

CONVERSATIONS

WITH BILL KRISTOL

Conversations with Bill Kristol

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KRISTOL: Hi. Welcome to CONVERSATIONS. I'm Bill Kristol, and joining me today, I am very pleased to have joining me, is Irwin Stelzer, economist, contributor to *The Weekly Standard*, *Public Interest* and many other magazines. My favorite economist.

STELZER: That is high praise indeed.

KRISTOL: Damning, if some kind of praise. I don't know that you would want to be considered my favorite economist. You are my favorite economist because you both defend, you make the strong case for the importance of economics when people are being economically illiterate, and then you spent half your time explaining to economists the limits of economics. Explain those both to me, here, in 90 minutes. Explain economics, basically. It works, doesn't it? At the end of the day, markets, competition?

STELZER: Yes. At the end of the day, markets and competition work. Unfortunately, we don't have perfect markets or perfect competition. So, in the real world, what you are dealing with is inclinations, tendencies. You're not dealing with hard and fast conclusions – as you can see from the mess we're in in healthcare and almost every other thing you mention.

Economists can tell you how to create incentives to good behavior. They can tell you what incentives the bad behavior can do – take Wells Fargo as a good example. And they can sort of lead you to ask the right questions, if laced with a significant amount of humility.

KRISTOL: I am curious. You're a PhD in economics, but then were in the business world for most, almost all of your adult life. Which influenced you the most, or is it a combination of the two?

STELZER: I think there were three things. First of all, what I learned, mostly, in graduate school. I had a great mentor, Alfred Kahn, very exciting. I had an exciting graduate career: I got to teach nine hours,

work for the 21st Century Fund, grade papers and take five seminars, and get the PhD done in two years. So it was very intense.

KRISTOL: Wow. It's not like my graduate – Two years, really? Wow.

STELZER: Well, you probably like hanging around campuses.

KRISTOL: Totally, yeah.

STELZER: I did not. I wanted to get back to New York.

KRISTOL: You were not sitting in the cafes?

STELZER: No, I wanted to get back to New York about as fast as I could. And then, I learned in business that a lot of what I learned in economics is true. If you reward people every quarter, they're not going to make any investments because they are going to want to maximize whatever they produce in a quarter. So I think it was a good combination.

But the third part, and this is not to flatter you, but at some point in the '80s, when I had sold my business – because I spent 25 years doing wage reviews for hundreds of economists, each of whom had his own theory of wages, and I decided that's not for me anymore – your father said, "Why don't you come down – you've made enough money – come down to Washington. I will get you at the AEI and you'll really thrive there."

So I went down with a whole bunch of free-market stuff. I was going to stay a year. And then I ran into your father and your mother, all of whom questioned everything I said and introduced what I considered non-economic considerations. And I said "Oh, I don't want this slippery slope; I like really what I got. I know if I raise the price, the amount of demand is going to go down. I'm happy with that."

And then I had to think a lot about it and I emerged from that really quite different from what I went in. So it was a combination of the three things: education, running a business, and then getting exposed to a whole different way of thinking about poor people – there's deserving poor, there's undeserving poor – and that changed me.

And I think that is where I am *now*. Who knows what will happen, who I will run into next.

KRISTOL: No, I think that what is so interesting about your work is you try to think about, let's call it "democratic capitalism," as a whole. Not just about, "there's this market imperfection that needs to be fixed in that way."

STELZER: Right. Well, I think as you get from, let's say from liberal – "when you get mugged by reality," as your father said – but when you get to conservative, you have to ask yourself: *What am I conserving?*

I don't much care about the environment, really, which is what conservationists think about. You are trying to conserve free-market democratic capitalism. Once you decide that that's the broad goal, then you are let loose because the specific things have to fit into where they go. So you get away from pure efficiency arguments. I mean, I could tell you the most efficient way to organize anything is. But then you get to distributive justice and equity and all of the mushy stuff that makes decision making much harder.

KRISTOL: And I suppose, the real world itself makes decision making so much harder, right? You were an anti-trust specialist and competition. I guess I would say, if someone got a good PhD in economics, presumably all of the competition, markets, supply and demand, price discovery – I don't really understand most of these things, but all these terms – how far off is that person going to be when it comes to Washington to try to figure out what the right policy should be in this area or that area?

STELZER: Well, it depends. I have hired a lot of those people, because I used to hire people by seeing who was writing doctoral dissertations in the areas I was interested in and then calling them up and say, “How would you like to come to work?”

KRISTOL: Is that right?

STELZER: Yeah, that’s how I did it. I studied the list of dissertations. And so I got them when they finished their dissertation, sometimes not, and now they were confronting reality. And reality was much more complicated. I mean, I could tell you, for instance, that it is important as an economist to internalize externalities.

KRISTOL: Right.

STELZER: If I turn on my electric and I pollute the air, I should have to pay for it. I mean, you can say that in a paragraph. Okay, how do you measure the social cost of what you are doing? Well, now you’re in a whole different area.

It’s that, but still the basic idea of asking the right question is what you could come out of graduate school with. And one of the things, when I was at the Kennedy School, Bill Hogan, who – you know him; he’s a very fine professor – always said, “If you ask the wrong question, you’re going to get a silly answer.”

When the governor of New York said, “Can I evacuate Long Island if Shoreham Nuclear Plant blows up?” Well, the answer to that is “No.” But it has no meaning. The question is, “What is the probability that that’s going to happen, what can you do to change the probability of that sort of thing?” And that is much harder.

KRISTOL: I want to talk about some of these particular areas of competition, externalities, democratic capitalism – but just, looking at America today, we are speaking in late June, 2017, which worries you more: That people don’t get the *basics* of economics, of markets, of prices, the kinds of things that really are important to have, you know, increased prosperity and a functioning economic system that has produced wonderful things. [Helped] so many millions, hundreds of millions of people on the one hand.

Or that people are dogmatically attached to a kind of free-market orthodoxy that doesn’t let them think more creatively about the broader society of democratic capitalism that we need to preserve, and about some of these complex issues of social externalities and so forth?

STELZER: Yes.

KRISTOL: Both?

STELZER: They both worry me. I would say, in the practical world of making policy, the second probably is more worrying. Because people, I mean, what is there in economics? You raise the price, you sell less. You grow faster, you have more money. It doesn’t take a whole lot.

KRISTOL: You don’t think all these fancy terms like price discovery and all, don’t do much for you?

STELZER: Have you looked at a journal lately?

KRISTOL: No, not my thing.

STELZER: I mean, I look at them.

KRISTOL: Yes, you do. I am always impressed. You occasionally send articles from some obscure journal.

STELZER: Yes, and they are useful because they refine how you think. But I think the real, the real-world problems today are trying to find a middle ground – I think I mentioned this before – between foolish consistency and sheer ad hockery.

Trying to find – you don't want people lurching from one thing to another, which politicians tend to do. You know, they wake up in the morning and Nancy Pelosi thinks we are going to kill a million people tomorrow, or the president thinks Amazon should go to jail. That kind of stuff is very bad.

But it's equally bad to say, well, look, Adam Smith wrote about free trade. Free trade is good. That's a good thing. Don't tell me about tariffs, don't tell me about currency manipulation, don't tell me about retaliation. I don't want to hear that.

