# Conversations with Bill Kristol

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Chairman of the Council of Economic Advisors (2003-2005)

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## I. The U.S. Economy Today (0:15 – 31:33)

KRISTOL: Welcome to CONVERSATIONS. I'm Bill Kristol and I'm joined, again – I think we've had one of these conversations, right, by Greg Mankiw, Professor of Economics at Harvard. Author of the bestselling economics textbook for a long time, right? It's amazing, right, 25 years or something like that?

MANKIW: Yeah, that's right.

KRISTOL: Wow. That's much more impressive than being a professor at Harvard. [Laughter]. The real market is speaking there, right?

MANKIW: Yes, absolutely.

KRISTOL: And, Chairman of the Council of Economic Advisors under President George W. Bush, and many other senior positions too countless to mention. So, really one of the most respected economists in the country, and respected on both sides.

We talked, I think, when we had our first conversation a couple of years ago about the surprising disregard for certain economic – well, what one would have thought would be certain economic truths and principles to some degree on both sides of the political spectrum. And the situation has gotten worse, so we need to address this again.

MANKIW: It has.

KRISTOL: And we need to do a better job this time, explaining to people what really is a problem to worry about, and why people may be falling in love with certain fake solutions and attractive-sounding things that wouldn't work. So, where to begin? There's so much bad information out there, right?

MANKIW: Well we're in a situation now of tremendous polarization, including on economic policy, but not among economists. If you talk to economists, they kind of range from center-left to center-right. And when you get a bunch of economists in the room they're more likely to agree than disagree with each other.

Despite that fact, the political parties are pushing out to the extremes. We have Donald Trump becoming very isolationist in his trade policy and you have Elizabeth Warren who's becoming very populist in her attacks on the rich. And so you have sort of both parties sort of drifting apart and going to the extremes. And the economists tend to be left in the middle, being a little surprised that both political parties are abandoning them.

KRISTOL: And so I suppose to defend the political types I could say, well, you guys got it wrong. You know, all these promises you made, it turned out globalization wasn't so great, and markets don't work, there's increased income inequality, there's wage stagnation, there's problems. Big tech is monopolistic. I mean, maybe we shouldn't listen so much to the economists.

MANKIW: For sure we don't get everything right. But I think most of what we teach in Econ 101 or we can call it EC10 at Harvard, is basically right. The basic theory of supply and demand, what markets can do well, when markets need government intervention – I think that basic theory is still right. And I think, so our economists really do know a lot about how the economy works.

I think there are two trends that are disturbing. We don't have a full explanation for it, but it helps explain the sense of dissatisfaction. So one trend is slowing economic growth. Economic growth has not been as robust in the past 15, 20 years as it was in the post-World War II era, more broadly.

KRISTOL: That's true here in the US, or globally?

MANKIW: Globally in developed countries. We've seen very rapid growth in some of the [less] developed world, in particular, like China and India. But in the developed world we've seen declining economic growth and we've see a widening income inequality. So people with less skills are not doing as well as people with more skills.

Now having said that, there's good news too. I don't want to say it's all bad news. We see sort of two pieces of good news. One is if you look at global poverty, like the percentage of people living on less than a dollar or two dollars a day, it's lower now than it's ever been in human history. And it's largely because rapid growth in Asia has pulled billions of people out of very, very deep poverty. And that's something that we should applaud.

The second thing is the United States is still doing pretty well by global standards. If you're a person living at the poverty line in the United States, you are wealthier than 85 percent of people in the world. So, maybe the U.S. economy is not living up to our aspirations, but it's doing pretty well if you take a global or a historical perspective on it.

KRISTOL: And so I guess one could say, okay, well that's nice; but what damage could some of these bold proposals do? I mean, surely trade has had its downside, so maybe it needs to be re-thought some. And surely income inequality, as you just said, has increased and so why not a wealth tax?

So maybe we should just go through some of these proposals. And what is true in them, or what is there useful in them, and how much of it are really false prescriptions for what ails us?

MANKIW: Well let's first talk about trade. The basic lesson about economic trade is that free trade expands the size of the economic pie. But while doing that, it's also creating winners and losers. So not everybody is going to benefit. And so in particular when the United States opens up to trade with the rest of the world, we tend to import goods produced with unskilled labor, because unskilled labor is abundant abroad.

And that's going to tend to reduce the demand for unskilled labor here, and increase the demand for our skilled laborers. Because we tend to export things that are intensive in skilled labor. So that's going to exacerbate income inequality.

We could reverse that by retreating away from international trade, but that the overall pie is going to shrink. And so we should think about ways to distribute the economic pie more fairly, but not shrink it.

Having said that, let me also say that trade is probably not the main reason that income inequality has gone up. Most economists would give more weight to technology. And there's a great book by two of my Harvard colleagues, Claudia Goldin and Larry Katz, it's called *The Race Between Education and Technology*.

And their basic story is that technology tends to increase inequality because technology tends to replace unskilled workers, and tends to increase the demand for skilled workers who are using the technology. So you can sort of think of me becoming more productive because I don't need a secretary to type my papers, I could just do it with a word processor. Or think of a bank – we replace the teller with an automatic teller machine, and that makes the bank overall more productive and better for customers, but reduces the demand for tellers, which is a relatively unskilled job. So, what economists call skill-biased technological change is going to tend to make the world less equal.

The other side of this tug of war is education because education turns the unskilled workers into skilled workers. And the Goldin/Katz story is that from basically World War II to the 1970s, education was winning this race between education and technology and we were becoming more equal as a society. And then sometime in the 1970s, educational advancement slowed down and technology started winning that race.

And so if you believe that, what does it mean? Well we probably shouldn't change technological progress. We probably don't even have the capabilities to do that. It'd be nice if we could create technologies that would increase the productivity of unskilled workers rather than replacing them. But innovators invent what they think of, and it tends to be easier to automate unskilled jobs.

But what we really need to do is focus on education, to get more of the unskilled workers into skilled workers. And that's why, from my perspective, actually increased educational attainment is probably the most important priority. It's easier said than done. The reform of the educational system is not an easy task, but that should probably be where the priority is, both in terms of increasing growth and on reducing income inequality.

KRISTOL: How about, since you've sort of acknowledged the income inequality – I think it's just a fact, right? It has increased.

MANKIW: Yeah, absolutely.

KRISTOL: Now, has mobility also decreased? I mean that would be worse I think, if there were both more inequality and less economic mobility.

MANKIW: Oh, I think the mobility story is interesting. There's two different notions of mobility. There's what's called relative mobility and absolute mobility. So let me tell you what they are. Relative mobility is, what's the likelihood of somebody born into the 20th percentile making it into the 80th percentile or moving among the percentiles of the income distribution? That's called a relative mobility. That has not changed. That's been relatively stable.

What has changed is what's called absolute mobility, in the literature. And what absolute mobility is, is, what's the probability that you will earn a higher incomes than your parents did? And that has gone down. And the reason relative mobility –

KRISTOL: We're talking in America, the USA?

MANKIW: This is in the United States, yeah. We have the best data on the United States. And a lot of this stuff has been done by my colleague at Harvard, Raj Chetty. And so you might say, well how can absolute mobility go down if relative mobility is staying the same? They seem like they're very related concepts, and they are.

But absolute mobility is also affected by the other two trends I've talked about, which is rising inequality and slower economic growth. So even if relative mobility stays the same, but we get slower growth, then the probability of you doing better than your parents is going to go down.

And if most of the growth is accruing to people at the top of the income distribution, then also the probability of you doing better than your parents is going down, since it's only the few people at the top that are getting the benefits.

So, relative mobility, people churning around in the income distribution, is pretty much the same; but it matters more because the gap between the people at the top and people at the bottom has grown so much.

KRISTOL: So my answer to that is, so we should really want policies that increase broad-based economic growth.

MANKIW: Yes, we should.

KRISTOL: If we know a way to do that.

