[0:03:30]

Bruce Bond: And so with that John, the floor is yours.

John Yemma: Thanks Bruce. So just in terms of civility if anyone has a cell phone let's be civil and shut them off, turn them into a brick, and also I'll remind you of this as we go along but we'll take questions at the end and you'll find in your program there's an index card. You can write the questions on the index card and pass them to the end and one of ushers will pick them up and Bruce will sort through them and we'll be especially interested in questions that pertain to the common ground area that we're working on because this is something relatively new.

This is not just a debate. This is an attempt to find out areas in which there may be policy agreement but without actually trying to force compromise or force someone to bend too far. We're just looking at areas that might intersect. Think of Venn diagrams where they kind of cross over. So let's start with the big picture.

We're talking tonight about the proper role of government in the economy. I think everyone knows that there will always be a role for government in the economy and that's been debated for probably more than the 224 years of the Constitution. A USA Today Gallop poll today indicated that about 1 in 5 Americans feel that government has too big a role and 1 in 5 feel as though government should do more. So those are the extremes and then in the middle is maybe the vast majority of people who do see a common ground.

So with that just thinking of the proper role of government in the economy, let's move to our panelists and let's talk a little bit about it in a big picture way. We'll drill down later and Kraft will help us with that, but let's just get the top line of where government should play in the economy. Mark, why don't we start with you?

Mark Zandi: Well thank you Common Ground for the opportunity to be here. Judy thanks for the invitation. It really is an honor and a pleasure to be here. I guess I would say speaking at a 30,000-foot level, the role has 3 aspects to it. First, defining the rules of the game. Everyone needs to understand what the laws and regulations are so that everyone can play by the same rules and I think we need that clarity for a well functioning economy.

Second, providing a minimum level of support for the most neediest in our society. I think we are a wealthy country, the wealthiest, and we have a responsibility to our population and we need to – it's a matter of debate how we define needy and what's the minimum level of support but I think that that's really important.

And then third and I think most relevant to the recent period I think it's key that government can fill the breach, that there are times when our economy isn't functioning properly, isn't functioning well. There aren't many times, but there are in historical experience a few, and I would consider what we have gone through as one of those periods and I think it's important that government is able to step in that void to make sure the downturn in the economy isn't even more severe. So I think there may be more, it may not be complete, but I think those are 3 key things that government needs to do in its role with respect to our economy.

John Yemma: Okay and we'll come back to some of those specifics later. Steve, how about you?

Stephen Moore: Well thank you for inviting me and Judy Kudlow was the one who invited me as well so Judy thanks so much for inviting me to come. It's a real honor to be here; it's an honor to be with Mark. Otherwise I'd have to be debating Robert Riche tonight and this is a lot more fun for me than that.

[Crosstalk]

Stephen Moore: So I'm a libertarian, I do believe in a limited government, I think that the role of the government in the economy should be really as small as possible. I remember I met with Milton Friedman who's one of my heroes not long before – shortly before he died and I remember asking him, "Milton, what's the most important thing we could do to make the economy grow faster and make America a more prosperous place?" and he turned to me and said, "Cut government spending." And I said, "Well Milton, by how much?" and he said, "As much as possible," and I guess that's where I am right now.

Mark and I agree on a lot when it comes to economics. I think the one area where we probably fundamentally disagree is on the role of government in an economic crisis like we've had over the past couple of years. We've spent somewhere in the neighborhood when you add up all of these programs that we've had, the $800 billion Stimulus Plan, the bail out of the auto companies, the Cash for Clunkers program, the $300 billion or so we've spent on mortgage modification programs for paying people's mortgages –

by the way, I have this wonderful bumper sticker on my car that says, "Honk if I paid your mortgage," and people are honking at me all the time when I'm going down the street.

You know you add up all of these things and it turns out that all of these interventions have cost US taxpayers and our children and grandchildren and grandchildren's children about $2 trillion and that is a massive amount of money. And we really have to ask ourselves, because this has been a big experiment on whether government can create jobs, and we have to ask ourselves nearly 2 years later has this worked? Has it really made our economy better and I would make the case no. I think we could – one way to think about this is with $2 trillion we could've suspended the income tax for 2 years and I'd make a strong case to you all that instead of all these government spending programs if we'd simply told every business and every individual in America today you don't have to pay income taxes for 2 years we wouldn't have anywhere near a 10-percent unemployment rate; I think it would be about half that big.

So I'm concerned – I'll summarize by just saying this: I think the biggest problem in America today is over government spending and we've got to bring that spending down if we're going to remain a prosperous country.

John Yemma: Chris, you've been inside and you're an observer.

Christopher Shays: Right, well first I need a disclaimer because I'm going to say things and then someone might say, "Well why didn't you do it when you were in power?" and there are reasons that it didn't happen. First, you keep it simple. We are trying to do so many things. You try to make sure that there are more people pushing the cart, pulling the cart than are in the cart, and we're seeing too many people in the cart.

You have an example of where legislators want to mandate healthcare benefits so that in essence all plans are the Cadillac plans instead of allowing choice and you get into dangerous ground there. So the government has to decide who it restricts, hopefully the bad folks, the people that are going to do things that you don't want them to do. The problem with the legislature is they try to make sure they get the 9th and 10th – the 90th percentile when they should probably get the 70th percentile and some people are going to get away with it.

If you try to restrict the government so no one gets away with it you stifle innovation, you stifle creativity. So I'd be happy to have us get the 70 percent and then you have to say who benefits? The autistic kid and the family that has an autistic child should benefit. Should you mandate healthcare benefits for everyone, even people who can pay for them, and do it without any government assistance? I'd say no.

John Yemma: Let's go through now with Kraft, let's go through the 5 big topics that our panelists are going to look at and you see them up on the screen now. Jobs and the business climate, we'll march through this, taxes, Wall Street, housing, and overall size of government. Now it's not important that we get through all these. We're just going to try this new approach to see if this actually works to find common ground and if it does ,then we can do another session and take the show on the road.

[Laughter]

So you see at the bottom the key areas and we've staked them out as minimal, maximum, and common ground and Kraft if we go to the next one, this is not going to seem like work for you guys. I know that a lot of people spend time in offices working through these kind of Power Points but what we're doing, as we go through we'll look at the outlying positions, the extreme positions if you will or the sort of more or less positions, maybe those are extreme terms that we've used, and then we'll try to find the common ground in each of those.

And if you go to the next slide Kraft I think you'll show how if you just take the first one, jobs and the business climate, we asked Mark Trumbull who is an economics writer for The Christian Science Monitor whom some of you know, to help us fill in what we think are the minimal and the maximum positions but we can work on the wording and in fact I'd invite our panelists to examine that, but for instance when it comes to jobs the minimal position is get government out of the way. The maximum position is you need a lot of federal support because you need to stimulate the economy when you have a big problem such as the great recession we've been through.

So that's an example from jobs and tax is another one. On one side it's keep taxes low to foster growth; on the other it's maybe you need higher taxes so that you can cut the deficit because you have a risky build-up of debt and there's a lot in between. And Wall Street, we've just been through a re-regulation move in Washington. On one hand do we need to keep America a leader in financial innovation and competition by not intruding too much on Wall Street and on the other hand to prevent another crisis do we need to make sure we don't get into these kinds of behaviors that occurred that may have caused – could've caused quite a catastrophe a couple of years ago.

And then housing, should government even be in the housing market? We know there are all kinds of incentives for people to own houses. There have been, going back into the 1980s and '90s, a big push for homeownership in the United States and on the other hand maybe Uncle Sam should be a player in this area. So should Uncle Sam be part of it? Are we doing too much to stimulate homeownership and has that gotten us into trouble? Or should we be doing more even because of the value of homeownership?

And then finally the size of government and this basically goes the extreme positions; strong government can support a vibrant private sector. Well maybe not; maybe it's limiting government that causes a strong economy. So those are the extremes and we'll move now into the first of these, jobs and the business climate. So first I'd ask our panelists just to examine these areas and see if you kind of feel – when you look at jobs do you feel as though we've got the extremes right and if we've got the extremes right, give us your sense of where we should be. Maybe we'll start with Steve on this.

