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Interview 1: February 8, 2011

Audio File 1: 1

Developing an interest in economics and educational background—Intertwining of macroeconomics and policy work—Graduate work at Stanford, then work as a staff economist for the Council of Economic Advisors under President Ford—Estimating the natural rate of unemployment—Economics, politics, and the Federal Reserve—Election of President Carter and changes in fiscal policy—The extent to which debt and deficits were areas of concern in the 1970s—The problem of inflation and over-stimulus in the 1970s—Tax policy in the 1970s—Relationship of broad shifts in macroeconomic thinking and policy to presidential administrations—The appointment of Paul Volcker to chair the Federal Reserve—Work at the Philadelphia branch of the Federal Reserve—Appointment to the Council of Economic Advisors by George H.W. Bush—Tax reform in the 1980s—The role of the CEA in Bush’s White House—Relationship between the Bush White House and Greenspan’s Fed—Creating the 1990 Budget Enforcement Act and budget agreement—The CEA and trade policy

Audio File 2: 21

Today is the 18th of February 2011. This is Martin Meeker interviewing Professor John Taylor for the history of debt and deficits oral history project. Let me begin by asking you to situate yourself within the world of economics. You are generally associated with the rational expectations school and the neoclassical perspective as opposed to the Keynesian perspective. And I’m wondering where your association and appreciation of that particular school of ideas comes from: was it primarily from econometric discovery or were you also influenced by what was happening in the world at the time. So I’m thinking about the failure of Great Society liberalism and some of the larger social and political issues when your ideas were formulating.

I first got interested in this approach to economics, macroeconomics, actually in the late sixties. This goes back to when I was an undergraduate. I thought that from what I was learning about how macroeconomics and its theory worked, you needed to have kind of a different approach to policy, which was different at the time, more rules based. I’d say, both monetary and fiscal. And it was based on kind of an understanding of how the economy worked, based on my courses and working with people, and then trying to improve on the policy, if you like, based on that. I’d say, with respect to being driven by events, that at that time things weren’t looking so good, say as the seventies got started and inflation started picking up and we had, I’d say, lots of booms and busts then. I think an additional motivation for me was: can we find a better way to do policy than what was going on at that point in time? But by that time I was pretty much into that style of work.

Then came graduate school. I was an undergraduate at Princeton. I came to graduate school at Stanford and took as many courses as I could that would prepare me to do the analysis, which I thought was the kind of thing to be doing. It was expectations-based, rational, as you say, but I think more important than that, just the dynamics of the economy. That this is not a static world, like some Keynesians would put it, but a dynamic world where things are changing and policy had to adapt to that.

I find it interesting the way in which you talk about macroeconomic theory and policy together. You don’t seem to separate them. Were those interests always combined for you?

Yes. I’d say they were always combined. The thing that most interested me about economic theory was the policy applications just from the very start. I think it is very hard for me to separate. Of course there’s a genuine interest in economic theory in per se. It’s, to me, a beautiful subject on its own right. But
I think the motivation for me has always been to what extent can these ideas be used to improve public policy.

Meeker: So shortly after you graduated from Stanford and you received your PhD, you started to work as a staff economist at the Council of Economic Advisors under President Ford. How did you end up in that position?

Taylor: I was an assistant professor at Columbia at the time and was looking for something in policy. I had been doing my research and thought it would be good to actually do some policy, to get a better feel, also to contribute. One of my colleagues at the time was Phil Cagan at Columbia. I talked to him. He knew some people and so I believe it was through his maybe first making a call to say, “Taylor might be interested.” But I was eventually hired by the Council of Economic Advisors. I think they were always on the outlook for people. It’s not that unusual for an assistant professor to be on the senior staff for a while. So that was the first time.

Meeker: How big was the staff at the CEA at that time?

Taylor: It’s always been pretty small. There’s three members, of course. Maybe fifteen or so senior staff economists. Then you have some of the statisticians and some of the junior economists who are usually graduate students.

Meeker: What were some of the main projects that you were working on while you were there?

Taylor: I worked on several. One was whether there was a way to do some reform of the tax code a little bit. So it’s corporate tax reform. Another one was whether we could really re-estimate or get a better feel for what the normal rate of unemployment was, sometimes called the full-employment unemployment rate. At the time, actually, it was kind of officially four percent. It made not a lot of sense to people given what was happening in the economy. So we had a little project to try to use all the data we could and re-estimate it and finally came out to 4.9 percent. It was just a smidgen under five. And eventually people raised that further. So that was another big part of the project. I had an interest in monetary policy to some extent, thinking about monetary policy, as well, at the time. But it was mostly fiscal policy and business cycle types of things.

Meeker: For instance, the work on the tax code or on the natural rate of employment or unemployment, how was that going to be activated in a policy sense? Were there particular policy initiatives that were related to what you were doing?
Taylor: Let me sort of outline a little bit. So I worked in the CEA on the staff. This is in '76, '77, across two administrations. So I came in with President Ford. Alan Greenspan was the chairman. But I continued when Charlie Schultze came in and President Carter for the rest of the academic year. So the projects were a little different at the time. I'd say the one, with President Ford and Alan Greenspan, was more on trying to estimate what the unemployment rate would be sort of in equilibrium if you like. What the normal rate would be. And I think it was very important in terms of really helping the next administration because everyone realized that given the demographic changes, given what we could see was happening in the economy, that a four percent unemployment rate was something that, at that point, didn't really make sense as a normal rate. So I think it was viewed by all of us on the staff as something that they could contribute to public policy, if not then, in the future. It was actually by that time an outgoing administration. So it appeared in the last Economic Report of the President, under President Ford, and as I say, eventually became adopted and actually increased again a little bit before we were finished trying to reflect the reality.