MANKIW: Well, I think –

KRISTOL: And do we know how to do it?

MANKIW: Well, education.

KRISTOL: Yes.

MANKIW: I mean, education increases growth because it makes workers more productive. And by turning the unskilled workers into the skilled workers it means they get the benefits of the skills. It also by the way – when people get educated, it even benefits unskilled workers, because the unskilled workers have fewer other workers to compete with.

KRISTOL: Right.

MANKIW: So, and by reducing the supply of the unskilled, the unskilled wages should go up as well. So, education really seems to be the magic bullet; but trying to figure out how to get more people through college and high school is not easy.

KRISTOL: So, I'd suppose if I were Elizabeth Warren I would say, "Well typical of economists, they want to say, hey, let's fix education. That's someone else's job. But why don't we just get – address some of this directly? What about a wealth tax, for example?"

MANKIW: Oh, yeah, okay, well, that's right. So, the idea of education is fixing the income inequality that's created by the market. You know, we want people to be able to earn more. But you might say well if they can't do that, let's fix the outcomes. The outcomes are given, then maybe we can redistribute the outcomes after the fact.

KRISTOL: Right. And we do that some already.

MANKIW: We do some, absolutely.

KRISTOL: With a progressive income tax and so forth.

MANKIW: Yeah, there's an income tax credit, for example and it's very important for helping people at the bottom. And if you look at sort of measures of inequality, inequality has gone up less, if you look post-tax and transfer, and if you look pre-tax and transfer because we have expanded things like the earned income tax credit.

So the question is why don't we do more of that? And maybe we should, actually, and the question is, which tools should we use? There's sort of two bold proposals out there being debated right now. I think one of them is a good and plausible idea, and the other is kind of a crazy idea.

The crazy idea, from my perspective, is the wealth tax because I think it's going to be very, very hard to implement. Many European countries have tried it, and most of them have given it up. And there's a whole variety of problems with it.

So for example, suppose I own a chain of dry cleaners or hardware stores or something. That's my privately held business. What's the value of that? You could just sort of add up the value of my merchandise and the real estate I own, but the truth is most of what I have is probably goodwill, which is a very intangible kind of thing – the value of the business as an ongoing concern.

Is the government going to have to go in there and try to evaluate the value of this business every year and how are they going to do that? They do that a little bit every once in a lifetime when they – with the estate tax.

KRISTOL: Right.

MANKIW: And that makes it – but people who've studied the estate tax know that's pretty difficult. The estate tax is, in some sense, a negotiated tax between you and the IRS. Do you want every small business to have to negotiate every year with the IRS over what the value of its business is?

KRISTOL: And there's no obvious way to mark to market because they're not –

MANKIW: Because there's no market.

KRISTOL: This business isn't for sale.

MANKIW: Yeah, that's right.

KRISTOL: And if you put it for sale, you could.

MANKIW: Yes. And if you have – you know, for Jeff Bezos it's easy because he has Amazon stock and that way we can value it, there's a market for that. But for a lot of closely-held businesses, there is no market. And it's not like you can sort of put your chain of seven different hardware stores on the market and see what the price is.

KRISTOL: Right.

MANKIW: So, the valuation issue becomes very, very difficult. So I actually think the wealth tax is a non-starter. I see why it has political appeal, because it, as described by Elizabeth Warren, it's going to only affect .1 percent of the population. So if you tell the 99.9 percent that they're going to get free stuff, paid for by the .1 percent, that sounds attractive. But it's probably not realistic.

KRISTOL: What I've always sort of – but why it's always slightly appealed to me, I've got to say, is – is in some sense don't you – in some ways don't you think it makes more sense though than the income tax? I mean, theoretically if you – leaving aside this rather big implementation problem – taxing people's wealth rather than their income makes a certain amount of sense because the income is stuff they're getting each year, which you don't –

MANKIW: I'm not so sure of that. I'm going to go back to the other good proposal in a second.

KRISTOL: Okay.

MANKIW: But let me at least talk about this issue. Let's imagine you have two people who make the same income. So I have two CEOs, both of which make $10 million dollars a year and so they're in the top .1 percent.

And one of them says okay, I want to take my $10 million dollars a year and have lavish parties, fly a private jet – I'm going to blow it. And the other one says I want to accumulate it and invest in small businesses and eventually leave something to my kids and grandchildren and nephews and nieces and give some to my alma mater. The wealth tax says the second guy should pay more taxes than the first guy. So to me, I don't –

KRISTOL: So it penalizes savings.

MANKIW: It penalizes savings.

KRISTOL: And the counter-argument, I guess, is that if someone, two people make $10 million a year and one guy already has a billion dollars, it matters to him less, obviously. I mean, the $10 million increment is less important. It seems a little unfair to tax them the same, I guess, the one guy who's making his first $10 million and the person who's making his hundredth $10 million. Or maybe that's a little silly, I don't know.

MANKIW: Let me go back to – maybe the proposal that actually I like.

KRISTOL: Okay.

MANKIW: At least is worth thinking about and that's the proposal of Andrew Yang. Now I'm not here to endorse Andrew Yang, but I think his basic idea at least seems workable to me. I mean, his idea is to put a value added tax, which is basically a flat consumption tax and use it to finance universal basic income, so everybody gets a lump sum back.

That, I think, could work in the sense that we know value added tax has worked in much of Europe. It's a fairly efficient way to collect revenue. That's why many European countries use it and have kept using it for many, many years.

Universal basic income is a pretty easy thing to implement – everybody gets a check, they do it in Alaska, right, with the oil revenue. So the whole thing would work and the whole thing would be progressive.

It'd be like sort of a super duper earned income tax credit. Although it does require you work, everybody would get it. But it's basically a way to redistribute resources from people high up in the income distribution towards people at the bottom.

To me, that's attractive in part because I think it would work, but also in part because of the distinction between the two CEOs, one of which is spending lavishly and consuming a lot and the other which is saving to give money to his alma mater. It's going to penalize the guy who's spending, who is living the lavish lifestyle more. And I think that's a good thing. So I think the consumption tax aspect is quite desirable.

The universal basic income part kind of makes sense as a way to help people at the bottom. This idea, by the way, has been floating around for a very long time. During the Nixon Administration, there was a talk about this.

KRISTOL: Right.

MANKIW: And I remember even before that, Milton Friedman talked about the negative income tax in his book in the early ’60s, *Capitalism and Freedom*. So this idea of a universal basic income or a negative income tax has been floating around for a long time. And so to me, actually that might –

KRISTOL: You think that would be preferable to the – I mean, so I think the earned income tax credit kind of become a version of that where it’s limited to people’s labor.

MANKIW: It does. Yeah, but you have to work some to get – you have to work some to get it.

KRISTOL: Which is a good thing though, you would argue, right? Or not, I don't know.

MANKIW: The system we have now, the social safety net we have now says okay, we’re going to distinguish between the deserving poor and the underserving poor. So if you work hard but have low wages – well, you’re deserving. Or if you’re disabled and you can’t work, then you’re kind of deserving. If it’s a period of high unemployment, we’ll extend your unemployment insurance benefits, well then you’re kind of deserving.

But other people aren’t deserving. So it requires the government to draw these distinctions between the deserving and the undeserving. Does the government really have that ability to sort of fine-tune the social safety net in that way? I think it’s hard to know. I mean, what if somebody has a serious mental illness, what if they have serious back pain, which is very hard to diagnose? I think just distinguishing between the deserving and the undeserving is a very difficult thing for the government to do.

Now some people object to the idea of well, what if somebody just wants to spend all their time surfing? Right, they’re fully able –

KRISTOL: Yeah, the lazy surfer kid of upper middle class parents, should he get our tax money, so to speak?

MANKIW: Yeah, exactly. So I kind of understand that. To me, that doesn’t strike me as as big a problem as the government trying to have to decide well, you’re disabled. You say you have back pain, but we can’t really diagnose it, so you’re not disabled so we’re not going to help you.