I can show you which page in Adam Smith supports free trade and please don't turn it over, because on the next page you are going to find qualifications. That will make you crazy.

KRISTOL: I want to talk about trade, but let's talk about – you cited Adam Smith now, which is not – most economists have a sort of hat tip to someone like Adam Smith or Ricardo. But of course, everything that they have really just read is modern economics and whatever, or the latest journal article. You really do go back and read the earlier economic thinkers very seriously.

STELZER: Well, I read them because – because it is very good. I mean, first of all, it is beautifully written. And that is one test. I mean, I am a great fan of Keynes. Keynes the writer – I'm not so sure about Keynes the economist, but Keynes the writer. And also, he asks himself very hard questions and sometimes gets murky answers.

But I think all of that is, it's grist for the mill. And then you have got to say to yourself okay, that's what he said, that's very helpful, it helps me frame the way I look at the issue, and now what do I do?

And I think, I can't imagine, for example, people who haven't read Marx or who haven't read Keynes or who haven't read Smith and taken it seriously. That doesn't mean you have got to be a Keynesian. But on the other hand, when you are listening to, say, Larry Summers say that we ought to do this and this and this, and you say to yourself, "Well, what did Keynes say about that? Well, Keynes said that, but not quite what Larry's saying Keynes said." It helps you analyze what is going on.

KRISTOL: And think more broadly, I think, because they were all sort of interested in political economy.

STELZER: Well, that was the original name of my racket.

KRISTOL: It was political economy, right?

STELZER: It was political economy. That was the racket, and it was before a) specialization, very narrow specialization. You know, "Don't ask me about GDP. I do labor markets."

And before mathematics, which is, in a way, a substitute for thought. If you can't say it, then you don't know it. And if you make it so abstract that only – I mean, what do you do with mathematics? You exclude as much reality as you can in order to get precision. And precision is – economics is not about precision.

KRISTOL: But I think the discipline has gone in that direction, no? Since you studied it with Fred Kahn?

STELZER: Oh, has it ever. Look, see, I snuck out of graduate school before the wave of mathematics. In fact, the debate in the department in the year I left was, do we buy a calculator or do we hire another secretary? So, that might tell you how old I am, but I escaped it. I don't think I could get a PhD today. I couldn't even come close, given the demands of mathematics. First of all, I wouldn't be interested, and second of all, I wouldn't be competent.

KRISTOL: And does it really tell us much? I really wonder.

STELZER: Look, it tells you something. Take model building, for example. Model building, which is based, it can only be based on historic data. Because there is no future data, or else you wouldn't be building the model, right? So you take data and you try to look at it in a way.

Now, what it lets you do is answer "what-if" questions. In other words, "What if the economy grows at three percent instead of two percent?" What does the model tell you? And then you look at it and say, "Does it make any sense?" But in terms, I mean, we have had experience with model builders predicting, and there's always something you forget.

For example, quants who came to Wall Street, and who were going to predict stock prices and so on, forgot one thing: They were all going to make the same prediction at the same time because they built the same models. Bad things started to happen.

So they're useful, but I think not as useful as the people who swear by them. It's like climate models. I mean, look at the range of answers you get. And that is fine, it tells you – and then you try to make your own judgement. Well, if this and this happens to temperature in the next five years, what does that tell me about what's going to happen after that? It is useful to ask questions, but not to build policy on.

KRISTOL: You always emphasize, and I always like this in your writing, a certain basic humility or modesty in terms of what we can know and how much we're going to get right. And that that almost has to be built into the decision making, no?

STELZER: It does. I haven't been accused of humility before. That's very kind of you.

KRISTOL: You're a not so humble advocate of humility. That's how I think of it, which is the best kind, really. Isn't there [a] Benjamin Franklin [quote], "Be proud of your humility," something like that?

STELZER: I mean, humility can be paralyzing and you have to avoid that.

But what you have to do in the process is say to yourself, "Okay, I am going to be wrong." Now the question is – let's say I am forecasting energy demand. "I'm going to be wrong." The question is then, "Which error is the worst one to make?"

If somebody is asking you, "Should I build an electric generating plant?" And so you do a projection of demand. You say to yourself, "This is going to be wrong." The question is, should I build it too soon or should I wait for a shortage? Well, then you say to yourself, "Which is worse?" And so you say, "Okay, I would rather build it too soon and bear the carrying costs."

So I think what you have to do is say I am going to get it wrong, probably get it wrong. The question is which of the errors I can make is the least costly, and then use that to begin to think about the policy answer you want to get.

And think about it in healthcare, think about it in anything. We are going to get it wrong. When you are trying to guess how many millions of people are going to respond to what kind of policy, we're going to get it wrong. So the question is, which is the least costly error we can make?

KRISTOL: You've written for us on climate change, carbon tax, many times at *The Weekly Standard*, I have gotten responses, on the one hand, people outraged that you are somewhat dismissive of the – not dismissive, but skeptical, I think – of the confidence of many that we know where the climate is going, where the crisis is and so forth.

STELZER: Right.

KRISTOL: But on the other hand, you are a very strong advocate for a carbon tax, which is a favorite of a lot of the environmentalists. People sort of say, "Well how could he be both? I thought he – he seems like a climate skeptic and then he is for this carbon tax." So maybe that's a good example you could walk people through.

STELZER: Well, you're looking at climate change. So they build these models and they tell you all sorts of things are going to happen.

Now the first thing you have got is, you have got to control your temper. Because if you don't agree with them 100 percent, you are a "denier." And I hate that term, because it comes out of the Holocaust. It's a terrible term. And I have told them that and they keep using it. So you say, okay, I don't like these people. But nevertheless, I got to look at what they say.

And it doesn't look to me like what they are saying is plausible – that the world is going to come to an end – especially since that's an invitation for more government. So the people who are doing it have an incentive. You have always got to look at what the incentive is of the person who is making the position. And so his incentive is to expand government, and naturally, he wants regulation.

So then you say to yourself, well, but I could be wrong. Now let me see, if I'm wrong and the globe heats up, that's not a reversible error. That is an error. You can't buy a fan and cool the globe down – you're done. So, maybe I am wrong. They think they're right, they *know* they're right. I think I am right, but I am not sure I am right.

So then the question is, what policy is appropriate that will do the least damage if I am wrong? Well, we should do something as costless as we can to reduce emissions, in case they are being generated by human behavior. Well, what is the most efficient way to do that? Now, there, an economist can be helpful. You can say, well, I have regulation with hordes of people at the EPA who have a stake in continually expanding regulation because then they get to hire more people and get bigger budgets.

Or, what happens if you just take these costs, whatever they may be, and they are very hard to measure – they have costs on health, they have costs on congestion and all sorts – and you measure as best you can. You're probably off by orders of magnitude, but you get a number that's not zero. And you say, well, now I have a number that's not zero – why don't we start slow, and make sure that we have a flexible program. And so you say, a carbon tax is the most efficient way to do this, it will restrain demand a little bit, it will compensate society for the costs, and we can raise it. So let's start at \$20 dollars a ton and see what happens.

And then you say, well, wait a minute, who's going to pay this tax? Who's it going to fall on? Now you notice that liberals can be had more easily on gasoline taxes, because they live in cities and they don't drive. And they have big limousines.

KRISTOL: And they don't think you should drive, either.