Meeker: With the unemployment rate, was this an attempt to intervene in the way in which the Phillips Curve was operating or understood to operate? So that there was more leeway for monetary and fiscal policy to address inflation?

Taylor: I'd say it was really trying to just get it accurate. We have this notion of a short-run tradeoff between inflation and unemployment, and getting the gauge for what the normal rate is, is really essential, both for fiscal policy and monetary policy. So it was really just a way to think—taking what was pretty clear in the academic literature, the literature outside of government, to just get that in, get the discussion going in the government and get it in the document. The Economic Report of the President is a document which is quite important because many agencies clear on it, look at it. The Fed always looks at it, but so do other government agencies. So to sort of get that in there and report on it I think was good. There’s an interesting anecdote which partly answers your question. The final Economic Report of the President was presented to the Joint Economic Committee by then Chairman Greenspan and the other member, who was Burt Malkiel at the time—the third member had left. They presented it to the Joint Economic Committee and said part of it was that they thought it was best to think about the unemployment rate in normal times to be 4.9 rather than four. Hubert Humphrey was the chairman of the Joint Economic Committee and he said, sort of scolding the economists, “You know, if we had a plague in the United States, a serious problem with respect to illness so that people’s normal temperature went up, your solution would be to just raise the definition of normal temperature.” And so he really took people on. But I think people recognized that it was important to make these adjustments. And as I said the next administration kept with it and, in
fact, I think raised it to some extent. That would be with Charlie Schultze and President Carter.

Sure. Well, that’s an interesting point. You’re bringing up the political element of the economic work that you’re doing. And, of course, raising the natural rate of unemployment to near five percent is an acknowledgement that there are going to be more people unemployed and that that higher rate of unemployment would be seen as unproblematic by an administration, by the Fed.

Absolutely. There’s the economics and there’s the politics. They’re always interacting with each other. In this case, the economics and the data were pretty clear. And by the way, you always want to be ambitious and find ways to make the labor market work better so you don’t have higher unemployment. The situation at the time was that a lot of younger workers were coming in whose normal rates of unemployment are higher just by their nature. That would change the statistics if you just considered that demographic change alone. And so the economics were pretty clear. But the politicians will always be questioning, I think rightly, quite frankly, because people want to understand. Hubert Humphrey asked a good question at the time and so I think it is a good example.

How did one respond to him?

I have to go back to the transcripts on that. Basically people were polite. Probably much like I’m saying right now. They tried to explain the economics behind it, or mainly the statistics behind it, the demographic statistics.

How then did your work change under Schultze as opposed to Greenspan?

The new administration wanted to do something about tax reform. So we worked on possibilities for tax reform. I don’t think it really went too far at the time. It was basically some of the staff working on things that hopefully were productive later. We were always talking about tax reform. I think it was pretty soon after President Carter came in that inflation problems became clearer and clearer to people. Then, of course, the Fed chairmanship changed to Miller and eventually Volcker. Remember, I was just there for maybe six or seven months after the administration started.

Going back to your question about the politics, I found it quite interesting to observe the change in the politics from Republican to Democrats. But the economists, in a sense were also changing—you had a chairman changing from Alan Greenspan to Charlie Schultze. But the economics were really
much more of a fixed point than the politics. There’s an economic view. And the politics are sort of going back and forth. But to me that was interesting at the time. It was more of a fixed point. The conversations I would have with, say, Alan Greenspan and Charlie Schultze about the economy were quite similar when we were talking about the economics. But the people in the administration, of course, were having a different philosophy. Probably a little more interventionist types of things would be the difference on the politics side, but much less on the economics.

Meeker: Well, there was some effort to pass a stimulus package early in the Carter Administration even though the recession from ’74 had already passed.

Taylor: Right. In fact, there was a big stimulus package in those days’ terms. Part of it was sending grants to the state for infrastructure, much like the stimulus package that we’ve had in 2009. That was after I left. But the Ford Administration had vetoed a similar bill. It was passed. It overrode the President’s veto. And then the Carter Administration came in and it basically increased the size of that Keynesian fiscal stimulus, effectively, and a big part of it was to send grants to the state, who were supposed to spend them on infrastructure. Interestingly enough, there were studies done out of Brookings at the time that said that didn’t work very well.

Taylor: About the stimulus? That it didn’t work very well?

Meeker: That stimulus didn’t work very well because the money sent to the states was not really used for infrastructure. The states either increased their bank accounts a little bit or didn’t borrow so much. Some really good studies were done by Ned Gramlich for Brookings. He was a professor at Michigan at the time.

Meeker: Similar to the studies about tax rebates going to people’s savings accounts instead of stimulating the economy.

Taylor: Very similar. Yeah, because we did have proposals for tax rebates. Alan Blinder did some of the work on that, to show that much of it wasn’t spent. Yeah.

Meeker: We’ve interviewed a number of people now about the economy of the 1970s and, of course, inflation was the main story, the headline story of the United States economy in the 1970s and actually much of the western world. There’s some debate, though, however, about the degree to which people, either economists or politicians, were concerned about debt and deficits. If you look
at the debt-to-GDP ratio, I think it hit its bottom sometime in the Carter Administration and then it started to go up throughout the 1980s. But still, there was some concern about federal budgeting. Hence the 1974 Budget Act, which created the two standing budget committees in the House and the Senate. From your perspective as an economist working in the Ford, and then for a brief period of time in the Carter White House on the CEA, were debt and deficits, maybe on a scale of one to ten, were they much of a concern or was there a debate about should they be concerned?