So I’ve always been – ever since I read it, Milton Friedman’s book when I was a student – I’ve always been attracted by the negative income tax, universal basic income idea because of its simplicity. And really, it takes the government out of people’s lives, including the lives of the poor.

KRISTOL: No, I think Charles Murray has endorsed a version of this –

MANKIW: Yes.

KRISTOL: But then he has always said – but you need to get rid of all these other programs from his point of view, from a sort of libertarian point of view.

MANKIW: Yes. And Yang proposed a little bit of that if you accept the – what he calls the freedom dividend. If you accept his freedom dividend, then you’re not eligible for certain other programs. So I don't think he goes the entire way that Charles Murray wants to go, but there’s something of that in the –

KRISTOL: And there’s something to be said, I suppose, for – I mean, when you have these other programs and you get endless disputes, gaming of the system, what is disability and you don't want to be hard-hearted and say no to this person, but then someone else fakes it and then you’ve got some government person or doctor having to certify something. And then the doctor is sort of complicit in the system.

MANKIW: Yeah, exactly. And one thing we learned is that once people become disabled, even when the economic conditions get better, they might be able to work part-time to do it, they are disinclined to do it because they've already established themselves as disabled.

Whereas this universal basic income tax is no we're not going to judge you and if you want to come back in the labor force when you want to, fine. So to me, actually, the idea makes sense. It would be a pretty radical change from where we are, I understand that.

But I think unlike the Elizabeth Warren thing, which is also a radical change, this one I could see working whereas Elizabeth Warren's wealth tax, I just don't see.

KRISTOL: It's like this kind of headline, the conservative economist endorses giving money away to everyone – the lazy surfers. But it seems to me the distinction is partly, as you say, you think the Elizabeth Warren tax wouldn't work, the wealth tax wouldn't work.

But also there's kind of a distinction in the way you are thinking about these taxes, right? I mean, one of them is, I don't know how to put this now exactly. I mean – well, maybe there isn't a distinction. I'm trying to think –

MANKIW: Well, it seems to me that the –

KRISTOL: You're letting the market work in the first place, and then saying but look, some people, there should be a better safety net for the people at the bottom.

MANKIW: Yes.

KRISTOL: And that some people at the top are paying, in effect, a higher progressive, what a VAT would be or a sales tax. And those people would sort of just be an additional income –

MANKIW: An additional consumption tax. So if you're buying, if you're rich and you're buying that yacht, you're going to pay the Value Added Tax on that yacht.

KRISTOL: Right. So it's sort of "let the market do its thing, but then correct some of the excessive effects of it." Whereas with the Elizabeth Warren thing seems more intrusive somehow. It's a real – it's really changed, people who are just sitting there saving their money, are not just paying taxes on the interest or on the dividends or on the capital gains as they do today, but somehow are marking to market and having to give the government a chunk of their actual resources.

MANKIW: The people who are in favor of the Warren wealth tax seem to have this idea that vast sums of assets are pernicious in and of themselves.

KRISTOL: Right.

MANKIW: They really want to get rid – read the work of Thomas Piketty and Emmanuel Saez, Gabriel Zuckerman, they really kind of want to get rid of billionaires. They somehow think that people sitting on vast sums of money is somehow a bad thing.

I don't look at that and see it's a bad thing, particularly. I want to help people at the bottom. I'm much more focused on what we can do to help people at the bottom, which I think is what the Yang thing does.

Whereas if somebody wants to sit on a vast – if Warren Buffet wants to spend, he's sitting on, I don't know, $100 billion dollars or so, if he wants to sort of sit on that and invest it during his lifetime, live modestly and then eventually give his money to charity, which is basically what he's planning to do, I don't see any problem with that. I mean, that does not to me seem – a problem that needs a fixing. It seems like it's a fine thing for society.

I’m more worried about people at the bottom who are losing their jobs, sometimes to trade, but more often to technology. I mean, to give you an example, there will be self-driving trucks probably in our lifetime. Several million truck drivers will be out of work, perhaps. What are we going to do for those people? I don't think it’s an easy – it’s not going to be an easy problem.

Are we going to decide okay, who can find another job, who can get another job? But otherwise, I think universal basic income, we’ll give you at least something. We’re not going to pay you as much as you earned as a truck driver, but at least you have some safety net to fall back on when you get unemployed from your truck driving job.

KRISTOL: Are you optimistic about job retraining and those kinds of programs? That would be another way of dealing with people who lose their jobs because of automation?

MANKIW: I think we need to think hard about how to do that. I don't think the track record there is great. And so the question is how do you encourage lifetime learning? I think that’s an important thing to do. But I think it’s, again, easier said than done.

KRISTOL: How about economic growth generally? I mean, how much are we stuck in, for whatever reason, a slower growth world than we thought we would be in or that we were in once? Was that just a weird product of post-World War II and so forth, both in the labor force, women coming to the labor force and stuff and now we’re just in a different world? Or could one reasonably do things to get basic economic growth higher?

MANKIW: That’s the million dollar question. I don't think we really know the answer to that. I think there is a view out there in the economics literature that what’s going on really is a depletion of ideas. You see this in work, a couple different lines of work.

One is a book by Robert Gordon at Northwestern called *The Rise and Fall of American Growth*. You see it in some work, Chad Jones at Stanford. And the basic thesis is that if you look at the history of economic growth, it’s mainly driven by technological progress – we learn how to do new stuff.

And it’s not like we’re not learning how to do new stuff; but maybe the stuff we’re learning is not quite as life-changing as it was in previous generations. You know, previous generations saw stuff like electrification, saw indoor plumbing, the internal combustion engine. Those are huge life-changing innovations. and now you get to tweet out 280 characters at a time.

So perhaps we’re inventing new stuff; it’s just not as profound. There’s nothing in economics that says that we can have two percent growth forever. There’s no economic theory that says that. And if you think of the path of human history, people lived pretty close to subsistence for thousands of years before the Industrial Revolution and things started taking off.

And there’s nothing that said okay, once the Industrial Revolution started, now growth is going to continue forever. It might plateau at some point rather than continuing up to infinity – it might. So there’s nothing that’s going to guarantee that we’re going to continue.

I think there’s things we can do at the margin. I think encouraging research and development is important. I think education which also contributes to economic growth. There’s also externalities associated with education.

Encouraging enterprise formation. So the United States is a very dynamic economy, venture capital is easier to get here than in most countries. And that’s a good thing. We don't want to sort of demonize the financial system, which actually does support new ventures. But I don't there’s any magic bullet that says if only we do this, we’ll go back to the three percent growth forever that we’ve experienced during some decades.

KRISTOL: I do think you mentioned innovation and enterprise. I'm very struck talking to people of how they just take that for granted, as if that's just going to always be a feature of our society and our culture and our economic system. And I think that's a – I don't know, my view is that that's a huge – people underestimate how important that is.

MANKIW: Yes, absolutely.

KRISTOL: You know, you can tweak this tax and tweak that, even education system, but at the end of the day, you really need that spirit of enterprise which is a little hard to put your finger on where that comes from, and there are cultural aspects to it and so forth. But it just seems to make a huge difference, ultimately.

MANKIW: There's a quote from Adam Smith, and I'm not going to get this exactly right. But he says roughly, "the only thing that's needed to bring a nation from lowest barbarism to greatest opulence is peace, easy taxes and a tolerable administration of justice."

And if you think of the dynamism of this economy, it's because we basically have a system that's pretty much free from corruption. The taxes are kind of low by international standards. We tend not to be really worried about – so we've been involved in wars, but not wars that affect the US economy directly.

Whereas if you look around the world, the countries that aren't prospering, they're often suffering from either widespread corruption, civil wars, threats from neighbors. So we really have, in some sense, the foundation that Adam Smith said is needed for populism and then everything else generates itself.

You create an environment where you can trust the rule of law, where you're not going to get – you don't have to bribe government officials to start a business. And then the private enterprise system is going to generate the dynamism. And that's why the United States is one of the most prosperous countries in the world today.