STELZER: And they come out West where my plumber has to drive 40 miles to work in a pickup truck, and they don't – and he's going to end up paying the tax.

So then you got to say, well, what is the equitable way to distribute this burden? Well, let's see, you don't want poor people to pay more than rich people, so we will make an adjustment. Anyone under X thousand dollars a year will get a rebate on the tax. And so then the policy fight starts, but at least you are starting from a basis where whatever you do, it's going to be a better thing than doing nothing.

Now, Ronald Reagan said, "Don't just do something, stand there." And sometimes that's a very good policy. And in the case of global warming, if you can't be sure you're right, and I am not sure I am right, although I am very skeptical – and I'm trying to discount the nastiness of the other side and the certainty of the other side. You see John Kerry, he really knows. What does he really know? He doesn't know anything. Somebody told him. They don't even quote their own stuff right. And then when you see added to that, they try to repress the other side and keep them out of the learned journals, you've got to be suspicious.

But, you can't be sure you're right, so you do what I said.

KRISTOL: And it is also a question, I suppose, just to take another minute on climate change, which is an interesting topic. There are ways, you can imagine the globe getting warmer, it has. And adjusting to it in ways that don't involve stopping it from getting it warmer so much as just adjusting to warmer.

STELZER: First of all, there's winners and losers from warmer. There's this town in Britain, Blackpool, which has probably the most horrible weather in the world. They're now talking about becoming the Riviera, okay? Now, they ain't going to make it, but it gives you some idea. If you are a farmer in Canada, warming is not such a bad idea.

So first, there's winners and losers. And the fact that somebody is trying to stop that process from winners and losers, that's true of every economic decision. So you say to yourself, okay, there's winners and losers. Now let's see what the magnitudes are.

But then second, you say, well, wait a minute, would it be cheaper to build a dike? Would it be cheaper? Now you are in Miami, where we have friends, and the town is built on very porous stone. So when the floods come, comes right up the sidewalks. It's not like Manhattan, which is the hardest stone in the world. That's why we have skyscrapers.

And so you say, well, that's really tough. But yet in some towns they have decided they are going to raise the sidewalks. Why did they decide that? Because property values were being threatened by this threat. Well, that's good, that's what markets say, that's going to threaten property values, makes you willing to invest to preserve your property values and that is a perfectly normal, capitalist, free-market reaction.

So you've always got to say, is it cheaper to ameliorate the cost of this. Now, you got to be careful when you say that because that leads you to: Is it cheaper to let this person die than to treat him? And there, you don't want to necessarily go that route. So that is why policymaking is so much fun.

KRISTOL: This has given wonderful examples. Now you said in passing, but I wanted to draw you out on this, the choice would be thousands of EPA regulators or a simple carbon tax. How much does the study of economics bias – I don't mean that in the sense, the bad sense – but instruct one to be in favor of price-type solutions, if that is the way to say it, as opposed to regulatory solutions.

STELZER: Yes, it clearly – if you are smart, it clearly makes you start there. You start saying, "I'm in favor of market based solutions." First of all, there is a freedom element to that. People are free to respond. And it worked very well, for instance, with the Clean Air Act, where we internalized the externalities and people responded.

But, on the other hand, for example, if you take a situation – let's take the automobile industry. An innovation-averse industry until it got foreign competition. There was no force on earth that you could get them, short of regulation, to do certain things.

So, in the end, you say, well, it's true if we raise the price of gasoline, they should make more efficient engines, but they don't, so let's have a dollop of regulation here. So you can't not regulate. There are some things that you've got to take account of and there are some things where – well, take Florida, again. You were at a meeting with me in Florida.

KRISTOL: Right.

STELZER: And everybody was all worked up about how a carbon tax was going to make everything wonderful and stop the Everglades, I think they call that, mushy stuff, there, with the alligators or the crocodiles or whatever it is.

KRISTOL: Irreplaceable wetlands.

STELZER: Exactly. Oh God, why anybody would go there. But in any event, everybody was all excited because some of the congressional people were all for carbon taxes. Yeah, but the wetlands are different. I mean, we want to regulate and prevent this from happening. They may be right. I mean, there may be no way you can get enough of a response to price to avoid a lot of social harm. So in that case, you regulate.

And the interesting thing – I have been around regulators all my life. They are basically honest, honorable people, with the exception of some people at the EPA who are not. And they try to do a job, and their job, as they see it, is to emulate what a free market would produce and then add equity. Which is, it is not a bad goal, and it's an honorable profession. I don't want to leave here letting anyone think that regulators are bad guys. There *are* bad guys, but basically regulators – there's a wonderful book by McCaw at Harvard reviewing five regulators, including Fred Kahn and so on, and their contributions to society. And what Fred tried to do was set prices that would have been the same as what a market would do. At the same time, he understood the limits. I remember, I called him up one day and I said, "What are you doing?" He said, "You are not going to believe what I am doing." I said, "What are you doing?" He said, "I am defining a sandwich."

KRISTOL: He was in government at this point?

STELZER: He was in government; he was running the Civil Aeronautics Board. And they knew that one of the problems –

KRISTOL: Which regulated airplanes.

STELZER: Which regulated all of the airplanes, regulated fares, regulated where they could fly, etc. And one of the problems they had was, because they had to pass on costs, the airlines were insensitive to costs.

So somebody beforehand had put a rule that in economy class, you can only serve sandwiches, to prevent costs from going up. Turns out, they were putting great big steaks between two pieces of bread and calling it a sandwich. And that is when Fred said, "We've got to turn out the lights and get out of here – I can't do this."

KRISTOL: He did do that.

STELZER: He did, he closed – that was it.

KRISTOL: A huge deregulatory success, right?

STELZER: And it is interesting. He had great support from Ted Kennedy for that – some people say because he flew from Los Angeles to San Francisco for \$25 dollars in a startup that was having the hostesses in hot pants. But that's not verifiable.

KRISTOL: That's a non-economic incentive, or something. I leave that to you.

STELZER: Let's not go that far. But again, it's particular to the circumstance *without* becoming a complete ad hoc solution. You start with a prejudice in favor of markets. You move from that to deciding whether any sort of price solution will help.

In housing, we got all the incentives wrong and got the crisis in 2008. Almost every economist saw what was going to happen, although they didn't say it. I mean, because they were looking at models of it rather than looking at the micro incentives being built up in the housing industry. *That* an economist can do. And then you proceed to – well, if I can't get that done, and this is the way it is going, and this is necessary to preserve free-market capitalism, then you begin to make exceptions.

Just like we have now, this problem with inequality. Technically you can say, well, it will work out. I mean, basically the unskilled will learn skills, and as I think I said to you, economists can tell you where you want to be, but they can't tell you how to get there from here. And we can't figure out how to get to the level of equality we want to do. So it is hard. It is hard.

KRISTOL: That is a good lesson for people in policymaking. I want to come back to both the '08 crisis and especially the inequality issue today, technology destroying jobs and so forth. But you said very quickly, in passing almost, the auto industry was resistant to competition from outside. I guess the normal, if I can put it that way, orthodox or free market economy would say, what do you mean, they're competing with each other, these companies, if what you say is right.

STELZER: All three of them?