01-00:15:37
Taylor: Yeah, there was. There was a concern. It’s hard to imagine because the magnitudes are smaller then than they are now. But yes, I’d say I can remember people being concerned about the budget deficit. You did have the ’74 Act, as you’ve mentioned. It was around that time that I think people became more concerned about the Keynesian expansionary spending. And you saw some of it coming internationally from the UK at the time. Yeah, I remember concerns about it certainly reflected by the people I worked with in the CEA, Greenspan, for example. And it was tied in with the inflation to some extent. Remember, you had a real mess with inflation. You had price controls, you had President Ford’s “whip inflation now” button. It was really unfortunate. Look back at that and recall what people were thinking about doing with inflation. With a button they kind of wished it away.

01-00:16:48
Meeker: Or Carter’s jaw-boning efforts.

01-00:16:50
Taylor: Jaw-boning. Yeah. So that was the focus. But the debt and the deficit is always related to inflation because people say, well, ultimately you’re going to have an easier monetary policy. It’s going to be caused by the debt and the deficits. That’s in people’s thinking behind inflation.

01-00:17:11
Meeker: So it sounds like what you’re saying, the concern about debt and deficits was secondary to a broader concern about federal government spending that was sort of juicing up the economy too much.

01-00:17:24
Taylor: It was part of it. Part of it. Although the deficit was definitely, definitely there as a concern—it was getting worse. You don’t want to go back too far in history but at one point we had a huge debt following World War II and I think it’s interesting that some responsible people said, “We got to deal with this” at that time. I gave a talk at the American Economics Association meeting this year and went back and reviewed the same series of talks that were given in the late forties. It’s quite remarkable. For example, Paul Douglas, who was an economics professor at Chicago, and then became a senator from Illinois. He dedicated his whole speech to the federal budget, saying that it’s a moral responsibility to deal with this deficit and this debt. To
some extent he became concerned about an over one hundred percent of GDP, debt to GDP ratio. That theme continued over time. We went through the fifties in that same mode. Then in the sixties, the idea of deficit spending became more conventional wisdom. You had fewer, if you like, fiscal conservatives out there. And I think that attitude continued into the seventies. And you began to have people more and more concerned. I think it grew in concern along with the inflation problem. So there’s this interesting trend in people’s concern about the deficit. Right after World War II, there were a lot of economists saying, “Geez, we’ve got to be worried. After the war there’s going to be a reduction in spending. It’s going to have a real hit to the economy.” That was kind of a Keynesian worry. It didn’t happen for many, many reasons. But we did have this greater focus on fiscal responsibility coming out of the war and it lasted for a while. But it kind of became less important. I think it’s, at least to some extent, because of the Keynesian influences, at least intellectually. There’s always pressure, of course, political pressures to spend and not to pay for it.

I think there’s a bit of a hazard for us at this point in history interviewing people about their perspectives in the 1970s on debt and deficits because of the high level of debt today compared to what it was then.

There was a debate staged at the American Enterprise Institute between James Lynn, who I believe at the time was OMB director, and Charles Schultze. And it was all about debt. But it’s interesting now going back and interviewing people. There was some debate about the degree to which it was an issue. So I appreciate your perspective here. You had mentioned in passing that one of the things you worked on under Greenspan at the CEA was tax reform. One of the things that has become apparent to us that’s a really key part of this story is the indexing of income tax rates and it passed in ’82 and was implemented in ’85 or something like that, and how that had such a profound impact ultimately on revenues coming into the federal government. Was there any thought at this point in time, in the 1970s when you were there, about indexing income tax rates as a part of tax reform?

Yeah, I think it was generally thought to be good to index as much as you could. That’s the argument made by economists. It’s more transparent. You give people more certainty about it. Also, the inflation rate was significant at that time and getting higher, so it really mattered. But as you say, the proposal didn’t really get adopted until later. The fact that there wasn’t indexing led to lots of confusions about what was going to happen with revenues. Some people would say there was going to be a big revenue increase. In fact, President Reagan, in his main argument for his tax cuts, said revenues were
going up a lot and that we don’t need to do that. I was not in the government at that time but it seemed to me those unindexed tax rates were a good rationale for cutting the rates.

Meeker: Okay. But at the time, it sounds like there was not a behind the scenes movement?

Taylor: No, I would say, in my sense, it wasn’t really part of a plan that it would be good not to index the rates because you’d have higher rate revenues. Basically what that does is it leads to more uncertainty about the tax system. You don’t know when the Congress will eventually make the adjustment, bring the rates down, the brackets down, I should say, to make the adjustment, and in the meantime it adds to confusion. So I think it’s best to have a tax system more stable through the indexing.

Meeker: Okay. So to wrap up on the Ford/Carter experience I want to ask you a counterfactual: I wonder, based on your position at the CEA, would it be possible to imagine what a second term Ford policy would have looked like? Particularly if you think about the overall economic context remaining the same as it was for Carter. So high rates of inflation.

Taylor: It’s a really a tough kind of counterfactual. Remember, President Ford vetoed the stimulus bill. It was passed over his veto. So presumably that could have continued. The thing that I would say, to answer your question, is most striking to me is that there’s kind of a cycle or a pendulum swinging back and forth between, what I’ll call, activist interventionist macropolicy and more rules based policy. I think the late sixties and seventies was a trend towards more interventionist policy such as stimulus packages. And then in the eighties and nineties there was much less intervention. I think you want to put monetary policy into this same framework, as well.

I mention this because if you look at these cycles they cut across different political regimes. Greater interventions started in Kennedy/Johnson. And then continued into Nixon, and then into Ford and then into Carter. That whole chunk of different administrations and different parties. And then in this period, which I think was much better, the eighties and nineties, you have Reagan and Bush 41 and Clinton. And then the more recent part, which I think is back to intervention again, is more President Bush 43 and President Obama. So it’s a very good question. It makes you think that the dynamics here are broader than the partisan politics that people focus on so much.
Meeker: Well, that’s an interesting macro-historical perspective, right? I’m wondering, stepping out of our narrative here, if you have any sense about what causes these broad shifts?