KRISTOL: I'd say immigration, don't you think, that that's really a – I just have come more to the view of, over the last few years, based on no empirical data – I haven't looked at the empirical data one way or the other, it's pretty hard to prove – that immigration is just such a huge plus in terms of – leaving aside the details, which are important of whether it puts downward pressure on some wages.

MANKIW: Yes.

KRISTOL: And other groups do better and other groups do worse and all of that. But that the degree which it does create a sense of ambition and enterprise and upward striving is really hard to replicate. I mean, it's almost unique, I would say.

MANKIW: I agree. I think immigration is basically a plus. But I do think the thing about immigration, you have to kind of distinguish between two different kinds – the skilled immigration and unskilled immigration.

I think skilled immigration is an unambiguous plus, along every dimension. These people – if an engineer comes in from another country or a physician comes in from another country, they're going to contribute to the US economy. They're going to surely pay more in taxes than they're getting in benefits. By increasing the supply of skilled labor, they're going to tend to reduce income inequality. So that's a good thing from an equality standpoint. So that's both pro-growth and pro-equality.

We talked earlier about the value of education. The simplest way to increase education is to import it. Get an educated worker from abroad and let them come in here. So that automatically increases the education of our workforce. So any foreign student that gets a degree from an American university, they should have the green card sort of stapled onto their diploma. Encourage them to stay, if they can.

Unskilled immigration, I think, requires a more difficult set of tradeoffs. Because I think by and large we do benefit in the same way that we benefit from all free exchange. But it probably does put somewhat downward pressure on the wages of unskilled Americans.

Not huge, because as I said earlier, I think technology is probably a bigger force. But I think it is one of the forces. My colleague George Borjas has done a lot of work on this and he estimates there are significant, not huge, but significant downward pressure on unskilled American wages because of unskilled immigration from abroad.

KRISTOL: And we now have the highest percentage, I think, of people born abroad in a century or something here.

MANKIW: Yes.

KRISTOL: And we have pretty good wage growth. It turns out that if you have –

MANKIW: If the economy is strong, that's right, it pulls all wages up. And I think –

KRISTOL: Which makes me a little dubious about how much alleged damage it's doing. Maybe it did in a period of slower growth, I suppose. Obviously by definition at some point if you have more unskilled labor, it's going to put some downward pressure on wages just because of supply and demand.

MANKIW: I think the harder question to ask, which is not really an economic question, is what obligation, moral obligation do we have to people in other countries? When an unskilled worker comes from another country, comes to the United States, by far the person affected the most is that worker.

And most of us have ancestors who came over as unskilled immigrants. My four grandparents all came from Ukraine just before World War I. None of them had more than a fourth grade education. And maybe they did a put a little downward pressure on US unskilled wages when they came here, but boy, the impact on their lives was huge.

And then their children became more educated and their grandchildren are becoming even more educated yet. So I actually have a lot of empathy for the unskilled immigrants abroad as they try to come to the United States because they're really not any different than what my grandparents faced a century ago.

KRISTOL: Yeah. And a lot of skilled people who are contributing a lot to the economy are the children of unskilled people. So that's why I'm very –

MANKIW: Absolutely – I feel that's absolutely right.

KRISTOL: That's where I'm slightly hostile or skeptical of the excessive distinction between skilled and unskilled. That's a static view of human capital if I can put it that way.

MANKIW: You're right. That's right. No, I agree with that. But the question is not – yes, I mean, but to be – before my grandparents came here, and I became a Harvard professor, that there's a century lag. But if you take a long view, absolutely for sure.

KRISTOL: Yeah.

MANKIW: And I do tend to take a longer view and that's why I tend to be more sympathetic to immigration of all kinds. But you have to sort of acknowledge there is some evidence that at least recently over the horizon, over the ten, twenty year horizon, that unskilled workers are affected.

KRISTOL: Right. Though there's a recent study I should – I saw it, I don't know how definitive it was. But I think it was from NBER, so a respectable study, presumably. That contrary to some fears, social mobility of what would be first generation, second generation, the children of immigrants – is as good as everyone else's. It's not the case that –

MANKIW: Oh, yeah, and I can believe that. I haven't seen the study, but that doesn't surprise me.

KRISTOL: Yeah. But there was a sort of a notion that some of the more recent immigrant groups were more static, their kids were doing less well, they were assimilating less well, their educational improvements were less dramatic than maybe your parents compared to your grandparents, or you compared to your parents. But that doesn't seem to be the case, actually.

MANKIW: Yeah, it's been –

KRISTOL: And some of the wealthiest groups in America are pretty recent immigrant groups. You know, some of them are kind of small, but pick an African nation and so forth.

MANKIW: Well I think in every generation there's the sense that, oh, the new immigrants are different from the old immigrants, you know?

KRISTOL: Yeah.

MANKIW: People used to look at, oh, the Italians aren't like the Germans; or, the Ukrainians aren't like the Italians. But we come here and then we assimilate. So I'm not worried about the long-term assimilation; I think it does make the U.S. economy stronger.

**II: The Economy, the Left, and the Right (31:33 – 1:09:19)**

KRISTOL: But, on the Right especially – Let's turn to the Right here. Well, let me ask one more question about the Left which is, the Left also does seem to have decided that money grows on trees, and we can have a Green New Deal, and we can have Medicare for All, and I'm exaggerating a little bit.

MANKIW: Yeah.

KRISTOL: But it is a little striking.

MANKIW: No, no, I don't think so actually. I don't think you're exaggerating at all.

KRISTOL: Yeah, it's a little striking how much – I mean, some people demur or some of the Democratic Presidential candidates who we probably shouldn't do it all at once. Or that's a little – goes a little too far. But it's surprising how little pushback there's been, I would say, to what once would have been thought to, gee, we have a trillion dollar deficit, can we really just afford that? I mean, so what about that kind of argument and how worried, what should one be, about just – you know?

MANKIW: I'm very worried about the long-term fiscal sustainability. I mean if you look at the CBO's long term fiscal projections, at the debt to GDP ratio, it's basically rising without bound. They say it's hanging off towards infinity.

KRISTOL: Now, currently it's not that bad, right? It's 65 percent of –

MANKIW: Well, it's – yeah, that's right. But it's really the trajectory.

KRISTOL: Right.

MANKIW: I mean if we were – if it weren't – if we were going to stabilize where we are now, than I'd say there's no problem. But the problem is, as my generation – I'm a Baby Boomer, so as my generation goes into retirement years and starts collecting what we're due under Social Security and Medicare, government spending is going to automatically go up and tax revenue is not there under current law to pay for it.

And so either we're going to have to sort of raise the revenue in some way to cover those commitments, or scale back those commitments. And my guess is, as my generation gets closer and closer to getting what we're due, scaling back things for the elderly is going to go harder and harder. It's one thing to scale back for the elderly when you do it with a 30 year lead.

KRISTOL: Right.

MANKIW: You say you expect less in 30 years, so you should save more privately. But once people are on the verge of retirement it's very hard to cut back on those benefits for the elderly. So, my guess is we're going to have to have higher revenues at some point.

KRISTOL: And so, the conservative party, the Republican Party in this case, which traditionally has at least talked about debt and deficit, even if it wasn't always super responsible in dealing with it perhaps, or super energetic and – though it's in Paul Ryan's credit they tried for a while there to get serious about entitlement reform and he got the entire House Republican Conference to be for it and so forth. And Romney and he ran on it in 2012, and it didn't obviously hurt them particularly I wouldn't say – but anyway, but that's all –

MANKIW: Well there were these ads about pushing grandma off the cliff.

KRISTOL: Right. But it's not clear that that really was the – you know, Obama did end up getting reelected by a sort of conventional vote.

MANKIW: Yeah.