Stephen Moore: Well I think this is an area where we've had a big experiment in government spending to try to create jobs; that's what the Stimulus Bill was about. I think it was a demonstrable failure. We spent $800 billion, we didn't gain the 3 million jobs we were promised, we have lost about 2.5 million jobs, so I think we should learn – one of the things that frustrates me about Washington Chris is we don't learn from our failures and this was an experiment that I don't think worked really well.

So I think it would've been much better to keep taxes low. When I talk to business men and women one of the things they're really concerned about, and I've heard many small businessmen tell me this, that Washington treats small businessmen like they're ATM machines, that they just get more and more money from them to have new social programs.

Just one example of that would be the healthcare bill, which I think was one of the biggest mistakes we've made in Washington in a long time and that's saying a lot. And I was in Dallas a few weeks ago and I met a gentleman who said he owns about 100 restaurants in the Dallas/Fort Worth area. And I asked him what are some your constraints and he said, "Well one of the things is this new healthcare law." He said that he employs somewhere around 4,000 people in his restaurants and he said that that healthcare bill is going to cost him by his calculations about $1,100 per employee. That's a lot of money; that's several million dollars for a small businessman.

And so I'm just using that as an example of how sometimes we do things and we think, "Oh, this is going to be great. We're going to provide health insurance for everyone." Well we've got to stop treating employers like they're the pay-for for everything that we're doing.

Christopher Shays: The problem where Steve and I may have a huge disagreement is I don't think you want to tell a legislator to take a pledge that they will not do something because what you've done then is you've prevented reaching common ground. You have basically locked that person in and so a 'no new tax' pledge I think is destructive to public discourse and ultimately has got us partly in the mess we're in.

I don't think we should raise taxes but I for instance would love to have been able to get in a debate with my colleagues about having basically a value added tax replacing the income tax. I can't have that debate. I can't have that debate with my constituents; they can't give me feedback. I have a general view if you tell the American people the truth they'll have you do the right thing.

And so in this dialogue about common ground a pledge basically means you will not break it; therefore, you can't even come to the table and I think that's why we have gridlock. So in the end – well so that's my point and I guess the other point is Republicans have got to talk about employers rather than businesses. Somehow people don't get the sense that maybe if you didn't even tax business that you might have a heck of a lot more jobs and, therefore, you have a lot more wealthy people. But it's hard to have that debate because 'you want to help the special interest business.'

John Yemma: Mark, you'll make a point but I hope you'll also address the question of whether the unemployment rate would've been worse if government hadn't jumped in.

Mark Zandi: The question of the proper role of government in our economy depends on the circumstances you're in. I mean at most points in time I would agree that it's important for government to be minimalist and step out of the way and allow the private sector to work. I think that's served us quite well in our 250+ year history. I do think there are times when the market isn't working properly or well when we're panicked and I just invite you to think about 2 years and the environment in that period and think about Bear Stearns and Lehman Brothers, Fannie Mae and Freddie Mac, Merrill Lynch, Wachovia, AIG. Goldman Sachs had to turn itself into a bank holding company because it was fearful that it would fail.

It was a very dark period and there was panic. And when we are panicked that's when we need government to be aggressive and step in that void. And so the proper role of government isn't immutable. It depends on the circumstances that you are in.

Now, having said that I think the government – the policy response to the crisis that we faced in its totality was a success. I agree if I were king for the day and I looked at every individual aspect of the response I didn't like a lot of what was done. I can sympathize with what you're saying with regard to healthcare. I'm not sure that was the proper time to engage in that kind of very epic kind of debate. But when you take it all together I think the response was very, very successful and it's no accident that the recession ended precisely when the fiscal stimulus, the much-maligned fiscal stimulus, was providing its maximum benefit to the economy.

And by the way, the fiscal stimulus is 1/3 tax cut, 1/3 income support for unemployed workers, Food Stamps to people who can't afford to buy groceries, and 1/3 is spending cut – spending increase but of that 1/3, 1/2 is infrastructure spending. So we need to put it in perspective: a fair amount of it wasn't just raw spending and most of it is temporary spending increases. All of this expires and it is expiring as we speak. It's not permanent increases in government spending.

John Yemma: So is there a common ground point that says that –

Mark Zandi: By the way, just let me finish because you asked a question that is would the unemployment rate be higher if we had not responded in the way we did and my view is firmly yes, measurably higher. We would've had a measurably worse economy and it would've cost taxpayers more. I don't think it's $2 trillion. By my math is going to be about $1.4 trillion in the policy response; it would've been measurably greater to taxpayers.

John Yemma: So I don't know if this is common ground or not and Kraft you help guide us on this. I mean in extraordinary circumstances is that when government should be involved in the economy in helping to create these safety nets and is there any way the government can do that without – and then back out or is government always, when it intervenes in these extraordinary circumstances, going to be staying in the economy in a big way and, therefore, growing.

Christopher Shays: I maybe should apologize because it sounds a little too political and I'm not intending it to, but when a school district gets $1.4 million to train teachers for 3 extra days from a stimulus bill, to me that's really irresponsible. I would think you would have wanted the stimulus to be things that have a payback for the generations that have to pay it. So I frankly would've put more money into infrastructure and so on and that's another issue just in terms of jobs.

We talk about pork; you know I guess Eisenhower was the porkiest of all presidents when he wanted our international – our national state highway system. We just don't have grown up dialogue about important things anymore.

John Yemma: Okay.

Dr. Kraft Bell: Could we go back to this and ask the question a little bit differently and say if we were looking before this happened and we took your best ideas how would you have framed it knowing what you know now so we can learn? What's the lesson learned out of this?

Christopher Shays: When times are good you don't deficit spend so that when times are bad you don't have to spend an absolute fortune beyond comprehension.

Dr. Kraft Bell: Okay.

Christopher Shays: No, I'm serious. I mean when you are spending deficits when you're times are healthy, when times are bad then the deficits are going to be so huge and that gets into this issue of a war – if I had to redo anything that I've done I would say if you're involved in a war after the first 6 months you pay for it and if you don't think it's worth paying then you probably shouldn't be doing it.

And the reason that was so significant is it was then hard to argue on the social side with my colleagues well then why can't you spend a little more for Medicare and a little more for this and we lost our ability to say, "Well, we'll pay for that too," because you're not paying for something else.

Dr. Kraft Bell: So if you look at that summary is that something that you all would agree to or not?

Stephen Moore: What are we agreeing to?

[Laughter and crosstalk]

Christopher Shays: I discourage deficits when times are good.

Stephen Moore: I just think that even if you accepted – look, here's the problem where this – here's where Mark and I disagree and maybe I disagree somewhat with Chris. You all remember this, it might be the most important economic insight of all time: there's no such thing as a free lunch. I don't think there's any kids in this room so I can say this to an adult audience. There's no tooth fairy out there. If the government spends a dollar that dollar has to come from somewhere. That's why the economic stimulus didn't work because you're putting $800 into the economy but you're taking $800 billion out because the money has to pay from the private sector so the government can spend it.

And so I just think it's an improper – I mean this is the thing, maybe the reason they asked Mark and I to do this. I just think – I look at what we did and I think, "Oh my god, we have a higher unemployment rate now than we did before we spent all this money and now we've spent all the money, we've blown our wad so to speak and now we've still got a lousy economy and now what we are going to do?" I mean you've got a lot of people who say, "Let's spend another $1 trillion of debt."

I saw a wonderful sign at one of these Tea Party rallies and it said, "Thank God Barack Obama doesn't know what comes after a trillion," and it's like thank God because these numbers have gotten so gigantic. So I just don't think that these policy responses have worked very well.

One other quick point on this is that even if you do think that the government through infrastructure is spending and things like that and not everything we spent money on was a waste of money but we did waste a lot of money in that $800 billion. I mean we built windmills and solar paneling and things that are going to have very little return in the long run. But the thing that I object to, and Chris you know this, it's impossible to divorce politics from the spending.

And so if you look at the way the Democrats spent the money all the money went to the special interest groups they wanted. For example on infrastructure, we could build so many more roads in this country and so much more transmission lines and things like that except we have to pay union wages for every one of these projects. Why? Because the AFLCIO bankrolled the Democratic Party. Republicans, it's the same way; they give the money to their constituencies.

Dr. Kraft Bell: So if you would go back to the situation you would say just let it all fall and don't do any government intervention?