Taylor: Well, I’ve thought about it. I don’t know for sure. One possibility is there’s an economics intellectual background and you did have the Keynesian approach to policy coming in in the sixties and seventies. And so there’s that anyway. You asked me about rational expectations but that was also part of a movement away from that sort of activism both of fiscal and monetary intervention to more rules based policies. So that was intellectual. There was some intellectual foundations for that. In the more recent shift, one has troubles with that explanation because it’s hard to see an intellectual change for what I think of as more interventionist policy recently.

Meeker: Also, for instance, you’d have a continuity with the head of the Fed changing perhaps as—

Taylor: Yeah. Just toward the end of Alan Greenspan’s term. That’s a good point. I have to say that’s part of the reason why that intellectual explanation doesn’t completely fit unless we look at some other intellectual currents. Another possibility is simply the political theory in more general terms. I don’t mean partisan politics. But there is an association between sort of activist macro policy, both monetary and fiscal, and one’s view of government more generally. Are you more of a limited government type? Do you want to emphasize personal freedom more? And there’s a relationship there obviously. And so of course we did, in the late seventies, early eighties, have a shift towards questions about government. President Reagan, of course, and Thatcher brought those ideas in. So that’s another possibility. But I have trouble with explanation applying to the more recent times, too.

So the third explanation I would offer, and sorry to be so long with this, which I think is probably more convincing than the others, is that people and policymakers through the democratic system react to the bad policy and they change it. So in the late seventies, with high inflation, double digit inflation, double digit unemployment, double digit interest rates, a recession every four or so years, people just got disgusted. And so President Carter appointed Volcker and Volcker took the inflation problem on and with huge support, despite much controversy, and so changed it. And things then got a lot better I think. So that was the reaction, if you like, to the poor performance. The policy changed for the better.

But then what could happen in the other direction is that people got a little complacent. “Hey, things are going pretty well. You got these long expansions. Could be better, but geez, we got these long expansions.” Then
you give up your guard, if you like, against what is always there in terms of political pressures to intervene and do this. You got to do something all the time. And so that could be the part of the pendulum that swings it back in the other direction.

01-00:28:03
Meeker: So kind of an amnesia or something operating?

01-00:28:06
Taylor: Yeah. That’s got to be part of it. Definitely people forget lessons from the past. There are different people, younger people who didn’t experience the earlier times. But also the idea that even though things are working pretty well, we can even do better than that, and that may mean trying to go beyond what we are really able to do.

01-00:28:27
Meeker: So I see that you’ve written on the turning point of October 1979 after Volcker was appointed, the move toward a tighter monetary policy. And then I also see that you were an advisor or visiting scholar at the Federal Reserve Bank of Philadelphia from ’81 to ’84 or thereabouts.

01-00:28:53
Taylor: Yeah. I have to get the dates down a little bit better.

01-00:25:57
Meeker: First half of the 1980s let’s say.

01-00:28:58
Taylor: Yeah.

01-00:28:58
Meeker: At a time that you would have been there to observe some of the negative societal consequences of the tightening monetary policy? So the recession and the unemployment, high interest rates.

01-00:29:11
Taylor: Right.

01-00:28:12
Meeker: I’m wondering if, at that time in the early 1980s—actually, let me go back to ’79 when the monetary policy started tightening under Volcker. At that time did you think that this was—did you think, “Yes, finally somebody is doing what should be done in order to get a grip on inflation”? 

01-00:29:33
Taylor: Yes, I thought that. So just about my work at the Philadelphia Fed—it started a little earlier. As I’m thinking this through, yes it was a little earlier, in the late 1970s. And it’s important because what that enabled me to do is to see really how monetary policy was getting behind the curve. I’d put it that way. They knew they should raise interest rates when inflation picked up but they
were too slow and not by enough. And you could clearly see that when they were making their decisions. So I sort of saw that a little more clearly being in the Fed system at the time. And so Volcker was coming in and, taking on this job was definitely welcome to me, from my perspective. This was really what had to be done to get out of the problem of being behind the curve all the time. So yeah. I think it was good. There was a debate, of course, about how much of an impact it would have on the economy. There's some people who said it’s just not going to increase unemployment at all, which seemed to me crazy. But then you had some people who thought this was going to be worse than the Great Depression. So I had some models that sort of put it in between, if you like, a little more modest impact. Those are models which incorporated some rigidities into rational expectations models as a way of thinking about things. And I think that model turned out to be pretty accurate. And Volcker took the correct action. We never knew how much it was influenced by the academic intellectual research. I think he just knew what had to be done and put together a coalition. He was really a master at that. It’s hard to do all this on your own. But I think he was able to form a consensus at the Fed and it made all the difference.

01-00:31:17
Meeker: Is this when you’re thinking starts to coalesce around what becomes the Taylor Rule?

01-00:31:23
Taylor: Yeah, a little earlier than that. I had started thinking about policy rules actually, as I said before, at the beginning of our conversation, way back when I was an undergraduate. But formulated in this way with new models came later, in the late seventies, eighties. Yeah.

01-00:31:39
Meeker: Okay. So there you are at the Philadelphia branch of the Fed. You were supportive of the measures that Volcker took but now, I’m sure just as a citizen, you’re observing high unemployment, recession, high interest rates. It was a hard time.

01-00:32:01
Taylor: It was terrible.

01-00:32:02
Meeker: Terrible time. Did that ever make you sort of rethink what happened?