KRISTOL: And the Republicans held the House and so forth. But boy that's gone away. And how worried are you about that? I mean if neither party cares about debt and deficit, isn't that kind of a worrisome sign about the – ?

MANKIW: Yeah. And we're in a time now, that there's nothing pressing because interest rates are low. And so as a result the cost of, to the budget, of paying for the debt is not – isn't impressing on them. But at some point interest rates will rise. And even if interest rates don't rise, at some point the debt is going to keep rising, and so the interest costs are going to keep rising. So at some point there'll be pressure on it. It doesn't have to be in the next two years or four years, but in our lifetimes it will – I think it'll become a big issue again.

KRISTOL: And what about interest rates incidentally? Isn't that like a little mysterious how they can be so low? Isn't normal –

MANKIW: It is. I think it has something to do with what we talked about earlier, which is the slow growth. You know, if technological progress slows down, it's going to tend to push down interest rates because there won't be as much demand for funds to find grants and investment projects.

But it's puzzled a lot of economists and economists are trying to figure out what it means for long economic growth, what it means for monetary policy. And we haven't figured out all the answers yet. I think there's a lot of internal debate.

KRISTOL: I mean, one of the weird things for me is that on the one hand everyone is sort of discontented. Some people on the Left are unhappy with mainstream economics, and certainly what free markets produced, or more or less free markets. People on the Right are now very unhappy. It's sort of found fashionable to decry simple minded belief in markets and so forth.

And you sort of think to yourself, well, if things really – are people unhappy because things are bad, or are people unhappy because things are actually or were pretty good for a long time? With a big hiccup in ’08, but it pretty quickly recovered from hiccups, to be fair. And the people are so complacent now, they can sort of indulge – I don’t know, fantasies is too strong. But, you know, pipe dreams, on the Left and the Right, in a way that, I don’t know, in the old days it seems like maybe you just couldn’t get away with that. I mean it does feel like a little bit – there’s a little unreality to our whole economic situation now.

MANKIW: I think people are judging the economy based on their aspirations of what they’d like it to be. And I can understand; their aspirations are higher. They’d rather have more equality; I would too. They’d rather have faster growth; I would too. But it’s not as if things are terrible.

I mean if you lift – the median American is better off materially than 99 percent of people that were ever born on this planet. I mean it’s not like economic growth is going into reverse; it’s just slowed down. Inequality is high, but it’s not like we’ve never been here before. You know, about a hundred years ago inequality was probably about the same as it is today.

So these things are not completely unprecedented. Would I like things to be better? Sure. But I don’t think we should lose sight of the good fortune that we really have, in many ways, in light of the challenges we face.

KRISTOL: And where are you, incidentally, I can’t resist asking – on the kind of, well, gee, wages haven’t gone up in 40 years, real wages, real median wages, whatever? Versus what I take to be the counter-argument which is kind of, yeah, but that’s an inaccurate way of measuring, and it doesn’t capture all kinds of improvements in standard of living, and stuff?

MANKIW: Yeah, well, I think that’s right. I mean there is – economists have talked for years about how inflation tends to – inflation measures tend to overstate inflation because we don’t take into account the improvements in the quality of products and so on, and new products.

So the flip side of inflation being over-measured, is that real wages are under-estimated because you’re always deflating wages by inflation measures. So if inflation is a bit too high, then the real wage growth is too low.

So I think we probably are better off than we were a generation ago, but there’s no question that inequality has gone up. And so people are comparing themselves not only to what they remember their parents enjoying 30, 40 years ago; they’re comparing themselves to what their neighbor is enjoying and the fact that their neighbor may have the bigger house and so on, I think. So there’s no question that rising inequality is going to lead to a sense of dissatisfaction in some segments.

KRISTOL: And you mentioned earlier I think that people’s – that children no longer are as likely to outpace them, as used to be the case?

MANKIW: Yes. The probability that you will – it used to be the probability that you will have a higher standard of living than your parents, for people who were born in like the ’40s and ’50s – the probability that you’d be better off than your parents was like 90 percent. It was almost a certainty that you will have a higher standard of living than your parents.

And now it’s much lower than that. And that’s because growth has slowed, and because the growth we’ve had has accrued more to the top of the distribution than across the board.

KRISTOL: And the baseline is higher.

MANKIW: Yeah.

KRISTOL: If more of your parents are already middle class.

MANKIW: Yes, yes – for sure, yes.

KRISTOL: I mean, you know. You could have a normal middle class life, but it's just not necessarily better than your middle class parents'. Whereas if your parents were working class immigrants, making it into the middle class was a huge step up.

But that is a big, don't you think, affects attitudes a lot. Because so much of the American creed, the American dream, is you will do better than your parents. There's so many parents who invest so much in the assumption that their kids will do yet better than them. And you could tell them, you know, hey, it's not going to be so automatic as it used to be. But I think people – that probably does lead to a certain kind of discontent.

MANKIW: Oh, it does, and I think particularly discontent for relatively unskilled workers. And if you look at the voting patterns over time, for most elections, people with college degrees and without college degrees sort of vote for the same candidate. I saw that Pew has sort of been working on this. And so the skilled and the unskilled tend to vote the same, except in 2016.

We saw a very big divergence where the college-educated tended to vote for Hillary Clinton, and the non-college educated tended to vote for Donald Trump. And that's perfectly understandable if you think that the economy's been particularly bad for the unskilled workers. Then they're the ones who really felt like, oh, the elites in Washington weren't doing us any favors, we need to shake things up.

And I kind of – so I understand that sentiment. I don't think Donald Trump has shaken things up in a useful way, but you sort of understand their motivation of feeling dissatisfied with the economy that they've been living through.

KRISTOL: Well so let's talk about some of the Trump-y, or you know the Republican, conservative discontents with sort of traditional markets. So, there's trade, there's immigration, they don't like that. There's the critique of the big companies, the corporate America, big tech. I mean it's striking how much of a nerve some of that nationalist, populist rhetoric has hit, don't you think?

MANKIW: It has. I think – let's talk about Trump trade policy. I think there's an element of truth to the Trump trade policy that in the end it has then gone haywire. So the element of truth is that we do have issues with China and China is one of our major trading partners. And then one of the big issues which the Trump administration does emphasize is intellectual property.

KRISTOL: Right.

MANKIW: And the United States tends to be an exporter of intellectual property, whether we're talking about software, or movies, or even economic textbooks. We export intellectual property.

KRISTOL: Which is good in the case of economic textbooks.

MANKIW: Yeah, exactly. And China tends not to respect intellectual property and that's a problem for the US. I mean from my perspective stealing, copying someone's software, or making it legal to copy somebody's movie, is basically a form of theft. It's really not functionally different from theft.

KRISTOL: Right.

MANKIW: And so I think we have a real serious issue. Now, the question is what –

KRISTOL: Did the Chinese pay for their translation of your textbook?

MANKIW: Well, it's interesting, you know. I've had students come back from China saying, I've been to the bookstores and I've seen several different versions of your textbook in stores. So some of them – there's an authorized version and there's unauthorized versions, selling in the same stores.

So the question is what do you do with sort of that failure to protect intellectual property? Well I think we have allies who have similar interests that we have. And there are organizations like the WTO that we should be working with. And so I think we do need to deal with that.

Instead, the Trump administration has really lashed out against all our trading partners, including allies like Europe and Canada and Mexico. I mean these are people we should be working with, not opposed to.

And then their complaints aren't narrowly focused on what is our problem, intellectual property, they're like, on all sorts of things. Like "we're running a trade deficit with China, why is that? That's terrible." There's lots of economists who'd say a bilateral trade imbalance is basically a meaningless statistic.

So I think there's an element of truth to the Trump complaints about trade policy, but then it's led to a completely, a trade negotiation stance that's completely lacking in nuance. And I understand sort of where they're coming from, but I think they really haven't handled it very well.

We've talked about immigration that I think is a plus for the economy, not to mention, I think, personally I think what's going on at the border and the family separations is morally repugnant. So putting aside the economics, I mean, it's hard not to be horrified by that.