KRISTOL: Yeah. Well, generally – maybe this is your real world experience has made you more of a doubter about competition in the real world than a lot of economists I read, who just assume, well, several companies, so competition. This is the price that is being driven by competition. I don't think you –

STELZER: That can often be wrong. First of all, there were only three of them. And you don't have to have a meeting to decide what you are going to do. I mean, so that is why –

KRISTOL: You mean you can just look at each other's prices?

STELZER: Yes. And also, there is – you are all members of the same club in Dearborn – I think that is a place in Michigan – and so on.

But take our friends, the real red-hot competition people in Silicon Valley, right? This is the –

KRISTOL: Yeah, let's talk about that.

STELZER: – the liberal people who want more visas so they can bring in people. Steve Jobs said, "If you take any of my employees by paying them more, I am going to ruin you." So they all agreed – and I am not saying, *this was found in court*. They had to settle this. They fixed wages by agreeing not to compete for each other's staff, and they had to pay a huge fine. Any other cartel like that, the guys would have gone to jail.

And Jobs – at one point, the interesting thing was, the then-president of Google sent an email around saying, “Let’s not leave a paper trail.” It tells you about his high-tech capabilities – let’s not leave a paper trail. No, leave an email trail.

And that’s the ethos of that industry. They feel, somehow, that it is perfectly appropriate, this is my person and you have no right to take him. And in fact, one human resources guy at Google got fired for hiring away one of Steve Jobs’ people. And this is all in a court record, so not telling anything, tales out of school.

So again, you have to look at the *practices* in an industry. That is rather important. There are people now who worry about Amazon, for example. I worry less about Amazon because they have such a small part of the retail business, but I could see the worry. I could see the book business, you can see businesses where they have had a major effect. And then you say, well, is the efficiency gain worth the effect? And if it gets to be a real monopoly, at that point, you have to regulate.

I mean, it is very rare that just free and open competition produces a monopoly. We thought that was true in the airline industry and the electric utility industry and lots of industries where it proved not to be true when we deregulated and we allowed competition.

KRISTOL: The “it” that wasn’t true is that it was a, quote, “natural monopoly?”

STELZER: Yes, they called it “natural monopolies.” Now again, I remember when I was at AEI, generation of electricity proved not to be a natural monopoly. People built generating plants; they competed to get to market.

Transmission is a whole other story. And one of my economists friends there said, “But sooner or later, somebody will develop alternatives to transmission,” which, undoubtedly true. But then you ask yourself, well, is it sooner or later? If it’s going to be in a couple of years, well, then maybe you just let it rip. If it is going to take 20 years because of the huge capital investment and the permitting problem and all of the institutional barriers to entry, well, then maybe we want to regulate it.

II: The Financial Crisis of 2007-2008 (32:30 – 40:04)

KRISTOL: You mentioned the 2007/2008 financial crisis, which certainly was the most dramatic I’ve been through. It did shake ones’ – my faith – in economists, and I think the public’s faith, actually. I think we’ve seen the consequences of that in Europe and in the U.S. over the last decade.

STELZER: Sure.

KRISTOL: Was it predictable, did people predict it? What does one learn looking back?

STELZER: What one learns, looking back is, number one, a macroeconomic model can’t predict turning points. Very good at trends, but turning points are very difficult.

KRISTOL: So just explain that at little. It was obvious at some point it was going to –

STELZER: At some point it was going to go down. And you didn’t know when or how fast. And it is very hard to build a model that is based on the going up to figure when it is going to go down. But if you looked at it in a micro way, look at the incentives that were at work there.

Number one, thanks to conservatives, we built into the tax code an incentive to own a house, right? You can deduct your mortgage. The theory was absolutely perfect. It would make for a more stable society, people with homes, you know – what is it Larry Summers said, “Nobody washes a rental car.”

They sort of forget about that – it froze the labor force, especially in a downturn where the people couldn't sell their houses, but never mind, it is a good thing.

KRISTOL: Good things turn out to have bad consequences.

STELZER: Right. The liberals then went one better: well, if housing ownership is really good and you give people deductions for mortgage, what about people who really can't afford it? Let's find some way to get them houses. So you get this panoply of assistance to people who have very little chance of paying back their mortgage.

Then along comes the guy who's going to lend the mortgage, right? Now, he would ordinarily have an incentive to get paid back. But he ain't hanging around to wait to get paid back. He's going to bundle it into a bunch of securities and sell them to somebody else.

What's his theory? Well, if I take all of these bad debts and I roll them in a security, that will spread the risk. And therefore that's a triple-A rated security, says the rating agency. Forgetting that what is going to affect one guy who can't pay his mortgage back is going to affect another guy who can't pay his mortgage back. And then, the guy who wrote the mortgage, he doesn't care; he's gone.

KRISTOL: What about the buyer? Why isn't this buyer saying, what am I buying here?

STELZER: Because he's told that he will get bailed out; he has the impression that no one is going to foreclose on his house. He has got a protected position from the government that sounds really –

KRISTOL: And I guess the ratings agencies, they were very important to that, right?

STELZER: Yes, the ratings agencies.

KRISTOL: The false reassurance.

STELZER: Yes, they said to investors, "This is a triple-A rated security." Now, remember, look at the incentives. The rating agency didn't get paid unless the deal went. So the security that they rated triple-A was the thing that generated their own fee. If they said, "Oh, this is a lousy deal; don't sell the security," they didn't get anything.

So we now have a situation where there was no regulation making the original writer keep skin in the game, which would have at least moderated his willingness. And then, we add to that the notion that we pay the bankers who sell this stuff bonuses based on short-term performance, and we don't claw back any of those bonuses that are based on earnings that really weren't there. Now, we have moved ahead a little on that. At Wells Fargo, they're clawing back *some* of the tens of millions of dollars of the fraudulent sales.

So we had – everybody had an incentive to do the wrong thing. And look what happened. But if you went to your model and said, is the housing market going to crash? Well, you put in all these old data and it didn't tell you that.

KRISTOL: That is so interesting. And I guess, what is the phrase, "The crisis happened more slowly than you expect, but then more suddenly," or something like that. That does seem to be true in life, you know; you get these inflection points–

STELZER: Yes. And look, again, if you think about, so what do you do about it? Okay, well, all of these incentives are wrong, so can the markets fix, can market action fix the incentive? Well, no. What you really should do is, first of all, the rating agencies shouldn't get paid on that basis. Second of all, you

should have had the guy who writes the mortgage should have to keep some skin in the game. And a whole bunch of –

KRISTOL: But some people were saying some of these things as public policy matters, right? In '05, '06, '07, but no one was interested.

STELZER: Yes, but look, people were making a lot of money at this. And the consequences, a lot of the consequences, were externalities. If you had a foreclosure on your block, your house was worth less, even if you were paying your own mortgage. So, it was a bad set of incentives.

How do you fix it? Well, then we go to the macro economists, right? And we go to the Fed. The Fed sees the world is coming apart. You are the Secretary of Treasury. Somebody says, "Well, you better bail out Goldman Sachs. You better let them become a bank, because if they go under, we are going to have a problem."

Well, you don't like to do it, but you say fine. And then Lehman Brothers comes along and says, "Well, what about us?" That's enough. We don't want to create moral hazard. Okay, now moral hazard means we give you an incentive to bad behavior.