01-00:32:10
Taylor: It made me think about all the cost of that inflation which was created beforehand. It demonstrated the terrible price we were paying for what we did leading to that inflation. So that’s what occurred to me most, quite frankly. Again, I think in terms of the predictions, of the models, at least the ones I had were not too far from what actually happened. And then I guess the other thing would be the hope (because you don’t know the future) that things are going to be different once we get inflation down: we can have longer
expansions and less unemployment. And there was the question of whether
the Fed is going to overdo it. When are they going to get back to another
monetary policy? What will the monetary policy in the future look like? All
that we didn’t know at this time, but it worked out I think quite well for two
decades after that.

01-00:33:06
Meeker: What was the nature of the work you were doing at the Philadelphia Fed at
that time?

01-00:33:11
Taylor: Well, partly I was advising people about policy. But I’d say mainly it was
research. I was working on models, international models of the transmission
of monetary policy, examining policy rules, of course. So it was a
combination of giving my advice as an academic and also doing some
research, working with some of the staff on research at the time. It wasn’t like
I was going to the FOMC meetings or anything like that. I was a one day a
week person coming down, originally from Columbia, but later from
Princeton.

01-00:34:01
Meeker: Yeah. You were a full-time faculty member.

01-00:34:02
Taylor: Yes, exactly.

01-00:34:03
Meeker: And teaching courses and advising graduate students, I imagine.

01-00:34:04
Taylor: Right, yes. So don’t overdo my influence at all.

01-00:34:06
Meeker: Sure. Well, then, maybe we should move forward to the period of time that
you served as a member of the Council of Economic Advisors under George
H.W. Bush. But before we get to that, I’m just kind of wondering if you have
any thoughts on the 1988 campaign. And first of all, did you play any
advisory role to H.W. Bush during that campaign? To his economic team?

01-00:34:34
Taylor: No, not really. Minimal basically during that campaign. Yeah. I did work on
other campaigns later but not that one.

01-00:34:44
Meeker: Okay. Well, we’ll talk about those later ones. I’m wondering, then, about how
was it that you were selected to be a member of the Council of Economic
Advisors?
Taylor: Well, I would say that I was always out there looking for it, indicating enthusiasm. But Michael Boskin, who’s my colleague, was the chairman. So he basically must have been a big factor in that decision.

Meeker: So you were at Stanford by then, yes?

Taylor: Yes.

Meeker: Good. So Boskin, of course, was the chair of the Council?

Taylor: Correct.

Meeker: And you were one of the two additional members. I wonder, as just an observer then, as an economist-citizen-observer of the 1988 campaign, about the ways in which people were talking about it. There was a certain extent that Bush was kind of presenting himself as the third term of Reagan: stay the path or something like that. But there was also a way in which he was trying to present himself as different: pointing out that there were some excesses of the 1980s. The increasing debt and deficits being one of those excesses, and that he was going to maybe take a more moderate conservative path to those. What did you think about the way in which he was communicating his economic agenda prior to being elected? And the other thing to add to this is his “no new taxes” pledge, which a lot of people say was great politically at the time but also he tied one hand behind his back in order to deal with the deficit problem. I think that’s the way that Greenspan writes about it in his memoir. So at the time what were you thinking?

Taylor: Of course, it did change when he was President.


Taylor: The revenue enhancements were back. From my own perspective, I would have preferred a more, in a sense, consistency with Reagan on those issues, okay.

Meeker: What would that have looked like?

Taylor: Well, we wouldn’t have the tax increase. We wouldn’t have the agreement for revenue enhancements. My own view of that would have been certainly consistent with my philosophy of keeping things steady. We had been able to
take efforts to deal with some spending towards the last part of Reagan. We’ve got the tax reform coming in towards the end of the Reagan Administration. Sticking with that would have been better. Again, the deficit problem at that point seemed to me not being due to the tax side. We had basically that good tax reform and so sticking with that I think would have been my preference at the time.

Meeker: When you say tax reform you’re referring to the 1986 Act?

Taylor: Yeah, yeah.

Meeker: That was supposed to be revenue neutral, though, correct?

Taylor: Right. Right. Actually, exactly. So then we had proposals to raise taxes later coming in. I think what I’m saying is the same as that. Yeah. So just generally, I think it would have been a little better for the economy and for the politics. But it would have been better for the economy to have stuck with the pledge in the campaign. And I have no idea where the pledge came from. I wasn’t involved in the campaign.

Meeker: We have some other people who have given us a little insight into that. When you’re a member of the Council of Economic Advisors, this is a full-time appointment.

Taylor: Absolutely full-time. More than full-time. You get into those jobs and you’re suddenly a workaholic no matter what you were before.

Meeker: Okay, yes. No such thing as a weekend for a couple of years there.

Taylor: Yeah, right.

Meeker: I’m wondering, when you get into the Council, did you have a particular idea of what role the Council should play in the creation of fiscal policy? And I’m thinking of this in the context of an economist, yourself, who’s more interested in rules-based, less convinced that a government’s fiscal policy, an interventionist fiscal policy, is actually going to help the economy more than it might hurt it. And so as an advisor for the President’s fiscal policy, is there much to do other than tell the President not to do much? I know that sounds like a naïve question but I’m finding it—
Taylor: Absolutely. No, that’s a very good question. Actually, behind you there’s a Wall Street Journal piece from I think those years which has me on the front page, one of those little sketches. The article says here is an economist saying do nothing, just at the time where they’re having more influence. But I’d say the idea is to emphasize the importance of systematic policies, predictable policies. Not changes in the law willy-nilly. And there’s lots of opportunities to do that. And there’s also lots of opportunities to be constructive and do things that are not going to be unpredictable or disruptive. So I think there’s just plenty of things to do. Some people say that 90 percent of the CEA job is to stop bad things, and I think there’s some truth to that actually. I observed that back when I was on the CEA staff with Ford and Carter. The switch in politics left the economists in a similar position across that switch. But it’s also important to take 10 percent and make sure you push your agenda of positive things you want to do, whether it’s tax reform or IMF reform or whatever it happens to be. And you push that agenda and help as much as possible in a constructive way. So you need to do both of those things.