Stephen Moore: No, I would've – this is the next topic but I would've said, "Look, we're in a financial crisis," Mark and I agree with that, it was an incredible financial crisis, I think the intervention to help the banks was important, but I've been saying for 25 years we need a flat tax in this country so we can be competitive and I've always said we're only going to get that flax tax when we have a financial crisis and people realize we've got to change.

Christopher Shays: But how can you have flat tax if you say no new taxes?

Stephen Moore: Hmm?

Christopher Shays: How can you have a flat tax if you've got legislators that say no new tax? That's a new tax.

Stephen Moore: Well look I agree with you. I think we should have a system where we have a value-added tax rather than a corporate business tax.

Christopher Shays: Yeah, but if you make legislators make a pledge that they will have no new taxes then you don't allow even a debate about it. You can't educate people about a flat tax because they've already pledged not to have a new tax.

Stephen Moore: Well I don't know about that. I just think that it would be a –

John Yemma: What if you make it revenue neutral?

Christopher Shays: No, but that's not the pledge. No new taxes. They don't say no taxes, you keep the tax rate the same, and then you adjust. No new tax and then if you take that pledge and you vote for a new tax, even if it's revenue neutral, you voted for new tax; you broke your word. Then people think you're a liar and then you don't have credibility with your constituents.

Dr. Kraft Bell: We're going to get to taxes in a second. Is there anything else that you all would agree on that knowing what you know now, if you were back there in the situation, is there anything you would've agreed on doing?

Mark Zandi: I think actually just listening to Steve we don't disagree about – our disagreement is very small.

Dr. Kraft Bell: So what do you think the common ground is on this?

Mark Zandi: It's everything except a couple of billion on –

Stephen Moore: Well we agree on the bank – we essentially agree that – I think. I don't want to put words in your mouth.

Mark Zandi: Yeah.

Stephen Moore: That the federal government has to maintain the sanctity and the soundness of the financial system and we were – again I don't want to put any words in your mouth –

Mark Zandi: I agree.

Stephen Moore: But that was when we had – you all remember the whole debate about the $700 billion – even that process, I didn't like the process very much. We just wrote a $700 billion check and –

Mark Zandi: But that worked.

Stephen Moore: That worked, yeah.

Mark Zandi: You needed the big number to make it work, to instill confidence.

John Yemma: And would you say Steve that you could imagine government intervening in the economy through a tax cut?

Stephen Moore: Yeah, I think would be –

Mark Zandi: But we had a tax cut.

Stephen Moore: Yeah, but I mean I'm talking more about of a permanent reduction in rates to make America more competitive.

Dr. Kraft Bell: Okay, what else specifically did you – because I think it's helpful for people to hear what else specifically do you think –

Stephen Moore: Well I want to toss out an idea that we might be able to all agree on. I don't like government spending generally but I do like good roads, I do like ___, I do like infrastructure. I think, and I mentioned this to Robert Riche once on the air, we ought to have – let's build more infrastructure but let's get rid of these regulations that say you have to have union works and so on on these things. You can build much more of the stuff; you can have many more companies compete to do these projects. I've talked to a lot of small businessmen that say, "The problem with the infrastructure spending, because I don't have a union workforce I couldn't bid on these projects."

Mark Zandi: But would you have said no increase on unemployment insurance?

Stephen Moore: Definitely not.

Mark Zandi: What about Food Stamps?

Stephen Moore: Let me – this is an important point actually. Unemployment insurance is a humanitarian policy; it is not an economic stimulus.

Mark Zandi: But we do it in every recession; we do it. Is that wrong? You would not do that in the next recession?

Stephen Moore: Again, I'm saying as a humanitarian policy I might do it but I would not do it – I mean there are a lot of people, I don't know where you are on this, but a lot of Democrats said we're going to give people money for not working and it's going to stimulate the economy. Now that cannot happen.

Mark Zandi: Let's decompose the $800 billion stimulus. $350 billion was tax cuts to businesses and a payroll tax cut.

Stephen Moore: Well it was just really a redo.

Mark Zandi: Well it was a tax cut, a temporary tax cut.

Stephen Moore: It just gave people money but that's not what we talk about as a tax cut.

Mark Zandi: All right, another $300 billion was unemployment insurance and Food Stamps.

Stephen Moore: Right, that does not stimulate the economy.

Mark Zandi: Another $150 billion was infrastructure spending, which you may debate the merits of windmills versus roads, but it was infrastructure spending. So what are we really debating here? The remainder of it, the $100 billion of the stimulus.

Stephen Moore: No, we're debating whether it would've been better not to do it at all. Would we be better off if we didn't have that $1.5 or $2 trillion of debt.

Mark Zandi: But you like the tax cuts?

Stephen Moore: I don't like the tax cuts.

Mark Zandi: Oh, you wouldn't have done the tax cuts?

Stephen Moore: No.

Mark Zandi: You wouldn't have the done the accelerated depreciation benefit for businesses?

Stephen Moore: Those were a small part of it.

Mark Zandi: It was $50, $60 billion.

Stephen Moore: Okay, out of $800 billion.

Mark Zandi: Yeah, would you have done the Net Loss Carryback, another $40, $50 billion?

Christopher Shays: What's in the Net Loss Carryback?

Mark Zandi: You really want to go down that path?

Stephen Moore: You brought it up.

[Crosstalk]

Christopher Shays: Who was it supposed to benefit?

Mark Zandi: Businesses. It allows businesses who are losing money now to take that and apply it to past problems to get a tax rebate.

Christopher Shays: Why not just reduce their taxes in general?

Stephen Moore: Exactly.

Christopher Shays: That's the thing that we've got to wrestle with. We put in all those requirements and then we –

Mark Zandi: We did that. We did that in 2001 and 2003; we did that.

[Crosstalk]

Dr. Kraft Bell: I mean it's magnetic so let's go with it.

[Crosstalk]

John Yemma: I mean it seems as though that's what it gets reduced to.

Dr. Kraft Bell: But let's go back to your key points on this because this is what you've got to – so we're on taxes now.

Stephen Moore: Well here's my view very simply: I don't like tinkering with the tax code every year. I think we've got to have a world-class tax system to compete in these global markets. Mark travels all over the world. I'm not a global traveler like you are but you said you've been in Asia and Europe and so on. I mean we've got to get serious in this country about competitiveness and you know you could call it flat tax, you can call it what you want, but a system that rewards capital investment here, doesn't double tax saving an investment, has a low rate so we're not the highest rate country in the world, we're one of the lowest rate countries; I like your idea of taxing people more on their consumption rather than their savings. We've got to move in that direction if we're going to beat these other countries that we're competing against because I always tell my kids – I live in Virginia and I tell my kids, "You're not just competing against kids in Ohio and California and Maine and Vermont. You're going to be competing against kids in China and India and Germany and France." And once we have that system in place that we're all proud of that we think promotes growth then we don't have to tinker with it and Mark and I don't have to have this debate all the time.

Christopher Shays: You know one of the challenges you have with taxes and the way you segregate them, it's difficult to have a discussion because they aren't segregated. For instance, the thing that makes us most competitive is our lower energy costs and our lower energy cost makes up for the fact that we pay people more. So I'm just making a point in general about you're wanting to segregate and we're going to do that but in the end they all interrelate.

Dr. Kraft Bell: Right, but in terms of taxes, I think you started to move towards what might be called common ground. So in terms of if you sat down and said, "Okay, what are the criteria that we should use?" you gave one view; we kind of got the other side. The question is how do we come up with something where there's common ground that says if we follow this set of principles or this approach to how we did taxes what would that look like?

Stephen Moore: I'll give you 1 principle and Mark and I haven't talked about this or Chris, but just as a general principle of good tax policy, lower the rates and broaden the base and that's – that means – I saw the article today in a journal talking about maybe taking away the mortgage deduction or this deduction. I'm all for that. I mean the lower the rates the less the deduction is worth.

Mark Zandi: Yeah, I agree totally. It's got to be simple and efficient and the lower the tax rate and the broader the base, the better off we're going to be.

Stephen Moore: And that means we have to – I think one of the problems in this country, and I want Chris's view on this because he was in Congress for many years, this attitude, soak the rich, this view that we've got to punish the rich, I think it's insidious myself but I'd like your view on this.