Too bad for you. We know you are small – oh, but it seems you are also interconnected somehow that we don't understand in the banking system. And we *still don't* understand in the banking system. We understand size; we do not understand the inter-relationships in the banking system. Who, when drowning, reaches out and pulls somebody else down with them.

KRISTOL: Are there ways that you could regulate the banking system to try to limit the ability of one entity to drag down another?

STELZER: Yes, there are ways, and we've done some of them. But yes, there are ways. Most of them are imperfect, but there are ways.

One way, which we have used a lot, is to have the banks have lots of capital so that they can't be dragged down because they have plenty of capital to throw at the problem. And we have got a much better capitalized banking system with capital determined by the risk at which your portfolio is from the inter-relationships. So that's good. I mean, that is better than we had before.

You could limit the size of a bank. I mean, there is a point beyond which humans can't manage something. And you could say, well, "You're a smart guy, manage this much and then you can't grow anymore." That's a way to do it. Or you could say, "Well, if you want insured deposits, that's your business, period. Don't take on a whole bunch of risks that will make the insurance company pay if you go down the tubes."

So there is a lot of – but that's regulation. You can't rely on markets to do that.

III: The Problem of Inequality (40:04 – 59:22)

KRISTOL: That's a big topic today, obviously, both income inequality, questions about upward mobility. Those seem to be perhaps more damaging to the system than the sense that the incentives aren't quite right or maybe even the after-effects of '07, '08 at this point. So how worried are you about that?

STELZER: I am a lot worried about it.

KRISTOL: Is that right? More than most conservatives, I would say?

STELZER: Yeah, more than most conservatives. And I'm worried about it for a lot of reasons.

First of all, we have a system where it is, it seems that performance and pay have become disassociated at the very high levels. And I think that's bad for the system. We also have a system where inequality is now worrisome, and it's worrisome for a lot of reasons. One is, there is a feeling that compensation and performance have become disconnected. You know, I mean, Warren Buffet is very good at the avuncular game, so nobody begrudges him – and also he has done very well, for a lot of people.

But there's something going on out there that is sort of troublesome. And I don't think it is mere envy. I think that the system is throwing off casualties of change, where people who were not responsible for the change and have no way of adjusting to the change –

You know, you're selling t-shirts in North Carolina, and suddenly, somebody in China can do it for \$1 dollar an hour. You paid your taxes, you scrub your children, you send them to school, you went to church – and suddenly, your living is gone. And meanwhile, I am getting a cheap t-shirt. There's something wrong about that.

Now, I am not a moralist. I mean, if I were, I would have lived a different life. But there is something upsetting about that in terms of the preservation of the capitalist system.

What do you do about it? Well, there are income transfers that you do; we do some of that. But we haven't solved this problem.

And when industries are localized, so you have coal where the coal is. I mean, you don't have coal in downtown Aspen. So where it's localized, and it hits a whole community so that you can't say, well, why don't you go to work, why don't you take a job for less money in the department store? But the department store has gone bust because you don't have any money. We haven't solved that problem. And it doesn't get solved by mere transfer payments. Because the transfer payments then become multi-generational.

And yes, the economy is doing great, in a way. I mean, we have low unemployment, as we measure it. It's really not that low, but it is low as we measure it. The economy is growing – is it growing two percent or 1.7? I always am amused. I think decimal points were invented to show economists have a sense of humor. It's growing modestly – not a lot, could grow more, might grow less.

But we haven't solved the distributional problems. And the distributional problems become multi-generational. So that it isn't the case – “well, you know, sooner or later the guy will learn how to become an airplane pilot and give up his horse and buggy.” It doesn't work that way anymore, if it ever did. And I worry about that. I don't think we have solved that problem.

KRISTOL: And how easy is it to solve? Maybe we have pretty unusual, I guess, a combination of globalization – especially China, it seems to me, which is just a massive shock to the system – but good things come out of it, including what has happened in China itself, which is not a trivial accomplishment of capitalism, you bring hundreds of millions of people up to a decent standard of living. But you combine the China shock with the technology shock, and maybe it's just something that no one knows much how to deal with.

STELZER: Yes, and we have had shocks before and the economy seems supple enough to adjust to them. So we've got a system of temporary, transitional transfer payments that are supposed to cover a permanent system.

Remember, 26 weeks of unemployment insurance, right? You're between jobs, whether you are going to find a job in 26 weeks – well, if it is not 26, we will make it 50; we'll make it 99. But basically, these are transitional circumstances. They *aren't* anymore. Some of these are permanent. And the question is,

what do we do? I am not talking about a permanent underclass in the Marxian sense, but what do we do about that?

It seems to me that if at the same time as you are doing nothing about it, and the upper-income earnings are less related to some economic activity that people can understand – not running a hedge fund, or pretending that something is a capital gain that is ordinary income – you get pressures on the system.

And look, this is the greatest economic system every invented. Not because of the goods and services it produces, but because of the freedom that it has produced that is associated with it. And that is not new to me: I mean, everybody, anybody who read Milton Friedman and so on knows that.

So the question that I worry about now is, what do we do about that? What do we do about, essentially, what looks to me like a permanent underclass? You are 50 years old, we have managed to fix it so you are going to live a long time, which, at some point, you may wish you weren't, and your coal mine closed. You're going to send [them] to computer school? It doesn't make sense. Are you going to arrange a permanent lifetime stipend? That doesn't make sense, either.

I don't know the answer to that, but I know we are not asking that question at all, because the political system, which runs on getting elected every other year, doesn't seem capable of coping with this kind of problem, which may require rather long-run solutions. Well, you're a political scientist, I am not.

KRISTOL: Well, it's the same thing with incentives. I mean, the system, the Founders did try to set up a system in which some people would take a longer view. The Senate has six year terms and so forth. The president, Hamilton explicitly says in *The Federalist Papers*, is eligible for reelection – and they didn't anticipate even a two-term limit – because you want to give the president an incentive, Hamilton says, to launch long-range projects.

STELZER: Right.

KRISTOL: Which, you know, with Reagan, he had the toughness to go through the Volcker contraction in '82 because he knew he wasn't up 'til '84, and then if he could make it there, he probably would have another four years after that. But yeah, it's an interesting political science question of incentives, too, as well as economics question.

But it seems to me on that 50-year-old man, I mean, I think it's very different if he thinks, look, I might have gotten a bum fate here. It's not new. There are plenty of people in 1932 who were working hard and suddenly found themselves in the Dust Bowl or something in Oklahoma. Never really probably got up to the standard of living they had in 1928; they went to California or something. But they did believe their kids would have a good chance. And I think that is what is a little scary. I mean, Bill Gallston always cites this poll, I'll get it slightly wrong here, but sometime around 2012, 2013 when, for the first time, a majority, or at least a plurality of Americans, said they were not confident their kids would have a better chance than they.

STELZER: Right.

KRISTOL: And that *is* worrisome. So what do you say to the 25 year old who didn't get a four year degree, thought he might follow his dad to the coal mines or maybe be a truck driver. He saw, looked around, saw people were doing pretty well at that – but whoops, here we have self-driving cars and trucks. And that, I think, that's really worrisome, I think. It is one thing to have one generation have a rough time because it is an unusual moment in world history with China and technology –

STELZER: But also, it seems to be the case that if a generation is having a tough time, it's more likely that the next generation in that same family will have a tough time. So, you know, I don't want to talk about permanent underclasses and all of that, that's silly, but that's the worrisome stuff.