Meeker: So emphasize the systematic and the predictable. What are some examples of these efforts during the period of time that you were a member of the CEA?

Taylor: Okay. So maybe I can talk about monetary policy a little bit, because my job was to liaison with the Fed. I knew Alan Greenspan quite well. I worked with him in New York when I was at Columbia. Worked at his firm.

Meeker: Yeah. Townsend-Greenspan.

Taylor: And of course I got to know him when he was the chairman of the CEA. So I’ve known him for a while. So I had lots of opportunities to talk with him and the Fed people. So I was interested at the time in whether there could be an articulation of this more rules based policy for a monetary policy.

Meeker: Like a public articulation.

Taylor: Public articulation. Yes. So, in fact, the Economic Report of the President, the first one that we wrote for President Bush, had a chapter on rules based monetary and fiscal policy. And the monetary policy side was a policy rule like I’ve advocated, but not numerical. It was the kind of thing that the Fed would be happy signing on to, because, remember, the Economic Report of the President is sort of an agreement, as much as you can, across different agencies. And so that was a big deal. It helped the Fed. There were other interpretations of what Greenspan was doing. Sometimes people called it the Greenspan standard. And so this I think helped articulate that there were some
systematic aspects to the policy. And on the fiscal side, fiscal policy side, there were some proposals to try to deal with entitlements in the future with a rule in which part of government would be saving for the future. Rationalizing this rule is also in the Economic Report of the President. So those were the things. I also worked a lot on international policy at the time and so the rules based aspects of that are simply good sound trade policy. So there was a lot of contention with Japan at the time. That was the economic rival people focused on. So we developed various strategies to tone down that rhetoric and have an engagement with Japan which could be productive to both sides.

Meeker: I wonder the degree to which reducing deficits was something that the Council was particularly concerned with and involved in coming up with solutions.

Taylor: Yeah, no. I think it definitely was and we had, of course, a lot of debates about what to do. And President Bush was very engaged with that. So he was very concerned with the deficit. Absolutely. And he was trying to be constructive in his revenue enhancement statement. Absolutely. It was a lot of concern.

Meeker: I wonder if you can kind of unpack that a little bit for me. What were the nature of the debates? What were some of the interesting solutions that came up that maybe didn’t go anywhere? But the ways in which the economists were thinking about this.

Taylor: There were debates early on about what to do about it. All right. There was a meeting out of Camp David, I remember, where the President invited several economic policy experts, and Paul Volcker was there. I believe Art Laffer was there. You had a mixture of people weighing in on what to do. So there was quite a bit of deliberation. How are we going to deal with this problem? And ultimately we came to the decisions that were made and that’s what he did. So that was a very conscientious effort to deal with it, and I think ultimately the efforts were well meaning and constructive. I just mentioned, a few minutes ago the only problem I had with it. But that was the political way it was handled. I don’t know if I could—what else I could say, except there was this intention and actions were taken.

Meeker: So when you talk about the actions that were taken, you’re primarily referring to the 1990 Budget Enforcement Act and the budget that was passed during that year?

Taylor: Right.
Okay. One issue might be the relationship between the Fed and the White House or at least Bush’s cabinet and also the relationship between the Council of Economic Advisors and Bush’s economic team, in particular Secretary of Treasury Brady and Richard Darman, who was the OMB head. I’m wondering if you can give me a sense of what you thought of both of those individuals and the shops that they ran during the years that you were there on the Council.

I was mostly interacting with Brady on the international side. David Mulford was the undersecretary. He was doing the Brady plan, which we were supportive of and were helping on the analytics. But that was their responsibility. And this period was really the beginning of doing some of the things to help transitional countries develop markets. I would say not so much emerging markets but the country’s emerging from central planning, such as Poland. So we spent a lot of time with them. We had a stabilization package for Poland at the time, so I traveled to Poland, interacted with the Treasury on those issues.

Darman was really a hard driven person trying to get some things done. He was driving a lot of the stuff on the budget deals and how those would work. I think he was very influential and very strong.

OMB is a big office and they have many economists working for them. To what extent was he engaging with the Council and your staff?

I’d say that there was good engagement with the CEA and the Treasury on those economic issues. There’s an effort, when you do the economic forecast, to be part of a team which include the OMB, Treasury, and the CEA. That’s done at various levels, including staff members and principals. I think worked quite well. In fact, one of the questions you might ask is about the forecast. I know we did pretty well but we were disciplined by staying pretty close to the blue chip forecast. Unless you have a really good reason, you don’t want to deviate from what is out there and the sort of conventional wisdom in your forecasts. But I think that process worked pretty well. Quite cooperative. And with the people I dealt with, it was good. With Secretary Brady, Nick Brady, most of my interactions with him were on the international side. He had a number of complaints about the Fed at the time and I think he still does about that particular period. But I was not as critical of the Fed, by any means, as he was at the time.

According to the accounts that have been published since then, it sounds like he was trying to get some assurances from Alan Greenspan about the degree to which the interest rates would be raised or lowered, the money supply
would be tightened or not. With the concern in mind that there was, it seems like, a fairly widespread fear that the economy was going to be slipping into a recession and that Brady, thinking both about the economy overall, and also thinking, I imagine, about the political prospects of his president, wanted to prevent that from happening.