And in general, I think, what's really bothering me a lot about the Trump administration goes beyond economics, which is basically treatment of our traditional allies terribly really from the beginning, but recently what's gone on with Ukraine, what's gone on with the Kurds in Northern Syria. I mean, it's just sort of morally repugnant along so many dimensions.

KRISTOL: And there is a kind of mercantilism which spills over from a sort of narrow economic mercantilism to a general attitude. And you see this very clearly with Trump. That the only way we do well is by other people doing worse.

MANKIW: Yes.

KRISTOL: And we need to, in fact, make other people do worse because that will even help us do even better. And the whole point, if I could say from an almost moral philosophy point of view of Adam Smith and free markets, leaving aside the strict economic arguments, is to try to cut away from that.

MANKIW: Oh, absolutely.

KRISTOL: And it could be overdone, it could be over-simplified, rising tide. It doesn't list every boat, but there is some truth to that. And it's a healthier society when you have that basic, I think, sense that you can do – in doing well, you can do good. And vice versa. And those are not at total odds with one another.

MANKIW: Absolutely. In fact, one of the very first things that I emphasize when I teach introductory economics is that trade is not zero sum. It's not like oh, there's a winner and a loser. It's that we can both be better off engaging in international trade. And helps us understand not just trade among nations, but trade among individuals.

KRISTOL: That's true of an internal market, too, right?

MANKIW: Exactly, exactly. I mean, why are we inter-dependent? Why don't we all live like Robinson Crusoe growing our own food and making our own clothing? It's because we all gain from trade and trade is positive sum. And so understanding the basic economics of that is the first part to understanding why it's not really bad to be inter-dependent. It's not bad to rely on other people or other countries.

Mercantilism is this old idea that trade is good only when you sell things to other people and the fact that people are selling you stuff is, in some sense, the cost you have to bear to sell them your stuff. Whereas economists, it's more the opposite. It's like we benefit from being able to buy things from other people and the reason we have to sell things to other people is we have to get some money to buy things from them.

And so it really thinks about international and inter-personal trade in a very different way. I mean, in one of my *New York Times* articles I said would Donald Trump object if Americans went on vacation in Trump International Scotland golf resort? We think it's a bad thing because after all, they're buying an import, a Scottish vacation. I presume he wouldn't object. He doesn't think an American flying off to Scotland to play golf there is a bad thing. Similarly, whenever we sort of buy an import, the person buying the import is going to benefit.

KRISTOL: And you mentioned teaching your students. I'm just curious about this. You hear a lot of conservatives particularly worried about the younger generation. The polls show that they like socialism and they don't like capitalism at all. What do you make of that? Is that real, is that just kind of, they say it but they don't mean it?

MANKIW: I think there's some element of truth to it because I don't, I mean for me, the Soviet Union loomed large as a tale of what could go wrong. And I grew up going to a Ukrainian church with my parents and every week they would pray for the independence of Ukraine. And I remember thinking as a snarky teenager thinking well, that will never happen.

KRISTOL: Yeah, totally.

MANKIW: Right? But it did, right? And so I think we've really learned a lot from comparing North and South Korea or East and West Germany, that essentially planned economies don't work. You see it now in Venezuela.

That lesson, I think, doesn't loom as large to today's students. So when they think of socialism, they think of oh, Scandinavia, the Scandinavians seem fine. And the truth is, that's not really essentially a planned economy; they just have a more robust social safety net than we have, but they're basically market economies with a lot of economic freedoms.

KRISTOL: And in some respects, I believe, tougher anti-entitlement growth and more fiscally responsible policies than we've had, right? And they've cut back on stuff that we've never been able to cut back on in terms of some of the benefits.

MANKIW: The thing to know about a lot of these European countries is the reason they have a more general social safety net is they tax the middle class higher than we do. It's often said that in our country the Left and the Right agree on 99 percent of tax policy. That is, the Republicans don't want to raise taxes on anybody; the Democrats only want to raise taxes on the top 1 percent. So there's 99 percent agreement.

But if you look at Europe, they actually have a robust social safety net by taxing everybody with this like the Value Added Tax. It's a very broad-based tax. So if we want to be more like Scandinavia, which we can decide to do or not do, you have to acknowledge that to do that, we'd have to basically tax everybody more, not just the 1 percent or the .1 percent. We'd have to have broad-based taxes and then we could use it to provide more benefits, if we wanted to.

KRISTOL: And do you think they do pay a price in terms of both general economic growth and innovation and enterprise with the higher taxes on the middle class?

MANKIW: I think they do. I think there's evidence that when taxes are higher, people work less. Ed Prescott, the Nobel Prize winner from the University of Minnesota, has a paper on that and I basically find that credible.

It's not a terrible – I mean, it's not like people that are miserable. But I think there's a trade-off. We could have more equality. We could do the Yang plan with a Value Added Tax together with Universal Basic Income. That creates more equality, but we'll probably be less, have lower average income and be less prosperous by that metric.

KRISTOL: And do you agree with the argument that I think Ed Conard and some others make that it's more businessmen than maybe economists, it's a little unquantifiable, that you need the outsized returns, which seem to some people a little bit crazy and horrifying and do to me, too. Some kid gets lucky with one invention and suddenly he's worth $800 million dollars or something like that. But you do need that to have Silicon Valley, to have the kind of almost insane churning and people taking risks and giving up jobs at reasonable salaries to put everything into some start-up.

MANKIW: That's a good question.

KRISTOL: How strong is that, do you think?

MANKIW: That could be right. I think it's very hard to know.

KRISTOL: But you know the argument.

MANKIW: I know the argument, which is would Bill Gates have created Microsoft if there had been a billionaire tax?

KRISTOL: I'd say it less of Gates, because he would have, because he would still become hugely rich. It's less even the number two and three people at Microsoft; it's the number 30 person who joined. I'm making this up, but it's in general, who left a good job –

MANKIW: Maybe a safer, more secure job.

KRISTOL: – yeah, at IBM where he was getting very well paid for being a senior blah, bah, blah, vice president of marketing, and went to some pretty obscure start-up with the offer of equity thinking you know what? It's nice to make – I'm making this up, but $400,000 dollars a year at IBM and it's very, it's pleasant, it's not even that hard work. But I'm going to give that up for a much, somewhat lower salary to start with and anyway, this place could go bankrupt in two years. But, I'm going to have a chance to really hit it right.

And I think his argument, at least Ed's version of it, is more – it's less Gates and Steve Jobs, they will do what they do probably anyway. But it's more the kind of, the amazing willingness of American upper middle management talent, including not necessarily the tech people themselves, but the people who make these companies succeed once the tech gets invented, the marketers, the lawyers – everyone. And it's an interesting argument.

MANKIW: There could be evidence.

KRISTOL: You sort of need that kind of –

MANKIW: There's certainly different career paths. You're leaving, you're deciding you want a relatively secure job, a physician where I know for sure I'm going to make my $300,000 a year, but I'm unlikely to become a billionaire, or do I go to Silicon Valley and roll the dice and maybe I'll become a billionaire, maybe not.

KRISTOL: In Europe, one has the sense, it has a lot of well-paid good jobs, really intelligent, well-educated people and they stay in those jobs.

MANKIW: Yes.

KRISTOL: Not only in government, but also outside of government. So you're at some big fancy French company and you move up in the French company, that's very nice. It doesn't even occur to them the way every American – you get the impression every American businessman even at the biggest companies in the back of his mind is thinking well, maybe I will jump to this – my cousin seems to think he has some clever start-up and maybe it's worth taking a gamble on that.

MANKIW: Yes.

KRISTOL: And that is something healthy, I think healthy about that.

MANKIW: I agree. And I don't know of any evidence that would absolutely conclusively prove that to a skeptic, but it strikes me as a plausible hypothesis.