Christopher Shays: The challenge we have is once you broaden the base you're raising the taxes on some.

Stephen Moore: On some people, right.

Christopher Shays: Yeah and as long as we're willing to admit that and have a discussion as to why we want to do that, what we want to do is make sure that you don't have so few people paying taxes that the rest are willing to keep raising taxes at infinitum.

Stephen Moore: Right.

Christopher Shays: And that's one of the problems we have with the debate on taxes and what concerns you is there's no restraint because it only impacts a few. But I'm still going to come back because I'm going to be dogged about this even if I'm way out on the right. If you're not willing to allow legislators to debate this issue by not having them make a pledge, this is all academic, this is what will occur here but won't occur in Washington where you need it. Free up legislators from a pledge that says no new taxes and have them say we will try to lower the overall rate – level of taxation but allow your legislators to have a debate among themselves and then a debate with all of you.

John Yemma: Well you've come from political campaigns and you know if you did away with the mortgage interest deduction it would be construed as raising taxes and gouging the middle tax.

Christopher Shays: Well first off it would be foolish to do it right away because people have basically figured out their lives for the next 5 to 10 years and their biggest expense is a house. So whatever we do it shouldn't be so radical. I mean we did – when you had the tax cuts under Ronald Reagan the Democrats and Republicans wanted to outdo Reagan on lowering the tax rate and so they took away some benefits to real estate, which were so sudden that they just, in my judgment, precipitated a real meltdown. It's got to be a lot more gradual.

Stephen Moore: The other thing that's really an important issue on taxes now is our corporate tax. We now have virtually the highest corporate tax rate in the world and that just doesn't work anymore. It's unpatriotic to support, in my opinion, to support a system where American companies – we're at 35 to 40 percent; there rest of the world on average, the major competitor companies, are at 25 percent. Well what does that mean? It means that every American company is starting with about a 15-percentage point disadvantage.

Christopher Shays: That means they're going to do things overseas and then legislators are going to blame them for doing things overseas.

Stephen Moore: Exactly and then they're going to say, "You're outsourcing jobs," and so I'd love to see us bring at least our corporate rate down to the international average.

John Yemma: How about you Mark?

Mark Zandi: Well I think you have to talk about common ground. No, I mean I think these are all good points. I think you have to do it in the context of broad tax reform. I mean you can't do any individual thing on its own. You have to put it in a broad plan. You can't talk about limiting the mortgage interest deduction without thinking about all deductions. You can't talk about the corporate income tax without thinking about it in the broader context of territorial versus other terms of –

Dr. Kraft Bell: So is there something politically or just with the way things are done besides the no pledge, but I mean when you lay these things out –

Stephen Moore: It seems obvious.

Dr. Kraft Bell: It seems obvious. So the question is what else needs to be done in order to facilitate it so that doing those things actually works?

Stephen Moore: Well it's – I call these tax reforms Washington versus America because most Americans, I mean I would bet most of the people in this room probably agree with what we're saying on it. The people who don't want to give up the power are the people on the Ways and Means Committee and the Finance Committee and so on. I mean Washington derives its power from the tax code. I mean this is a cynical view of Washington but they don't want to give up the power; that's my view.

Mark Zandi: I think at the end of the day we've got to be put under financial pressure before we make the wholesale kind of changes that we're going to need to make. I mean we're going to have to have global investors say, "If you don't address this is an adequate, reasonably graceful way we're going to drive up interest rates and you're going to pay." So I think it's at that point when it becomes crystal clear like it has in Europe that we will make those harder choices and we'll think about tax reform in the context of broader, fiscal restraint.

Frankly, you also have to think about the tax question in the context of what are we going to do about future spending growth because at the end of the day it's much more important to restrain spending growth than raise taxes. We've got to do both to address our fiscal problems but ultimately more of the ownness has got to come on the spending side.

John Yemma: Are we essentially at that point Mark?

Mark Zandi: No, I don't think so. I mean the interest rate is 2.5 percent. Even if the fed didn't have investors back, global investors still view us as the place to be. If there's a problem anywhere on the planet, including in the United States of America, they come to the United States because in the past we have always made good on our promises and we will always make good on our promises. I mean I know we will and everyone knows and so, therefore, they're still buying our debt at 2.5 percent so there is the pressure there.

Now I do think we're not going to make any progress on this in the President's next – the second half of the President's next term just given the political environment but for the next – in the next term, whomever the next president, whether it's President Obama or someone else, they're going to have address it then and that's when global investors are going to say, "Okay, you've got to make some hard choices here or otherwise we're going to ask for a higher interest rate."

Christopher Shays: I don't know if this is going to take you too off subject but the bottom like is legislators respond to interest groups, a president or a governor has to run the country. I'm not saying they're oblivious to interest groups. And when a president or governor starts acting like a legislator then you're in deep – you've got huge problems. And I'll just illustrate it this way: just on an environmental issue, the environmental groups are locked in with every different group saying, "We're going to stick together," so the people that don't want offshore drilling get their way, the people – and you end up, as soon as a legislator deviates from that then they have that group.

The experience for me was I decided a number of years ago that I was for choice in schools just quickly to illustrate the point. As soon as that happened, the NEA and the CEA came in and basically told me they could no longer support me and from that point on they opposed me in every election. Now I think we should have a debate on choice in schools, charter schools and so on, and you get – it's like a horse jumping over a jump and someone holds out a barbed wire and they get cut up and the next time they're not going to want to jump over. That's what happens to a legislator continually as soon as they're off the reservation. So it transcends all these issues we're talking about.

Dr. Kraft Bell: Okay, let me just go back one step. In working with businesses and working on large-scale change what you described is kind of the burning platform. The assumption is when we have a burning platform it's easier to get people excited and energized about change. Business people have learned that they have to come up with other ways to deal with it and it seems like our government hasn't – you know education is the primary thing. War-gaming – you know when you sit down and say, "Here's where we are, here's what happened last time. How would this play out?" and you do this on a broad basis so that everyone in the organization is educated so that when the changes come about it may not be a burning platform, but everybody understands that there'll be something out there and I guess the question is is there a parallel in politics and what would that look like?

Mark Zandi: Well we're doing it, right? We have a fiscal commission; they're coming forward presumably in December with a plan. Hopefully it will be a plan that both Democrats and Republicans are able to come together on, but they may come up with 2 different plans, but we are going down that path. We are thinking about what possibly could be done to address this.

Dr. Kraft Bell: Well the difference is there's a group of people that are meeting in private somewhere and a few things are getting out. It's not been – our goal is to educate people to share.

Mark Zandi: But it will happen. They released the report and the whole idea is that next year we have this collective debate about the merits of these proposals that are being put forward. So the first step is for the leadership to come together and come up with a plan that people can come up with common ground, hopefully they can come up with some reasonable common ground, and then we can begin the debate. So in a sense that's what they're doing. It may not be as efficient as GE when they do it, but of course they have a CEO that says, "This is the way we're going to do it."

Dr. Kraft Bell: Well but they may not even know that's what they're doing.

Stephen Moore: Well the difference is in politics it takes oftentimes a mandate to do these things. And I've been following these elections pretty closely; I'm sure most of the people in this room have been. What are the Republicans saying? What's their one message? Stop the spending. Now I'm not here to defend the Republicans. I think the Republicans are the ones who got us into this crisis to some extent. They were big spenders when they were in charge. But at least they're basically saying to the American people, "We've got to stop the spending." And I think if they win in November, if they take the House, you'll see a new – at least for a while at least you'll see a new focus on fiscal discipline.

Dr. Kraft Bell: As long as it doesn't become a pledge. That was what Chris's point was. Okay, why don't we move on to another one?

John Yemma: Why don't we move onto another topic? Here we go. Please excuse us because we're having to look down here so we'll probably look a little dower. Wall Street, so –

Dr. Kraft Bell: Just remember everyone if you have questions please write them down on your cards and send them to the outside.

John Yemma: So we know that there was some awfully risky behavior on Wall Street. The question is should government adjust the balance? I mean listening to the 2 of you especially it seems as though you see a role for government. I mean you both endorsed the bailout of the banks. You probably endorsed some degree of the financial regulation that went on but let's hear it. Steve?