The inequality that seems beyond anyone's control. I mean, this is what, the deserving poor and the undeserving poor. But that worries me.

What worries me most about it is that conservatives seem unconcerned by it. Democrats have all sorts of very simple income transfers: We'll tax one guy and we'll give it to the other guy. Forget about what incentive that creates for the other guy.

KRISTOL: It does good for him in the sense that he has more money.

STELZER: Yeah, but it doesn't do what we want done. And conservatives just, I don't know what they think. But they're certainly not addressing that problem.

And you see it now in this incredible debate about healthcare. I mean, for the conservatives to sit and, in one fell swoop, –

KRISTOL: We're speaking in late June, as the Republican alternative to Obamacare is faltering on the healthcare side. Go ahead.

STELZER: And also, we are not, don't seem concerned that at the same time, we're reducing taxes on people who have benefited from being – I don't want to say that they didn't earn some of it, but there is no question that the macro economy has favored people who had assets.

KRISTOL: Capitalists have done better than the laborers.

STELZER: Right, right, and because of public policy, which was to inflate the value of assets.

I worry about the long-run acceptability of free-market capitalism, partly because it has been the most productive system the world has ever seen, partly because it has the greatest component of freedom that the world has ever seen. And partly because no one seems to, in power, seems to be addressing it. I mean, certainly the current administration is not overly, doesn't seem overly concerned about these problems.

KRISTOL: And the Republican leadership on the Hill neither, which you think, in the current administration, has its own kind of unique problems.

But not for me, I was actually alarmed. I will say, I was skeptical of this from the beginning, but I wish I would have been more, in a way, outspoken and negative on it.

I mean, the replacement – and people aren't really focused on this – Republicans campaigned on repeal and replacing Obamacare. We must have published 50 pieces in favor of superior, conservative tax credits based on repealing and replacing Obamacare, which I think stand up fine.

It never really occurred to me, I guess, that part of repealing and replacing Obamacare was replacing, repealing all of the Obamacare taxes that paid for Obamacare, that were in the same piece of legislation. So as a kind of literal matter – if you repealed that bill, you repeal the three percent surcharge on capital gains for people over \$250,000, or whatever that was, and there were a few other things.

But then you do end up with this kind of nutty, frankly, proposal in 2017, that, okay, we are repealing the healthcare parts of Obamacare – replacing it, maybe, maybe not, whatever, with a different system, okay. And we are repealing all of these taxes, which Obama, perfectly intelligently from his point of view, made sure were taxes on, pretty much entirely, on the wealthy.

STELZER: Right.

KRISTOL: But the wealthy have done well since Obamacare passed in 2010.

STELZER: And not entirely by their own effort.

KRISTOL: Right. And so you are really getting a tax break. I mean, conservatives hate it when you say it this way, but it is empirically a correct statement. You are giving a tax break to the people who have done best over the last six years. Which is a little nuts, I mean.

STELZER: I don't know how you sell that. I don't know how you sell it.

KRISTOL: Meanwhile, this thing is crashing on the Hill.

STELZER: Also, there is a magnitude question. We are not talking about giving a tax break to people who made \$50,000 dollars a year or \$100,000. We are talking about people who have made a lot of money, a lot of it as capital gains. I hate this phrase, "unearned income," but not due entirely to their own effort, but due to the Fed, which inflated the value of assets.

So when I look at these rather stupid children who follow the new pied piper, aging pied piper, you can sort of understand it. They see that what has come out of this is they owe a lot of money. People who caused the, as they see it, caused the bust, come out of it richer than ever. And there is something wrong with that. I personally don't think there is something wrong with that *except* the magnitudes. If at the same time as you want to cut healthcare for poor people, you want to cut taxes on rich people, you got to be –

KRISTOL: Unless you can make a very strong, macro case that this is net-net going to be wonderful for healthcare or for –

STELZER: And almost immediately. That's another thing. I mean, Keynes' famous statement about, "in the long run, we're all dead," is certainly true. And there's, again, a question not only of magnitude, there's a question of timing.

Again, you have to worry that the political class seems incapable of responding to this. You sort of wonder. I think one reason that Trump got to where Trump got is because people didn't want what was going on. I mean, some people fell in love with Trump, but some people said there is just something inequitable about the system, and so let's rattle the cage. Let's rattle the cage. And then we got a cage rattler, who probably would be better inside of it than outside of it. It bothers me a lot that we haven't figured it out.

I remember that – and also, at the same time, that conservatives want to make an assault on the entitlement state. Now, if I could ever think of a bad time to make an assault on an entitlement state, it is now. What I wonder, if conservatives who are thoughtful wouldn't do now, what sort of the deal your father said, you know? "We got the New Deal; for better or worse, it is there. We are not going to change it, so let's go on from there and figure it out." Now, you wouldn't go so far as The Great Society, but we got it.

I can't see how we can reverse a lot of the perversions that have been built into the system. We bailed out the banks. Go tell some poor son-of-a-gun who can't pay his mortgage that "We're sorry, we can't bail you out." I think we are going to have to live with what we did so far to get out of the 2008 problem and begin to build, to accept some sort of safety net. But I am damned if I see any hope in the political system the way it is.

KRISTOL: I mean, what's interesting to me about what you just said, is it's probably one of the more sympathetic accounts of Sanders' supporters that we have had on these conversations, but I think may

be accurate. But also, I think very importantly, recognizes that Bernie Sanders, in a way, was as big a deal as Donald Trump, in 2016.

STELZER: Yes.

KRISTOL: They got the same number of votes in their respective primaries: Sanders was running against one candidate, so he lost, in effect 55-45 [percent]; Trump was running against 16 candidates, so he got 45 percent of the vote and won.

But I think people, especially – people everywhere – Trump won, so it's a much huger phenomenon, obviously – but the significance of that Sanders vote, most people don't appreciate as I think you do. "Well, they were young people; they didn't like Hillary; they were voting some aspirational vote because he's an interesting, authentic guy." But I think what you said is very important.

STELZER: And I think the same thing happened in Britain. Where – I mean, really, a nutcase compared to Sanders.

KRISTOL: Corbyn. Jeremy Corbyn.

STELZER: Jeremy Corbyn got a huge – now he didn't get elected, but he certainly got a very big –

KRISTOL: Much closer than people expected.

STELZER: – than people expected. Partly because, let's call it "the ruling class," couldn't figure out how to adjust.

And I think – there's something happening out there to American capitalism as we know it. It used to be, "Well, that's appropriate. They are 20 years old; they are going to go out, they will go to work and then they will understand that you work hard and you make money." It doesn't look like that anymore to them. and we got a demagogue as president.

Now, he has done some things that I think are useful to have done, and the people working for him are trying to do some things that are useful for them to do.

But you know, I guess everybody feels that when they're living is the dangerous time. And I don't really think it is all that dangerous, but I think the system now is more at risk. Now, you could say when the New Deal came along, it destroyed the system it replaced, or you can say it fixed it or it made it acceptable.

I don't think we see a ruling class or a set of ideas that can repair what we now – I mean, look what's going to be on offer. We are going to have Hillary running, we are going to have Biden running, we are going to have Trump running. I mean, these are a pretty grim prospect for a democratic society.

KRISTOL: What happened to that generational turnover we are supposed to have?