KRISTOL: So what worries you the most? I mean, each party's economic – leaving aside President Trump's personal character as president, which you and I are not crazy about, to say the least. But in terms of polices, where would you see things really going off the rails as opposed to just kind of a little bit of silliness?

MANKIW: Well, I mean the trade war could get worse. I mean, it could really escalate.

KRISTOL: And it's not that the Democrats are great free traders either.

MANKIW: No, I think generally the Republicans have been the better party for trade. Interestingly, Democratic presidents are often better than Democrats in Congress.

KRISTOL: Yes.

MANKIW: Like I was skeptical about Barack Obama because his record as a senator was not great in terms of voting on trade things. But when he became president, he became much better. But you're right. In Congress, the Democrats are not great free traders and the Republican constituency seems to have disappeared on this because they're following Trump on this issue, even though I'm guessing in the back of their minds, they're thinking that's the wrong direction to head.

So I'm worried about that. I'm also worried about climate change, by the way. I mean, I actually do take the scientists seriously. I'm not a scientist, so I can't really evaluate the science behind climate change. But when the majority of scientist tell me it's a real thing, then I'm inclined to believe them. And I think the fact that President Trump, apparently legitimately thinks it's a hoax, is a bad sign. And then I think the longer we wait, the harder it's going to be, so I worry about that.

KRISTOL: It seems like a manageable thing if you had sensible market friendly policies, right?

MANKIW: It does. I've been part of this group, something that is called the Baker-Shultz plan of putting a carbon tax, along with deregulation and using all the tax revenue to rebate in terms of what they call carbon dividends. The Climate Leadership Council is the group that's been pushing this and I've signed on to that.

I think among our economists, that's got a large consensus of economists on both the Right and the Left. Because it's a market friendly, it takes climate change seriously, it wants to do something about it. Wants to incentivize people to reduce their carbon footprint, but does so in a way that's going to let market forces work. It's not going to micro-manage business decisions, which is what I'm afraid of. If you want to sort of do this via central planning, it's not going to be as effective and it's just going to be very interventionist and very inefficient.

KRISTOL: I mean, the Green New Deal I think shows a way in which the climate issue can be used to justify an awful lot of government planning, some of which honestly has very little to do with climate, but it's just they want to do a lot more planning, I suppose.

MANKIW: Yeah, that's right. So right now there doesn't seem to be the constituency for this carbon taxing dividend plan. But I think there's some people in Congress that kind of know it's the right thing to do. I think they know it's politically dangerous for them, but I think they know. It's not a complicated idea and the idea has been floating around long enough. I think Congress will be ready to do it if the American people were behind it.

KRISTOL: And on the left, if Elizabeth Warren becomes the nominee and president and even has a fairly supportive Congress, which of the things that she would do would you think – ah –

MANKIW: It's interesting. That's why I'm deeply skeptical of, is the whole change of corporate governance. I mean, she wants to take all big companies and say "look, your job is no longer to maximize profit for shareholders; you now have to take into account all your stakeholders. And we're going to put more labor representatives on your board. And so when you're deciding whether to close a factory, you shouldn't think of whether it's profitable to close the factory and move it to a different country or a different state, you've got to think of the effect on all your stakeholders."

That's a fundamental change in American capitalism. So it changes the role of companies in a way that I think sort of moves them in a not good direction. Because once you have CEOs saying my job is not to maximize profit, my job is to be central planners and decide what's good for everybody, well then who are they really responsible to?

If you have three or four different masters, who's really your master? And it's really hard to hold CEOs accountable if they can always say oh, I know this didn't maximize profits, but it's benefitting labor or it's benefitting the environment or they have some other reason. They have sort of complete discretion to do whatever they feel like.

KRISTOL: What about the counter-argument that the current system incentivizes them too much to worry about quarter to quarter, short-term profits and not be responsible in terms of longer-term?

MANKIW: I'm not convinced by that. Because if they're really, they're not thinking about the long-term profitability, that's going to tend to depress the stock price. Some private equity guy is going to come in there and throw out the management.

KRISTOL: It's usually that markets are sensitive to it.

MANKIW: Yeah, the whole private equity guys are there to basically take over companies that are badly run and make them more profitable. Now I know those are evil in some people's eyes.

KRISTOL: Yeah, maybe they're just taking them over to strip them of their assets and sell them back quickly.

MANKIW: But that's only a profitable thing to do if the assets aren't being used well. I mean, if assets are being used well, then they're not going to strip them. They're going to try to figure out how to make them more profitable.

KRISTOL: So you're a pretty firm defender of the kind of, more or less, the current system of incentives and rewards in terms of corporate governance. You don't think there's a big crisis.

MANKIW: No, I don't. But I think we could create one if we really try to change the rules, which Elizabeth Warren has proposed.

KRISTOL: You think that would really would be a problem? You could just end up –

MANKIW: I think so. I mean, I think it would be very hard to know how to run a company if all of a sudden you're told you have these five different stakeholders and you have to take them all into account and you the CEO get to weight the importance of one stakeholder versus the importance of another stakeholder.

KRISTOL: My colleague, Jonathan Last, had a piece where he went through a little bit of the history of We Work and said that's why people are for Elizabeth Warren. There's something wrong with our capitalism if we have this kind of ludicrous bubble in one company and then the guy walks away with hundreds of millions of dollars when he seems to be totally irresponsible and stuff. I mean, what's your answer to that?

MANKIW: I haven't followed that particular situation.

KRISTOL: No, I'm not stipulating that, either.

MANKIW: I mean, the boards of directors have an important role to make sure that the management does do their job, which is maximize profit for the shareholder. And if the boards aren't doing their job, we should figure out some way to reform that.

So I'm perfectly happy to think about corporate governance, but telling the managers oh, you're not responsible to shareholders anymore; this is only one of a list of people who you should care about. That strikes me as just a dangerous way to go.

KRISTOL: And one answer to Jonathan's point is, of course, you know what? People have lost money and we work for a bunch of investors who stupidly believed in some promises that were, probably should have been obvious if you looked at them more closely, were not sustainable.

I mean, this is not quite true, because there are side effects, of course, and innocent third parties who get punished when a company goes under and index fund that have a little bit of money in that. But on the whole, it was willing investors who lost.

And I suppose that is something, the point people don't make enough, I think. When you see these headlines and it's an outrage, how could that happen? Well, it happened even that these fraud – obviously fraud is illegal and stuff, but even the people who lost money on that fraudulent Silicon Valley medical company or whatever, Thanatos or whatever it was.

MANKIW: Theranos.

KRISTOL: Theranos. But that wasn't – right? That didn't cost Middle America, really, I don't think.

MANKIW: No, it was a bunch of rich investors, actually.

KRISTOL: So the system worked, in a sense, right?

MANKIW: No. There's no question that there's a role for government in dealing with corporate governance, things like fraud. We should put people in jail for fraud. That's a good thing. So I mean, it's not like I'm advocating for anarchy, but I just don't want to turn every CEO into a little central planner trying to figure out what's good for society overall.

KRISTOL: Yeah, that seems like a mistake. And what else would worry you the most? So Elizabeth Warren takes over. Corporate governance, the wealth tax, I suppose is what you are saying –

MANKIW: The wealth tax – to be honest, I suspect the wealth tax will never actually happen, only because the Ways and Means Committee will look into it. They'll start studying it and say this is not such a good idea.

There's other ways to tax the rich, by the way, than the wealth tax. There's things like closing the carried interest loophole and there's some other things we can do. I'm not particularly in favor of raising the capital gains rate or the income tax rate, but that strikes me as sort of less problematic than, say, the wealth tax. So I think there's other things you could do to increase taxes on the wealthy, which she'll do.

And the question is the medical system. I mean, to me Medicare for All is a very radical step. We have a medical system that works well for most people, it's the engine of medical innovation in the world, really. And if we go in the direction of Medicare for All – we can probably save money in the short run, but we're also going to reduce the incentives for technological innovation.