Stephen Moore: I very reluctantly endorsed that bailout because I hate bailouts. I think most people in this room hate bailouts and I do think there are consequences to bailing out people who make bad decisions, whether it's people who made bad mortgages or investors who made bad decisions. And so even – I want sensible rules for the way our financial system works but I think right now my bigger worry is that one of our greatest competitive industries where we dominate in the world is what Mark does for a living in financial services. We're the ones who put the deals together that happen all over the world, whether it's in Taiwan or Beijing or London and I worry that if we continue to put shackles on our financial system that those deals won't get done here. They'll get done in London or they'll get done in Tokyo. So I'm a little uneasy about the demonizing of Wall Street, I really am, because I think New York can't exist without Wall Street.

John Yemma: Mark?

Mark Zandi: Well I think the TARP, the bank bailout aspect of TARP, was a slam-dunk success. I mean we made money on the deal and we saved the banking system and the economy to boot. So I think that was a great success and I think picking the $700 billion number was important I think for sending a strong signal that the government was going to do whatever it took to save the banking system and by so doing it established a modicum level of confidence and the system worked.

I think financial regulatory reform is reasonably good. You know if I were king for the day I would've designed it a big differently but I think it's good in a number of certain respects. You know ultimately it's going to mean the banking system is going to have higher capital levels, stiffer liquidity requirements. The system I think will be sounder as a result. It won't forestall future financial crises, but it will make those crises less severe in the future.

And of course we can't think of financial regulatory reform without putting it in a broader context of international regulatory reform, Basel III, Solvency II, all very important aspects of this. So I think the policy response to the financial system problems were very good and at the end of the day we probably – given that they were – these policymakers were making epic decisions at a time of extreme uncertainty what we got out of it was pretty darn good.

Stephen Moore: What we didn't do though was we didn't address in my opinion the root causes of what caused the financial crisis in the first place. Just as one example. Certainly in my view and the view of the Wall Street Journal editorial page that Fannie Mae and Freddie Mac played a central role in the housing bubble by providing 100-percent taxpayer guarantees on so many of these mortgages. And that gave an incentive – you know there were a lot of bad actors in this whole process of the housing bubble but that certainly gave an incentive for banks or mortgage writers to make loans that should have never been made in the first place.

And I'm still incensed that they passed this 2,000-page financial services overhaul bill and not one page of that bill ladies and gentleman dealt with Fannie Mae and Freddie Mac and I don't understand that. I mean it's such a dereliction of duty to say that –

Mark Zandi: Can I take a crack at that? That's next on the agenda.

Stephen Moore: Yeah, but they always say that.

Mark Zandi: Steve, you could not address Fannie Mae and Freddie Mac in the time that they had here to nail down financial regulatory reform. To take that task on I think would've been much too difficult because we don't, even now, it's not quite clear what is the proper mortgage finance system, what is the best mortgage finance system. So we really have to think that through and I think ultimately we'll get a better mortgage finance system out of it.

But let me say this: I think Fannie Mae and Freddie Mac played a role, they certainly did, but their role was minor in the context of the broader financial crisis.

Christopher Shays: Bull.

Mark Zandi: Pardon me?

Christopher Shays: Bull. They were not minor.

Dr. Kraft Bell: Would you guys like to move to housing? I think it would be better if we would just go to housing and talk –

Christopher Shays: For the life of me I don't know how anyone can say that Fannie and Freddie were minor. They were 3/4 of the housing market. If you took the funding of SEC –

[Applause]

Fannie and Freddie weren't on the 33 and 34 Act. When we tried to get them under the 33 and 34 Act they basically said we were racist because Frank Raines was running the show at the time, we got them under the 34 Act and they finally had to disclose what they were doing and inflating their profits. And in my judgment they were right in the center of this.

Mark Zandi: No, that's wrong. You're wrong. Let me give you a statistic.

John Yemma: We're not getting common ground on this one.

Dr. Kraft Bell: Let's at least document what it is.

Mark Zandi: I'm not saying that they did not play a role. I do think they played a role but it was a bit part. The major reason for the financial crisis was the failure of the private securitization process and I'll give you a statistic to show that. In 2002 and 2003 Fannie and Freddie's share a mortgage debt outstanding, their share of the mortgage market, was 52 percent; that was an all time high in 2002 and 2003. By 2006 at the height of the mortgage and housing bubble their share was 40 percent. It had fallen 12 percentage points because the private securitization market had come on and filled that void. So Fannie and Freddie actually were pushed out of the marketplace by the subprime, the alt –

Christopher Shays: How much set aside did they have? They had less than 3 percent for all their mortgages.

Stephen Moore: It's ridiculous.

Mark Zandi: Yeah, but that's a totally different matter.

Christopher Shays: No it isn't.

Stephen Moore: But it was $200 billion of -.

Mark Zandi: I'm not saying they were –

Christopher Shays: Let me just make my point because I could be wrong but I'd at least like to make it. They basically had close to 2 percent set aside to cover all their mortgages. When we asked Frank Raines he said, "Well 3 percent would be too much," and we all know and they had a weak regulator that basically let them do whatever they wanted, and so when they had this bad debt what did they have to cover it? And they were 40 percent of the market. I don't care of they were 50 or 40; they were 40 percent of the market, one company, 2 companies.

Mark Zandi: Yeah, but they weren't the agents for all of the bad loans that were made. The Sub Prime, the Alt A, the Option Arm, these are the loans that blew up and created the crisis. They did not make those loans. Those loans were made by private originators.

Christopher Shays: What about their set aside?

Mark Zandi: When the housing market, the mortgage market, and the economy went south it took the entire economy with it then they were dragging. They did not have enough capital to withstand that.

Christopher Shays: But that's my point and they were 40 to 50 percent of the market, just 2 companies.

Mark Zandi: And I agree with your point that they were undercapitalized but they were not the catalyst for this crisis.

Christopher Shays: And then the government is supposed to regulate them and didn't.

Dr. Kraft Bell: So if you ask yourself the question given those perspectives what would be a common ground? What is it that you agree on that should happen with Fannie and Freddie now having learned from this experience and seen it?

Mark Zandi: I think we're going to agree. I think there should be no Fannie Mae and Freddie Mac.

Christopher Shays: Yes.

[Applause]

Mark Zandi: I don't think we need them. I do think though we need government in our mortgage market. We need the government to provide catastrophic insurance if the mortgage market fails and price it explicitly, not implicitly like Fannie Mae and Freddie Mac were implicitly pricing it. But we need government backing of our mortgage market so that we can add affordable mortgage lending to our population, but not Fannie Mae and Freddie Mac.

John Yemma: What about the current problem with all the houses that are under water and the foreclosure crisis? Is there anything government should be doing to relieve the burden on homeowners Steve?

Stephen Moore: I think the most – unfortunately mortgage modification programs that I was talking about earlier, they really haven't worked really well. I mean the problem is – I saw a statistic today that was – it must be right because it was in the Wall Street Journal. Mark, you probably can verify this but they said 20 percent of all mortgages in America today have negative – 20 percent of homeowners have negative equity in their house. That is a frightening statistic. That means people have an incentive to walk away from – just a financial – that means that their mortgage costs more than the house is worth and that means they have negative equity in the house and that is a frightening thing.

So in my opinion we have to just let the market hit the bottom because the housing crisis caused this economic recession that we're in and we're not going to see the robust turnaround that we should see, that we all want to see with strong job growth and so on until we hit the bottom. And I worry that what we've done is kind of artificially tried to hold up home prices rather than just let them hit their natural bottom and then grow out of this.

John Yemma: But as the market clears, as the housing market clears, doesn't it bring even more people? I mean you've got this high unemployment rate so people are having problems meeting their mortgage obligations and then you have all the houses that are under water and that are in foreclosure and that are in short sales and isn't that pushing down even more people?

Mark Zandi: Here's the problem with letting it burn so to speak because it was burning back in 2008 when house prices were falling straight down is that you do drive many people into negative equity positions, deep negative equity position. And when you're in a deep negative equity position it doesn't take much of a catalyst to create a default. I mean I'm in Florida; I spring a leak in the roof. If I'm $50,000 under water and you ask me to put another $5,000 into my home, even if I could afford to do it would I really do that?

