would never say this either, there's no role for government. But so often there's government failure when government comes in.

>> Peter Robinson: Should the government of the United States be bailing out automakers in Detroit?

>> Dr. John Taylor: No. I think that's a mistake.

>> Peter Robinson: That is not a close decision for you?

>> Dr. John Taylor: No it is not actually.

>> Peter Robinson: Should the government be taking equity positions in banks as it is now?

>> Dr. John Taylor: Well this is a cleanup from a government induced problem, so in this case I unfortunately have to say we should go ahead and do this and get out as soon as we can.

>> Peter Robinson: Alright, John do you have the feeling, look I'm a layman and I see Nicolas Sarkozy says ah, the free markets symphony, and there's a fellow called the naked economist for Yahoo and he said even as the Berlin Wall came down, nobody could continue to believe in Communism now that this crisis is taking place, nobody can continue to believe in unfettered free market. And I get the feeling, now you have just laid out your views, but Paul Krugman is a very eminent economist. Larry Summers is a very eminent economist, and Larry Summers in particular has been saying we gotta spend, spend, spend; we need to jolt the economy with a dose of Keynesian economics. It is very difficult for me as a layman, to resist the feeling. I don't know enough about it, but the feeling that there's a lot more going on here than sheer economic analysis. There are two world views, two different views about the structure of economic reality and the correct role of government.

>> Dr. John Taylor: I think you're right, I think it is a philosophical orientation. Larry Summers also promoted the idea of the stimulus package. In 2008 he was one of the... which has not worked. So you have to think, well people who suggested that... are gonna do exactly the same thing or do something modified, which is along the same philosophy. But I think you're on the right track here, but that also suggests that economists, people like me, should try to spend as much time as we can showing about the fact, talking about the facts - what happened, what's a reasonable cause? Does the Sarkozy statement make any sense to me? It doesn't, but I just don't want to say it doesn't make sense, I want to show why.

>> Peter Robinson: John, give me your best and worst case scenarios for, let us say, three and a half years from now; when President Elect Obama will be deciding whether to run for re-election. The best case and worst case.

>> Dr. John Taylor: The very best is that the credit crunch, malaise, we're in right now - we jump back out of that like we did in 1980.

>> Peter Robinson: And that can happen quickly?

>> Dr. John Taylor: You asked me for the best Peter. I didn't say it was a high probability but that happened in 1980, credit controls were put up by the government, GDP fell, they were taken off - GDP rose. This is a different circumstance, you can't just turn it on, turn it off. Somehow the problem in the banking financial sector gets resolved, and that will bring us back. The worst case is that we're gonna have declining GDP all through next year, all through 2009 and see it turn around towards the end of the year or next year, and then a slow recovery. And I hope that doesn't happen, but it's possible. We raise taxes, it certainly increases that probability.

>> Peter Robinson: John Taylor of Stanford University and the Hoover Institution, thanks a lot.

>> Dr. John Taylor: Thank you Peter.

>> Peter Robinson: I'm Peter Robinson for Uncommon Knowledge, thanks for joining us.