STELZER: Yes, right.

IV: In Defense of Democratic Capitalism (59:22 – 1:19:28)

KRISTOL: How much do you think the young people worry about the sense that maybe there will just never be the kind of jobs available that there were once. You know, the very top tier in education and connections, and just luck and entrepreneurial skill will do fine. And maybe some – there will always be a need for people to work in hotels and hospitals and stuff like that. But that kind of middle tier, people do

have, I think, maybe worry that automation, especially, and technology *really could* replace a lot of these jobs in a way that is different from the earlier technological changes. Where are you on that?

Are you like, oh come on, every twenty years everyone thinks that technology is going to destroy jobs in ways that have never been seen before, and that guess what? People who were working – driving the horse carriages end up, they can –

STELZER: I worry about it. I am not overwhelmingly worried about it. The fact is, if you talk to a lot of these – now you go on campuses and you talk a lot. Unfortunately, you talk to people who are interested in politics, not getting work, so –

There are opportunities out there. It is not the kids on the college campuses [we need to worry about]. It is the unskilled people. And there, the question is, do you go for a guaranteed annual income? But that's uncomfortable.

First of all, it makes them supplicants for their entire lives; and second of all –

KRISTOL: It is just means their giant safety net? It's better than not having a safety net, but it's not a life–

STELZER: Right. So the question is, what combination of incentives do you create that would make them respond to something that's productive.

I am less – now, you live in a welfare state, in Washington. I spend time outside of Aspen, which is kind of a socialist republic. Where we are now – a socialist republic. But you go West – Minneapolis, I am thinking of where I have gone; I don't go to Chicago, Minneapolis, Phoenix, those – places where I have a house – I don't like to concede that I live there yet.

KRISTOL: You live in New York, spiritually.

STELZER: Spiritually I'm in New York, right. And there you don't see what you see in the East Coast. I see more people, young people, who understand the nexus between effort and result than I see in Washington. In New York, the people who understand that nexus are really way up there, and for them, it's beyond describing, the level of the nexus.

But what I see in Arizona, in New Mexico, in places I go, the young people are encouraging. They understand the nexus. And I'm not talking about the guys who put on the masks and try to bust up a meeting at Berkeley, which probably may have needed busting up; I'm not sure. But certainly, the University of Arizona and places I go around the Midwest where I try to see what is happening – I like to go to shopping malls, I like to talk to shopkeepers, I like to meet with kids there. They want to learn; they want to go make money.

And I think that's encouraging. Will it be difficult, more difficult than when I went to go make money? I am not so sure. Are their aspirations greater? That is, their expectations are higher and they may be doomed to some disappointments. But it's very – the most encouraging thing I do is getting out of Washington after a visit. And where people are talking about, you know, getting a job or – I said to one guy, "Would you mind moving this here," some guy we were paying to move some stuff. "Oh yeah, I do that for my grandma." Well, I'm not sure I like the analogy. But there are young people who seem to me more to understand the relationship between effort and result than in Washington where it's – first of all, it's much harder to determine, to discern. I mean, a guy gets elected senator. Why did he get elected to the Senate? Because he is smart or did he get elected senator because of who knows what?

Whereas the guy buys a new car in Phoenix, you know he didn't steal the money or he'd be in jail, if the sheriff didn't shoot him. He knows there is some relationship between his effort. So that is sort of encouraging. And maybe that is the way we ought to go – try to reconnect.

Because the problem is, at the highest levels, we have *disconnected* the relationship between effort and result in a lot of ways that, including inheritance, you know, my favorite – big inheritances.

KRISTOL: Another conservative heterodoxy that you are – Not in favor of a 0 percent “death tax,” right? As they call it. “Death tax.”

STELZER: “Death tax,” as if the guy who is dead can pay.

KRISTOL: But you know, just on that point, I think that’s very interesting. Because one also doesn’t want to romanticize the past and the effort, relationship between effort and hard work in the past. There was also hard work and results in the past. There were also a heck of a lot of people getting jobs through connections in unions, and there was a system that compared, you could argue, to the current opening up of the economy, often for people not at the very top, but the kind of Uberization, I guess you would say.

STELZER: Yes.

KRISTOL: Getting rid of ridiculous professional qualifications for barbers or beauticians, that really were just restraints on –

STELZER: On entry.

KRISTOL: —on entry. You can imagine a sort of healthy entrepreneurial, somewhat entrepreneurial, but also – we’re not talking launching Apple or Microsoft, but sort of self-reliant kind of attitude on the part of an awful lot of citizens. Almost more [than] in the past when you had to be nice to the union boss to try to get yourself in the door, right?

STELZER: Right. Look, it’s entirely possible. I see more entrepreneurial activity when I get out of Washington, and even out of New York. I mean, the entrepreneurial activity in New York is a whole other story. But the guy who does my IT work is an independent. The guy who does all sorts of maintenance, they’re all independent. They all have the same problem: they can’t find people, they have trouble competing with corporations who offer healthcare. That’s the biggest –

KRISTOL: But that’s fixable problem by public policy.

STELZER: That is a fixable problem.

KRISTOL: Maybe they should fix that instead of what they are doing –

STELZER: Well, it certainly would increase labor mobility, for one thing.

But I just get encouraged when I get out of there. And then if I get to San Francisco, I get discouraged again because the street life there is horrendous. But in the Midwest and fly-over country, as the liberals like to call it, in “fly-over country,” you do see whole families. And to me, who went to Arizona fearful of evangelical anti-Semitism, which I was taught in my household was really deadly and I ought to be careful, I find out that it is a very productive force. And the kids go to school, they are scrubbed –

KRISTOL: Not the anti-Semitism, but the religious –

STELZER: No, not the anti-Semitism. It is more, it gets my energy more.

KRISTOL: You haven’t found much.

STELZER: No, it is amazing – I haven't. And now I'm spending half my life in a town with more churches per capita than I have ever seen in my entire life. And it has a cohesive effect on families, and they expect kids to scrub and go to school, and they expect them to work in the summer. You know, there is a lot of good stuff going on. And the question is, maybe we should not try to develop public policy to replicate it because we screw it up, but just to let it happen. But I don't believe that. I mean, I really think –

KRISTOL: You need policies.

STELZER: You need policy to make it happen. You need tax policy; you need education policy. And that part of it is encouraging.

I get discouraged when I go to towns that are having real problems because policy is so lousy – Baltimore, Chicago, those places. I mean, they are horrors by comparison. On the other hand, the rich parts of those are wonderful. So I don't know, maybe – well, guys like you keep thinking about it. I'm sure you will come up with something.

KRISTOL: It does seem to me, a decent education policy, decent policies that help mobility but also help independents, in a way, and self-reliance. It shouldn't be that hard. But I do think there is something strange now about – and I find this myself, I don't think I am doing as much creative thinking as I should be doing because there is something that in Washington, the contours of the debate are almost – they're so confining and so at odds with the *actual* problems.

You need to step back and say what are we, what do we want to achieve here in terms of society and the country? Not so much what governmental issue is now before us because of some deadline or something, budget process. I mean, we're making healthcare policy – which is kind of a big deal, 19 percent of the GDP, kind of important to people – because of the *budget process*. Well what is the budget process? It is just something that some people came up with 40 years ago that can be changed; it should be changed. And it has become inefficient and incompetent, anyway, right?