Or it's just a small disruption in your income. I lost my job and I got a part-time job but that's not enough. Or my spouse lost his or her job; that's not enough. So if you let it burn you run the risk of getting into this self-reinforcing, viscous cycle down. And we were in that cycle back in 2008, early 2009 and the government intervention I think was very helpful in stemming that, breaking that psychology, that vicious cycle and we did a lot of things. The Fed came in and brought down mortgage rates, there were 3 housing tax credits, there was an increase in the conforming loan limits, of course the FHA filled the void left by the fact that securitization market died and they filled the void so we did a lot of things.

And in my view the government intervention stabilized housing values and it wouldn't have worked at all well if it was done at a point where house prices had not gotten to their long-run equilibrium value. They're probably pretty fairly valued at this point. You see investors coming in scarfing up property because they see value. So I think the timing of it was actually pretty good.

Now I'm not arguing that the government should be in here for very long. They've got to get out and they've got to move quickly and I think they're trying and I think they will but I think what they did was very helpful. I agree with you though on the modification efforts. I think that was – of all the things that policy makers did that was the least successful.

Dr. Kraft Bell: So going forward what is the role of government in dealing with this?

Stephen Moore: Get jobs, get people in jobs. I mean look, we've got to get the economy growing. If the economy starts growing and we get jobs back people can pay their mortgages. We're in this kind of death spiral right now where you've got high unemployment, if a person loses their job, they can't pay their mortgage that reduces home values, so I hate to say this but I think it all circles back to what are we doing as an economic growth job strategy to get Americans back to work to have high-income jobs in this country so people can afford expensive homes?

Christopher Shays: You know what I'm struck with speaking – thinking about it as a legislator, when someone comes to you, when one of my staff who is making enough to pay her mortgage but can't refinance because she missed one month and so I could end up paying 4.5 percent and she's still stuck at 8 percent, it's like you know how the story's going to end up. And so in my mind as a legislator I would want to find a way that that person who's willing to pay and eager to pay can pay a lower interest rate.

What I take disappointment in was that we were so eager to get everyone to own a house that shouldn't have owned a house. So we have 2 problems; one problem is we got them in that mess, they got themselves in the mess, so we can't do the ideal but when we can do the ideal I want to see very little intervention. But right now if we allow the market to implode then we're going to have a lot of innocent people who are going to go down with it.

Mark Zandi: I don't think we need to do much more now. I think the market is finding its bottom now. I mean I think the interventions work reasonably well there.

Christopher Shays: Can I ask you a question?

Mark Zandi: Sure.

Christopher Shays: I'm just struck with the fact that there are a lot of delayed foreclosures, huge numbers. When is that bubble going to bust and how do you deal with it?

Mark Zandi: Well I think we are – we've been digesting these bad loans now for a couple, 3 years and I think we're 2/3 of the way through the process; we've another 1/3 to go. There are another couple of million loans to work through.

Christopher Shays: So we haven't just been pushing off those decisions? I know banks that have kept houses for 2 years for people who haven't paid mortgage or taxes.

Mark Zandi: No, no, I don't think we've been pushing it off. I mean we've had – if you go back to the beginning of the housing downturn, which is now 5 years ago, there's been 6 million – 6 million people have left their homes either through foreclosure or short sales. That's working through the problems and we probably have another couple, 3 million to go. So it's not working as fast as anyone would like but that's a boatload of loans to work through.

Stephen Moore: One thing on the role of government to me gets to the point Chris was saying. What I like to see the government do is facilitate the lender and the borrower getting together and renegotiating the terms of these loans. Look, if you've got a mortgage like this and the house is like this, you've got to get together and you've got to renegotiate. And look, banks don't want to have to force people out of their homes. I mean they lose a lot of money on foreclosures.

So that's the thing I've been frustrated with is that this process of renegotiating and you don't need the government necessarily to play a role other than just to facilitate bringing them together so that like you said they may not be able to pay that 8 percent interest rate but if it was brought down to 4 percent maybe they could stay in their home. That's what I'd like to see.

John Yemma: Chris, we're going to go to questions now but before we do I just wanted to ask since you've been in government, is there anything government can do, when we talk about some of the subtext here or listen to the subtext, a lot of it has to do with re-instilling confidence in Americans, whether it's businesses to hire people, whether it's home owners to feel as though they can – people who can take on risk by buying up some of these cheap properties. Is there anything government can properly do or is that too -?

Christopher Shays: If McDonald's spent all of their money telling you why you shouldn't buy Burger King and Burger King spent all of its money telling you why you shouldn't buy McDonald's both companies would go out of business and that's what legislators and candidates are doing to each other. And so there's no –

[Applause]

There's no faith in your legislators. I have to tell you the guy who beat me is a hard-working guy. He's got 2 kids and he's given up a lot and they're good people. You may disagree with them but they're honorable people. But you would be hard-pressed to know that anybody is honorable down in Washington.

Stephen Moore: There is one thing the government can do I think that would have such a significant positive, confidence-builder, it would just unleash the animal spirits of this economy. If an hour from now Barack Obama would go on national TV and he would simply say, "Given that we're not out of this economic crisis, that we still have near 10 percent unemployment, for at least for the next 2 years we're going to extend – not raise taxes on anybody," I think you'd see explosion in the market. It would be such a relief to everyone. I mean it is insane to be raising – January 1, 2011 is a massive tax bomb and one of the most irresponsible things Chris I have seen in the 20 years I've studied politics, they left town 2.5 weeks ago to campaign and nobody knows what the tax rates are going to be next year.

Christopher Shays: You know what, someone told me and I'd love to know if it's true, they said because of the alternative minimum tax the impact of that tax increase is going to be marginal.

Stephen Moore: But still it's insane now to be raising capital gain taxes, dividend taxes, estate taxes, business taxes and I just – I really mean that. If President Obama would just say, "We're not going to do it for at least 2 years," and we can have this debate 2 years from now, I don't know how you feel about it Mark but I think it would be a real positive.

John Yemma: Everybody would be watching TV an hour from now. Alright, Bruce let's go with some questions.

Bruce Bond: All right, first of all I'd like to acknowledge a wonderful discussion. Thank you guys very much.

[Applause]

Mark Zandi: I do feel bad. I told Chris he was wrong and I shouldn’t have said that. I just got a little carried a way. I'm an economist; I'm not a politician. I have a rough edge.

Christopher Shays: I was thinking it was getting pretty boring because we do agree on more things.

Bruce Bond: Well we have a number of wonderful questions and frankly I don't think we're going to be able to get to all of them so those of you whose questions we don't ask our apologies for that. We've tried to call out the ones that we think are the most relevant for the things we've been discussing. So first of all John the question here really crosses all the categories that we've had and that we've been speaking about and that is is there any country or city that we know of that's actually getting this right, that we can point to and say, you know there are some real lessons that we could learn from these guys?

John Yemma: Mark, you're the world traveler and also domestically.

Mark Zandi: Well there are some countries that are doing quite well. All 7 million Norwegians are doing okay. All 500,000 North Dakotans are very fine, thank you, and of course they've got plenty of oil in both Norway and North Dakota. You know I think that we're unique because we have such a large, diverse, complex economy and we can look to other countries for guidance but ultimately at the end of the day we have to make policy fit our American experience because we are different.

Stephen Moore: I totally agree with that. You know I always say that the number one issue for our country, the reason you're all here today, is this question: what country on this planet is going to be the global economic superpower going forward over the next 5, 10, 20 years? Is it going to be – for all of our lifetimes the United States has been the unrivaled economic superpower but now we do have an honest to goodness rival in China and what's happening in China is an incredible miracle. Quick story, we met with the Chinese economic minister at the Journal a few months ago and he was talking about how great things were in China and they were going to surpass Japan, which they've done. You may have seen a few weeks ago they're now the second largest economy in the world. And then he said to us, "Our models show that within 18 to 20 years we're going to pass the United States and then we're just going to leave you in a cloud of dust," and I said, "Sir, with all due respect that's not going to happen because our Chinese are much smarter than your Chinese."

[Laughter]

There is a point to that. But the point of that story though is China, I've only been there once and I'm sure you've been there many times, those folks are hyper obsessed with the competitors. They want to be number one in manufacturing, aeronautics, defense industries, workforce; we've got to – that's why we're all here and that's why we're talking about it. How do we make sure that the world continues to look at the United States as number one? We're going to get this right because we as Americans don't tolerate failure.