We could sort of control the drug prices, for example. Other countries do that. But if we do that, we're the biggest market now, if we do that, there will certainly be less innovation and new drugs. And so if you think about the long-term, your children and grandchildren, what's going to make their lives better, medical innovation is probably at the top of the list. So we don't want to reduce the incentive for that.

KRISTOL: It does seem to me, in general, that people on Right and Left, that is really what the Trump Right and the Elizabeth Warren Left have in common is I think a total lack of appreciation for innovation, enterprise, growth and what makes that possible.

MANKIW: Yes.

KRISTOL: And it doesn't automatically happen. And there are some aspects of what make it possible that are sort of not so beautiful. They have like side effects that aren't so nice and some unpleasant people get rich because they get lucky and it's being at the right place at the right time or whatever and it's not really their – they don't deserve it quite the same way that someone who invents a genuinely life-saving drug so on and so forth. But they don't understand kind of what could – yeah, how much you would give up if you started to have a system that didn't award innovation in various ways.

MANKIW: Yeah, the economist Joseph Schumpeter writing nearly a century ago talked a lot about this. That it's basically creative destruction that's driving the standard of living higher. And the process of creative destruction does give monopolies to innovators in the short-run until some other innovator comes through and replaces their innovation with a better innovation.

So yes, there's dynamics where people seem to get very rich and sometimes things get very expensive, like drug prices because of that. But we have patents on drugs for a reason. That's a policy decision. We want to give people patents to incentivize innovation. And then when we grant them this monopoly, we shouldn't be appalled that they charge monopoly prices because we've decided as a society to give them that monopoly for a good reason.

KRISTOL: Yeah, if we want to deal with particular drugs, we can subsidize them or whatever, I suppose.

MANKIW: Yes.

KRISTOL: Yeah, Schumpeter would be worth really having – both for the creative destruction argument, but also for the capitalism, socialism, democracy argument. The extent to which people lose an understanding of capitalism once capitalism starts to succeed and lose an understanding of its preconditions.

MANKIW: Yes, my understanding is that Schumpeter thought we would eventually drift towards socialism inevitably.

KRISTOL: Yes, out of a kind of – it just shows that I should go and reread it, too – but a certain kind of complacency, almost, right? And sort of –

MANKIW: Yeah, I don't think he applauded it. I just think he seemed to think that we were drifting in that direction.

KRISTOL: Yeah, he maybe wouldn't have been so surprised by, really, by Elizabeth Warren, Donald Trump in the sense that – and taking it for granted after all these years. I guess that's what strikes me, too.

I see this in foreign policy, too. You talk about the last 70 years and people [say] "Well of course, all these good things were going to happen anyway. We weren't going to have a Third World War, we weren't going to have, you know, 1920s, '30s type recession. We weren't going to have this, we weren't going to have that. The Soviet Bloc was eventually going to tumble. India was going to be a prosperous nation instead of being on the brink of starvation all the time. But just take that for granted. And now we're going to be extremely upset about a bunch of other things that didn't quite work out as well as we like." It does seem to me like people don't appreciate the –

MANKIW: Yeah, I think the more, the more international view one has, the more historical view one has, the more appreciative one should be of where the United States is today. Because yeah, things aren't perfect. We have aspirations that are perhaps better than the reality we're living. But compared to the international experience, compared to the historical experience, we're actually not in a terrible place.

KRISTOL: And you wouldn't know that from our rhetoric from either side, really. And somehow the rhetoric can then become self-fulfilling, right? Because it could then push us towards solutions that really would sort of damage our situation.

MANKIW: That's right. One of my favorite books about the intersection between politics and economics is *The Myth of the Rational Voter* by Bryan Caplan. And what Bryan does is he basically documents that the typical voter has a lot of systematically wrong beliefs about how the economy works. Has no particular incentive to correct those wrong beliefs given that the probability of their vote being decisive is so small. And politicians who are hyper-rational in terms of getting elected are going to then shape their policy proposals to appeal to the systematically mistaken voter. And that seems to be playing out in spades right now.

KRISTOL: And I guess the political science version of that is also the concentrated, you know, cost of use benefits thing.

MANKIW: Yes, yes.

KRISTOL: So this group – still a plant closes and 500 people lose their job. The thousands, tens of thousands, hundreds of thousand people who benefit from generally lower consumer prices on all the goods et cetera, you don't think – you don't think when you go buy something that hey, it's lucky there's international trade because it's really making this refrigerator more affordable or something.

MANKIW: Yeah, he documents, Bryan documents a variety of different biases that voters have. One of them is an anti-market bias. Another one is an anti-foreign bias and another one is a general pessimism bias. That people are generally more pessimistic than they should be.

And it's one of the great things about teaching economics, especially at the freshman level, is you're helping to educate the next generation of voters, specifically insulate them from some of the automatic biases that they might have.

KRISTOL: Is that happening?

MANKIW: Well, you know, I've thought for the longest time that introductory economics should not be a college level course; it should be a high school level course. Because much in the same way that everybody takes a year of American history in high school because to be a smart voter you need to know a little bit of American history. I think to be a smart voter, you need to know a little bit of economics.

So what we teach in Econ-101 really should be taught to juniors and seniors in high school. I don't think it's too hard. It can certainly be taught at that level. And I think we'd have a better body politic if everybody had gone through that.

KRISTOL: Just the concept of trade-offs and no free lunch.

MANKIW: Exactly.

KRISTOL: Very basic things would be healthy, I think. But it is striking. We're better educated than ever, I suppose, as a country, and I would argue people are more credulous than, to some degree, than ever – not than ever, but than they were 20 or 30 years ago, perhaps, about various promises on the Left and Right. In a surprising way, you would think, with all the information that's out there and so forth.

MANKIW: We'll see. I mean, right now the Democratic Party, they are sort of playing out between the left lane and the moderate lane. And I think it's still a 50/50 at this point which lane is going to prevail.

KRISTOL: And I suppose whether Trump really ends up dominating the party or whether it's a kind of temporary thing with a kind counter-personality and so forth.

MANKIW: I'd love to believe it's a temporary thing just due to, call it personality. But watching Brexit it makes me wonder that it's not. Because the Brexit phenomenon in the UK is not all that different from the Trump phenomenon here. It's this xenophobia, general suspicion of elites.

So I think this sense of dissatisfaction that affected American voters I think affected a lot of the British voters. And I think much in the same way that a lot of Americans are thinking that maybe this Donald Trump thing is not working out so well after all, I think a lot of the Brits are thinking maybe this Brexit thing is not working out so well after all.

KRISTOL: But also what happens with that, I think psychologists would say that one reaction to that is gee, I better rethink that. Another reaction is a kind of stubborn sticking to your guns and even doubling down in a certain way.

MANKIW: Yes.

KRISTOL: Blaming this elite or that group for not letting it work out the way it was supposed to, right?

MANKIW: Yes, one of the developments in economics in the past 30 years has been the rise of behavioral economics. And one of the big findings in behavioral economics, originally came from psychology, is confirmation bias.

The tendency to interpret evidence to confirm what you already thought because changing your mind is difficult for people. And it's kind of a useful thing to know that because once you sort of recognize all these biases that the behavioral economists have documented, you start seeing that in yourself.

And it sort of forces you to say huh, am I interpreting it this way just for confirmation bias? So I think it would be useful for people to learn that in this new high school course we just designed, to learn about some of the decision making biases so maybe they can counter-balance them.

KRISTOL: I like that. Well, at least they can learn about, re-think some of their biases and hopefully in this conversation and others like it. And thank you for taking the time to join me today, Greg. And thank you for really bringing, I think, fairness and clarity and fair-mindedness to this discussion.

I really wish more people thought clearly about all these issues and as you say, didn't simply either indulge hopes or go with confirmation bias or whatever.

MANKIW: Well thank you, Bill. It's a pleasure.

KRISTOL: Thanks, Greg.

And thank you for joining us on CONVERSATIONS.

[END]