STELZER: Well, it's like this ten-year – we're going to look at the results of any tax policy over ten years. Where did ten years come from? And I mean, any business leader who says, "Well, you know, I need stability, I have to look at" – he is looking at his quarterly earnings and he's saying to you, "You've got to extend the ten years to 20." He knows where he's going to be in 20 years, and it ain't going to be where he is sitting now.

So we have built – I mean, one reason we can't get things done is because of the constraints we have imposed on – well, if we do this, you need 52 votes, if you do this, you need 60 votes. This is crazy. And I don't know what you do about it because this is the meat on which those Caesars feed.

KRISTOL: But it's easier to fix public-policy mistakes than fix the people. If the public is generally okay and the policies are wrong, that's more optimistic than the opposite. So I think –

STELZER: Well, we haven't had any rioting in the streets by anybody, beyond 18 years of age, who is wearing a mask. At least they know it's not nice, or they wear a mask.

And we haven't had any direct assaults on the system. Even Trump, who is sort of outside the system as we normally understand it, is outside of it in a way that is not really threatening to the system.

KRISTOL: And the system and the institutions seem to be constraining him mostly, in a pretty good way.

STELZER: Right, the courts are constraining.

KRISTOL: Well, we have had six, seven years of decent economic performance. And I guess what worries me is, what if we get a recession in a year or two? The 45 percent Sanders and 45 percent Trump voters are a bit of an alarm bell perhaps, a fire bell in the night. What if you got a recession, what if you got a difficult war, a Vietnam-type of situation? People could really go – Then, I think the support, the thing that you have been most focused on, the worries about the support for the system, credibility, belief in the system, and the failure to address the problems in the system, that could get dire, in a way.

STELZER: But break that into two parts, right? One is foreign policy, and one is domestic policy. Foreign policy, I don't get it. I mean, it's not my field. I don't understand why 5,000 more guys are going to be able to accomplish in Afghanistan what the whole Russian army, which had no worry about wiping out civilians, couldn't accomplish. And you know, I always said, "Oh, civilians shouldn't meddle in military tactics." I'm now not so sure.

But on domestic policy, at least we know the directions we should push it. What we don't know is how to make it happen. Now, we're going to have an election. Half of me used to root for divided government so that nothing would happen. I think we are beyond the stage where nothing works. I think we have to do something. And I think the something we have to do, among other things, is *seem to be doing something* rather than just saying –

KRISTOL: Roosevelt understood that well in the New Deal, right?

STELZER: Right, he figured that out early on, and it really worked. I mean, if you think about the numbers, it really worked. That's why I have to laugh at people who say the New Deal didn't work and they write pieces about where we had high unemployment until the war started, so. The fact is, the country didn't come apart.

So I have decided that the way to do this, there is a sure-fire method, is you have to elect politicians who you have seen laugh. Reagan laughed; Roosevelt laughed. I don't think I ever saw Hillary Clinton laugh. I mean – cackle, yes – laugh, no. Politicians who have enough of a vision beyond themselves to not take themselves as seriously as some do. I mean, Roosevelt is my model. I mean, he had a bad deck of cards to play with. And you could say, well, sure, he fixed it with a war. He didn't start the war, I'm sorry to tell his critics. He didn't start the war.

And I think what conservatives have to do now is say, okay, here's where we are. Look, Barack Obama won. People with pre-existing conditions are going to get healthcare and they're not going to pay for it. They're not going to pay anything like what the actuarial tables say they should pay, okay? That's it. Good, let's accept that. Then what do we do about it? How do we make that as least costly as possible and as most efficient as possible?

Take the cards we've got – which are not bad cards. I mean, the fact is, we have a healthcare system that is very expensive, but we have a country that is very rich. So if we spend part, another 1 percent of our marginal income on healthcare, so what? It's not like it is coming out of people's mouths. I mean, we're talking now about replacing essentially all of your body parts before you die, so that you are bionic man by the time you die. That's fine with me. I mean, if anybody wants it, they're welcome to it. And we're talking about trying to get a system that enables us to afford that, that is productive enough to enable us to afford what it is that *keeps the system going*. And yeah, do we have an inflated –

KRISTOL: And preserves freedom and individual [liberty] –

STELZER: Yes. Do we have an inflated view of entitlements? Yes. And the people who complain most about it are the most entitled. So I think we have to ignore them. We have to figure out as a body politic what are the reasonable entitlements, and then try to deliver them – that's where economists can help – in an efficient way.

If you look at Britain with the NHS, it's a horribly inefficient system. It has got moral hazard; it has got every wrong thing, bad incentives, and so on. Try to get the incentives right, try to limit moral hazard, try to keep a nose sniffing for blatant inequalities. That, even if that's what the market produces – listen to Adam Smith. You know, just intervene.

I particularly liked when he talked about, when he talks about trade policies for free trade. And then when he gets to, well, what if the other guy is doing that? He said, well, "Revenge." He uses the word *revenge*. One sentence: "Revenge." It's appropriate. Why not?

Will we survive Trump? Yeah. I mean, we're a great country; we will survive Trump. I don't doubt that for a minute. Is it a bit unnerving? Sure. But has it got Germany increasing its defense expenditures? Yeah.

KRISTOL: And the problems are deeper than Trump, as you can see.

STELZER: And the problems. I mean, Trump is a symptom.

KRISTOL: That's what needs to be addressed.

STELZER: But that's the weakness. I mean, we are not doing that. Now, you're more familiar with the think tank world than I am. I follow it some. But I worry that we're not doing that.

KRISTOL: People are getting there. I think it's a little bit of an adjustment, and there's always a lag. But I kind of feel like people are coming to where you are, in terms of thinking in a broader sense of political economy and trying to step back from the particular, narrow debates of the last few years and the last decade, maybe, and really try to say, okay, what do we accept, what are the cards we have, what can we fix, what do we just live with? It's perfectly tolerable.

But also, I think, the notion – this is where I think you're so, what you have been saying is so important. I mean, think in terms of the system as a whole, the system of democratic capitalism, political liberty, you know, certain amount of economic equity, but also growth.

I mean, that's the right way to ask – those are the questions we have to ask. Not this very narrow, you promised to repeal this, and therefore, you've got to help people who make more than a million dollars a year with their capital gains taxes.

STELZER: And we also have to recognize that a lot of the things we thought we knew, we don't know. I mean, we know that making more money is an incentive, right? But we don't know at what magnitude it stops being an incentive.

KRISTOL: And also things we knew were correct in 1983 may not be correct in 2017. That's just the way it is.

STELZER: Well, that is one problem that conservatives have is that, this Reagan love. I mean, Reagan was wonderful and all of that, and that was then and this is now. And we now have different family structures, we have –

But this is a great country. We can't "sell it short" – I hate that expression. But somehow you have got to go back there and persuade people to *think again*. Because what they're doing now is kind of a mindless process. I mean, we'll go around the room and everybody will say hello.

KRISTOL: Thinking again, maybe, is a big task, but I'll do my best, and you'll do your best –

STELZER: Well, with you in charge I am relaxed.

KRISTOL: And with this conversation, I hope this conversation will help people think again. Irwin, thanks very much for taking this time to join me. And thank you for joining us on CONVERSATIONS.

[END]