John Yemma: Chris, anything on that?

Christopher Shays: Well Europe can't be our model.

John Yemma: Bruce?

Bruce Bond: Alright, so the next question has to do with jobs and that is that there are a number of companies out there that are doing pretty well making some pretty good profits and coming back from this recession. Yet hiring continues to be very weak so the real question is what's behind this? Why is it that people are not hiring and what do we need to do to encourage them to start opening up the payrolls?

John Yemma: Mark?

Mark Zandi: I think there's a multitude of reasons but I'll give you 2. First is a lack of credit for many small businesspeople. There's a statistic:

establishments that employee 100 employees account for 1/2 of all the jobs of our economy and 2/3 of the net job creation in the last economic expansion and if they can't get credit they can't hire and that job machine can't get going. So not all small businesses – many small businesses there's just no demand, they don't want credit, but I think there is credit constraints and you can see that in different ways.

The second reason is just a general lack of confidence and I ascribe this to 2 things. One is that we just were put through the ringer. It's hard for business people to forget. Just so you know, I'm not just an egghead. I started my own company in 1990, myself and my brother, and I sold it to the Moody's Corporation 5 years ago so I know exactly what it means to be a small businessperson and I know when you get through something like this you just don't forget it. It takes time to overcome the psychological competitiveness that it creates.

But I also think policy uncertainty is playing a role here. Steve mentioned the tax code. I agree that that's a problem and we have healthcare reform, financial regulatory reform, we've debated energy policy and immigration policy and I'm not saying we shouldn't have these debates. We need to have them and we need to nail these things down but when you're in the middle of them they create a great deal of uncertainty and I think businesses are just nervous.

But here's an intrepid forecast for you: businesses are very profitable. Small businesses aside, big business and mid-sized companies are very profitable and their balance sheets are very strong. If we don't get sideswiped by anything else like a European debt situation our economy is going to be measurably better a year from now and 2 years from now we're going to be off and running.

John Yemma: Chris?

Christopher Shays: My response would be a lot of good businesses with sound business plans went out of business because they didn't have cash and then they had to sell their resources, their – what they owned at bargain basement prices. And so what was the lesson for them? They've got to accumulate cash because they do not know what the next government is going to do.

John Yemma: Steve, maybe you could address, you can certainly address anything you want to address, but maybe you could also address the question of whether China and China's currency is in a sense continuing to flood our market with great goods that everybody walks into Wal-Mart and buys but is basically – isn't that a deterrent on little businesses here that might start something?

Stephen Moore: Boy that's a tough issue and Mark probably knows more about this than I do. I would simply say this: I am really – one of the things that does worry me is the China bashing right now because look, the growth of the China market is so positive for the United States. First of all, I mean you go into a Wal-Mart today you get damn near anything you want in America for $.99. I mean it's just unbelievable. And so China is one of the things that's keeping prices low and making things affordable to America.

It is also true that China has a very – they're not buying our products and I would love to see policies try to open up their markets more. But I'm really worried about this currency idea that everybody is going to have a race to the bottom and we're going to deplete our currency to nothing and somehow that's going to make us rich. I think that's a really flawed way to look at the world. In the 80s and 90's when we had what my friend Larry Kudlow calls the 20-year expansion it was so powerful and the most greatest period of prosperity, the dollar was strong. We had – we created more jobs than all of Europe and Japan combined even with a very strong currency. So I don't buy this idea that weakening our currency is going to be a ticket to prosperity.

John Yemma: Chris do you worry at all about protectionism?

Christopher Shays: I truthfully worry about it but then I agree with them.

Bruce Bond: All right. We have a question here about taxes and this one has to do with this notion that we go through cycles where every now and then we come up with surpluses and then we end up with deficits. So the question here has to do with the desirability of government policy that essentially would do the Joseph play from the Bible, which is to take the 7 years of plenty and put them aside so that when we have the 7 years of famine we are in a position to get through that tough time a little more easily. What is your thought about A, is that just plain good government, and then I'd be interested – I think part of the question here is is that actually feasible.

John Yemma: Chris, you talked –

Christopher Shays: I would be happy if we did 3 years of plenty. Ross Perot ran in 1990 and almost became a third party but frankly both parties tried to gobble him up and he did. It's the only time in the 90s that we were ever educated anything. People – Larry King allowed him to have charts and people looked at these charts and said spending here, revenue here, big gap, it's going to get worse and we balanced the federal budget.

And so there's all this talk about taxes but frankly we have a huge spending problem and that's what we've got to get at. And then the challenge is to not allow ourselves to think – what happens is as soon as you have a surplus people say, "Well you'd better spend it." So pay down debt would be what I'd do with it. I wouldn't put it anywhere where someone could spend it. That's what states do and then they end up spending it. Just pay down your debt. Pay to properly finance your teacher retirement and your state employees.

Did you know your healthcare liability in the State of Connecticut is $25 billion? Your underfunded liabilities for teachers and state employees combined is $9 billion and that's high. $25 billion so pay down debt, pay down liabilities.

John Yemma: Either want to argue on that? Feel like paying down debt? Good.

Mark Zandi: It'd be nice.

Bruce Bond: Spoken like a true economist. Okay, there's a question here about the viability of supply side economics. We've alluded to President Reagan here who was the champion of that. The concern that this individual has is that there's a tremendous amount, from their perspective, a tremendous amount of capital that is actually flowing out of the country as we find better opportunities overseas. If indeed that is what's going on is there a fundamental flaw in supply side economics from a tax perspective and so forth that perhaps didn't exist back when President Reagan was in power?

Stephen Moore: This is sort of up my ally because I wrote a book on this, which is available on Amazon.

[Laughter]

Look the lesson of the last 25 years is just how important tax rates are. You want to be the lowest tax rate country, not the highest tax rate country, as my co-author Arthur Laffer and Larry says every night on TV, if you've got location A that's lowering taxes and location B that's raising taxes where are the jobs – everything else equal? Jobs are definitely going to leave B and they're going to go to A. That's pretty simple and you see that within states and you see that within countries. We were – one of the things that happened when Reagan cut tax rates from 70 to 28 percent, which was one of the great policy achievements of our lifetime, is we became a magnet for capital. And one of the things that caused the massive growth and prosperity that we saw in the '80s and '90s through around 2005 was the United States was a net importer of capital. We imported something like the magnitude of $6 trillion of capital from the rest of the world, that is foreigners investing more in the United States than Americans were investing abroad. That’s what we want to do.

One of the ways we can see a recovery, we were just talking about the housing market. Let's have foreigners continue to invest in the US housing market. And so it is really critical that we keep our rates as low as possible and that's why it's such a major, major mistake to be raising capital gains and dividends.

Christopher Shays: May I ask you a question in that regard?

Stephen Moore: Yes.

Christopher Shays: This is what I wrestled with as a legislator. Conceptually, I understand that, but you could basically eliminate – you say as low as possible so where is that point where you become irresponsible?

Stephen Moore: Well I think we can get our rates down to –

Christopher Shays: Just eliminate them entirely, that's irresponsible.

Stephen Moore: No, no. Look, I mean we have to pay for government obviously. I mean there's no reason we couldn't do something like what Steve Forbes talked about when he ran for president in 1996. He was just ahead of his time but we should have a tax rate of between 18 and 20 percent with as few deductions and loopholes and carve outs as possible. I think that would be highly – I mean if we could do that, I mean folks if you want to see a _____ for this economy, if we did what Steve Forbes talked about in 1996 you would see so many jobs and so much capital coming into this country. I mean with no double tax and capital gains and dividends and so on – I mean John F. Kennedy said it best that we have a system now where the rates are too high and it doesn't generate enough revenues.

Mark Zandi: Yeah, but interestingly enough I mean if you look historically since World War II it's always been 18, 20 percent and right now it's actually 16 percent, right? It's low because of the bad economy. So the effective tax rate on the economy –

Stephen Moore: Right, but what's important is the marginal rate, not the effective rate. I mean all decisions are made at the margin so we want to get rates down as low as possible so we can get more growth and more business.

Bruce Bond: May I interject and if you would just explain the difference between those 2 things? I'm not sure everybody in the audience understands.