Taylor: Yeah. So I don’t know about the specific conversations that took place between Nick Brady and Alan Greenspan, if that’s what you’re getting at. Zero information. I’d say that my own view is that one of the most important things about why things worked well in the rest of the nineties was that the Fed was able to make their moves as they saw fit in terms of raising the rates when it was appropriate. They didn’t forecast the 1990-91 recession any better than anybody else. Basically it seems to me that their decisions were pretty close to what they should have been doing at the time. We did have a terrific expansion after that period. We came out of that recession and longest expansion in American history. And I think that the Fed deserves a lot of credit for that.

Meeker: So thinking about leading up to the 1990 budget agreement. This is, of course, an extremely politically charged issue and we interviewed chief of staff John Sununu recently about this and he provided a really interesting in the trenches account of what went on. His account says that Bush basically could have gotten the savings. In other words, the deficit cutting approach without having to raise revenues, but in the end he was sort of betrayed to a certain extent by Gingrich, which then put Democrats in a position to raise taxes, which they did not because they needed to but because they were going to gain political capital by forcing Bush to do so. And they did raise revenue, enhanced revenues.

Taylor: Yeah, right.

Meeker: It was the gas tax and a few other things. Not like a major income tax increase or something. I’m wondering what sort of advice the CEA gave Bush on the 1990 budget and, from your interpretation, the degree to which he chose to follow that particular path or not.

Taylor: I would say that the CEA, as a whole, did not take a position about his compromise. That was the President’s decision. But I was not in those negotiations and if you talk to John Sununu I think he can provide much more information than I can. As I said, my own view is that we could have gotten away without the tax increase and it would have been better. Sounds like what you’re saying, that John Sununu agrees with that. I didn’t know that, that’s for sure. And I think it’s one of those things that you’re negotiating, you don’t
want to negotiate with yourself. You need to hold firm. I think what would have been the right thing to do is to resist that tax increase at the time.

01-00:53:24

Meeker:

But I guess what I’m asking is really what was coming from—what sort of advice was coming from the CEA at the time regarding the options?

01-00:53:33

Taylor:

Well, I’d say mainly it was that you’ve got to deal with this deficit. With respect to where it was going to happen, on the tax side or the revenue side, my own view would be to emphasize the spending side. Whether that was the only view coming out of the CEA I can’t tell you.

01-00:53:51

Meeker:

Personally, then, how did you feel when you saw the agreement, the compromise agreement that was reached?

01-00:53:58

Taylor:

The revenue enhancement side was something I had responsibility to talk about. I’ll give you a little anecdote about that. Once the decision was made, we were asked to communicate about it and so I had a list of people to call. One of the persons on my list was Milton Friedman. He was here at Stanford. I was in Washington. As soon as I got him on the phone he said, “You don’t have to say anything. I know why you’re calling and the answer is no. And by the way, you better come back from Washington to Stanford soon because you’re getting corrupted.” I was called on to talk about the deal. I’m in the administration. That’s my responsibility. The President made the decision. Again, you asked me if I would have liked to. I can say no now but at the time I had responsibility to call Milton Friedman and I got a big no as loud as possible.

01-00:55:03

Meeker:

You were going to ask him would he come out in support of it?

01-00:55:05

Taylor:

Yeah, basically. Would he say something about it in support and whatever. We didn’t get that far.

01-00:55:10

Meeker:

I wonder the degree to which the White House accepted the recommendations of the CEA on highly political issues, such as the budget, versus more obscure issues, because I’m sure the CEA was also advising the President on issues that—

01-00:55:33

Taylor:

Trade policy.

01-00:55:34

Meeker:

Trade policy. Yeah. There are certain interests that have a stake in that game, as well.
Taylor: Sure.

Meeker: But did you feel like there were certain things that you were working on that weren’t going to hit the cover of the *Wall Street Journal* or the *New York Times*? That political considerations were less of a consideration and that your recommendations would have had much greater sway?

Taylor: I think trade policy would be an example of that. I mentioned dealing with Japan and how we were doing with them. Basically President Bush seemed to be completely supportive of all of that. And he also had a trade policy team, a strong alliance between CEA, OMB and the Treasury, arguing it’s good economics, it’s good for the country, and so resisting some of the pressures. We set up a program to engage with Japan and to sort of reduce the pressures, the political pressures there. So those are more micro issues which seemed to me to be really an important—very, very important part of the CEA. They have to speak out when they have something to say. The CEA represents the consumers rather than particular industries. And there’s pressures from commerce, from labor, sometimes even from USTR that you have to resist. And I think basically I feel pretty good about that.

Meeker: Can unpack that a little bit? If you can give me a sense of what the trade policy was, that there was some agreement between OMB, Treasury and CEA.

Taylor: Well, it would concern, for example, how to deal with Japan. Under the ’88 Trade Act, the Administration had to designate countries as unfair in some way. The argument was over how to proceed. The CEA hoped to find some other ways to reduce that pressure. And so the specific program was called a Structural Impediments Initiative talks, which involved myself and colleagues from USTR and Treasury and Commerce. We would go to Japan and the Japanese would come to the U.S. We’d have a list of things, structural changes to do. We’ll work on our deficit. You work on opening your economy to more competition. So that would be constructive to both of our economies. The SII was heavily driven by the CEA. I think it helped dull the sharp edges that might come from Commerce Department on these kinds of issues or from Labor Department. So I think of it as an important accomplishment at the time. NAFTA was moving through at that point. We had a lot of enthusiasm for NAFTA, which ultimately was passed with President Clinton. But that was a lot of work to try to get that going and go beyond Canada and include Mexico.