Stephen Moore: Oh, just the marginal rate is the rate you're paying on the last dollar that's invested and those – all decisions we make in life are made at the margin and that's why to say we're having – just raising the tax on the top 2 or 3 percent is crazy because those are the people who are the wealth creators and the business investors and so on. Those are the people who can move capital in and out of the country in great magnitude. So I just think it's – you know the capital gains tax is just a tax on asset ownership. So if you raise the capital gains tax what happens to value of stocks? They fall. I mean the stock market has to fall if you raise the capital gains tax because the capital gains tax is just a tax on the ownership of the stock.

So those are – I just don't think the president, and I have a great respect for him, but on this issue he just doesn't have his tray table in the upright and locked position. I mean this is a really important position, that you keep the rates low –

Dr. Kraft Bell: So here's question just so I don't violate the agreement here, should that be in the center or over on the red? Do you fundamentally agree with that or not?

Mark Zandi: I think yes, I agree with that because that's where we've been since World War II and that's where we're going to stay, 18 to 20 percent. Some times we're a little low when the economy is bad; right now it's about as low as it's ever been. Sometimes it's high. When the economy was great, 1999 –

Dr. Kraft Bell: Okay, but you're accepting the definition of the marginal tax rate and not just the effective tax rate?

Mark Zandi: I'm not sure I see the distinction here at the moment. I mean the effective rate is what we pay on the margin, right?

Dr. Kraft Bell: Aren't you trying to make the distinction that the way a businessman makes decision is on the margin? The effective rate –

Stephen Moore: I'm just making the point that there's an efficient way to raise the revenues and there's an inefficient way to raise revenues.

Christopher Shays: The challenge you get in the legislature is there is a moral question of redistribution and then there's a question of what creates economic activity and ideally you want to create economic activity. That's what you want.

Mark Zandi: I was just going to ssay with regard to the tax cuts, I would agree, I wouldn't raise anyone's taxes in 2011, perhaps not for the same reasons you wouldn't.

[Crosstalk]

I mean given the fragility of the economy I don't think I would be raising taxes – in confidence I wouldn't be doing that. But I think there is a distinction from a supply side perspective to be made between Ronald Reagan cutting the top marginal tax rate from, what was it, 70?

Stephen Moore: 70 to 50 or something –

Mark Zandi: Or even lower, right, yeah, to what we're talking about here. It's a very different kind of order of magnitude. The marginal rates are lower and the increase is a lot smaller so the impacts are going to be much less significant you would think.

Stephen Moore: That's true.

Christopher Shays: And I just want to say you have the alternative minimum tax that every year is taxing more and more and congress is not about to address that because it is such a huge number. So what the impact on you is more and more of you are going to get captured in the alternative minimum tax rate and legislators are going to say they didn't raise taxes.

John Yemma: Bruce?

Bruce Bond: Alright, we have a question about Wall Street and I think sort of behind this question is just a general view that okay, maybe it was necessary to do the bailout but there's a lot of resentment out there, people feeling like these guys got off easy and shouldn't have. So the question here is going forward, should part of financial reform remove the burden of bailout from the taxpayer and place it squarely on the backs of the banks?

Mark Zandi: I think it would be appropriate, talking about rainy day funds, to – first of all you can raise capital levels and liquidity requirements to make it more difficult for these financial crises to occur and I think everyone's on board with that and we're doing that.

Christopher Shays: But you slow the economy.

Mark Zandi: Yes, you will slow the economy because credit won't flow as freely, but we can all agree that credit flowed too freely.

Christopher Shays: Right, but I'm just making the point that's the cost. As we ask them to set aside more money there's less.

Mark Zandi: Right and there's a balance. You've got to strike to a balance. I think we got the balance wrong previously and I think it's better balanced now. But I do think there's an argument to be made for – there's different mechanism being discussed to try to impose more market discipline on institutions. So for example there's discussion about having bonds, the financial institutions would have to have these bonds that convert into equity when the financial institution is getting into trouble so that their capital ratios rise when they're approaching a point where they might fail.

It's an interesting idea. Some regulators overseas have endorsed this. It’s something I think we should consider. Another approach is just to impose a tax on non-deposit liabilities because it's usually those non-deposit liabilities that is the fuel for the very aggressive lending that occurs. So if you impose a tax on that to generate revenue that you keep in a fund just in case there is a failure then in a sense the banking system is paying for it itself.

Stephen Moore: But you know there’s one thing that frustrated me about the financial crisis people blamed the banks, people blamed the government, Fannie Mae, all these things, but the 2 institutions that we haven't mentioned that were really – that failed miserably in this whole thing were the credit rating agencies, right? I mean the credit rating agencies were giving AAA bond ratings to these worthless bonds for years and they didn't really pay much of a price on that and the other is the aauditors. And so we've got to – I’m just so frustrated that the private sector didn't achieve its function and we wouldn't need these kinds of things that you're talking about if the market worked well. I know I'm just – I don't know how many of you who lost money in this catastrophe feel the same way but we should have – I don't know, Mark. Maybe you can answer that. It's something I've always been puzzled about. Why did – the credit rating agencies didn't even pay a price for this and they've missed 2 or 3 – they've missed the Enron crisis; they missed the housing crisis, so on.

Mark Zandi: Yeah, well of course if I address that it's a no-win for me.

[Laughter and crosstalk]

I made my views and I love to express them.

Christopher Shays: Well when we had Enron come before us was I'm going to tell you the most frightening day I ever had as a congressman. Management didn't manage, employees didn't speak out except one individual who spoke out privately, the law firm was in cahoots, the auditors were part of the problem, everybody in the list, the rating agency, no one, not one person other than one employee at Enron spoke out and called the question in the entire system.

Stephen Moore: That's amazing.

Mark Zandi: This goes back to a broader point I made earlier when we were debating Fannie, Freddie, and securitization. In my view the real problem was securitization and the credit rating agencies failed in that regard and they were one piece in the chain. There were the originators who made the loans, there were the issuers of the securities, the investment banks, there were the rating agencies that rate the bonds, there were the regulators that should be looking over the entire process, and there are the investors themselves. I mean they, in many cases, didn't do their own due diligence.

So to me the real failure, Fannie and Freddie played a role, I agree with you, but the real failure was in the market and the way the securitization process worked.

Stephen Moore: This is maybe off-topic but it doesn't make any sense to me that the credit rating agencies work for the people whose – they should be working for the investors.

Mark Zandi: Here I would disagree only because – I could care less what happens here except that do we really do we really want the hedge funds paying for the rating? I'm not sure that we want that.

Stephen Moore: Well they're the ones whose money is at risk.

Mark Zandi: Well it depends on who's paying for it. I mean if a hedge fund says, "I want to go short the bond," then they can get a rating that makes the institution look bad." So it's not clear-cut that you want to go down that path. There are other mechanisms; that's I don't think the right way to go.

John Yemma: So it's not just government's role in the economy; it's sort of our role collectively in the economy. I mean there was failure at all of these different levels of all the agencies.

Christopher Shays: It was stunning. Not one, not one, there wasn't one good player, not one good agency, not one good regulator, and I was concerned that then everyone had to redo their – you know they had to redo their books and I thought there would be hell to pay and it wasn't followed and there didn't appear to be. Could I just go back on one issue? We didn't ask the banks when they had bad debt overseas to write down their bad debt. In the early '90s when we had a huge problem we didn't ask them to write down bad debt. That was one way we kept the market afloat. This time we basically told every bank, every institution they had to write it down at the market, whatever the hell it was, and we didn't even know so they basically put it at 0. So I kind of felt that why didn't we do it the way we did it in the 90s?

Mark Zandi: You mean not have mark to market?

Christopher Shays: Yeah.

Mark Zandi: That's a good point, yeah. I agree with you. You're right.

[Laughter]

Dr. Kraft Bell: A great point to end on.

Bruce Bond: I would say if I'm Chris Shays I want the meeting to end right now and indeed we have run out of time. So first of all I'd like everyone to know this is the first public forum that Common Ground Committee has put together and based on the results tonight we're going to work on another one and we appreciate everybody coming out tonight and also watching us over the Internet. Please pay attention to our website, www.commongroundcommittee.org, for future events and finally if we would all just recognize the fine job these gentlemen did tonight and we're so appreciative.

[Crosstalk and applause]

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