Meeker: Negotiating during the Bush Presidency passed on to Clinton.
Meeker: I do want to talk a little bit more about the relationship between the White House and the Fed at this time, because I think it’s interesting and there was some tension there and I think in that tension is—rather instructive. So Bush basically cautioned the Fed against tightening interest rates sort of throughout his presidency and clearly these words were not well received by Greenspan or the Fed overall. They liked to remain separate and not feel political pressure. I’m wondering if you have any thoughts on the administration’s strategy for dealing with the Fed, especially because it sounds like you are also a big believer in the separation of the Fed from the White House. Were you uncomfortable with the way that the White House was approaching the Fed on these issues?

Taylor: Yeah. I think it would have been better not to take the approach they took, especially to the extent that it’s public. Again, as I was saying, my efforts were really to describe what the Fed was doing in a coherent way to try to help them, if you like, help the Fed explain what it was doing. So I think that the lesson from that, and I think that’s the lesson we learned, is that that really wasn’t a constructive part of the policy. I think they’re very well meaning. Secretary Brady was very much well meaning. In a democracy, this independent agency may have too much power, so you should be weighing in, the Congress should be weighing in. But I think it is important for the Fed to be able to remove itself from the day to day intervention of whether interest rates should be higher or lower from the administration or from the Congress. They should have a strategy and if they deviate from that strategy they should be accountable to the Congress. I’ve written about that. The administration should certainly communicate its views. There are plenty of opportunities. Lunches with the Treasury, lunches with the CEA and the Federal Reserve Board. So there are lots of opportunities to talk. And you should not necessarily raise the subject of interest rates at each meeting but figure out what’s the outlook for the economy. I think that’s fine. But I think, in effect, after this period, I think during the Clinton Administration, there was much less of that. Secretary Rubin deserves credit for sort of stopping a lot of that kind of conversation, which I think was beneficial. The 1990’s expansion started with the Bush Administration, but the expansion continued for a long, long time.

Meeker: Well, so it sounds like from your position at the CEA you counseled other people within the Administration to—based on your perspective that it’s important to maintain a separation and that, for instance, basically that Greenspan was applying the appropriate monetary policy at that point.
Taylor: As much as possible. As much as possible. I was doing lots of other things, too. But the *Wall Street Journal* piece I just referred to is about that. The Economic Report of the President articulated a policy which is close to what the Fed was doing. So that piece probably had some influence within the administration. People talked about it. But there’s other ways to communicate. You discuss it with individuals. I was one voice of many, quite frankly.

Meeker: Sure. Do you know how this position of yours was received in the White House? It sounds like it was listened to but it also sounds like it was maybe—

Taylor: Well, some of the conversations you’re asking me about may have taken place with Brady and Greenspan. I just don’t know about them.

Meeker: You didn’t really get any feedback from the perspective that you were offering?

Taylor: I got positive feedback about what we were doing. Whether that affected conversations, I don’t know. But definitely positive feedback. Absolutely.

Meeker: Yeah, I don’t mean to ask you to speculate as if you were in the room.

Taylor: No one ever objected. They seemed to be appreciative and so as far as I can tell it was positive. And I think as far as I can tell, I don’t know, the Fed went ahead and did what it was going to do. So the only thing, I would say, is that maybe there were some conversations which I don’t know about which could have pursued the approach which I wouldn’t have been so pleased about.

Meeker: So also from your vantage point at the CEA, were you ever asked, or did you ever witness any conversations about the decision to reappoint Greenspan? It sounds like there was a period of time that that was not for sure.

Taylor: To the extent that I was asked at all, I would have been positive about Greenspan. But I don’t really remember a lot of the specifics about that.

Meeker: I’m trying to remember where I read this but it was a brief publication of yours in which you were talking about the actual immediate positive impact of a deficit reduction strategy. This must have come out in 1993 or thereabouts. But you were trying to evaluate through an econometric perspective whether there would be an immediate sort of positive impact on markets of legitimate deficit reduction regime or program. I’m wondering if you can tell me how
was it you came about to this particular topic and what the response was to your—

Taylor: I believe I started writing those kinds of pieces in the eighties. I built a model, a multi-country model. It had rational expectations, so people were forward looking. It also had rigidities of various kinds. But because people were to some extent forward looking, you could at least see what was the value of laying out a credible plan to reduce the budget deficit. Could you get some immediate action? And since the budget deficit was a problem and people had fears of taking actions, it seemed to me that looking at this perhaps positive impact that could occur would be worthwhile. So I simulated this in my model and found you get some beneficial effects very soon because interest rates would come down. Basically people would see, oh, the deficits are not going to be so high down the road. Maybe because of government purchase it’ll be lower, so that will tend to lower interest rates now and so you get a very quick crowding in of investment and that’s what I found. And I wrote about that a lot. I still write about that. I think it’s an important reason to get started with a credible plan to reduce the deficit now and that’s what I thought then.

Meeker: What made, according to your perspective, a credible plan? It seems like that’s an important definition.

Taylor: Yeah, absolutely. Well, it’s got to be in the law. It can’t just be something we’ll promise to do. Can’t be like a proposal to take care of the problem later. It’s got to be part of the law. These days, I think it’s important that it be scored by CBO as dealing with the problem. So the way I talk about this now is CBO is projecting extraordinary explosion of the debt to GDP ratio. That’s based on mainly current law, but a little bit of their thinking about what will happen to the law. So they’re taking what’s there and evaluating it. So the idea would be that we change the law and you give it to CBO and then they project declines. That would be credible because the CBO has credibility. And I think that would be a goal. It’s hard to get there, but that would do a lot for credibility. If you want to think about the political economics, the more that the people who vote are comfortable with that, then it becomes even more credible.

Meeker: So then what about using this perspective to evaluate what happened in 1990? Did that seem to you like a credible plan for deficit reduction?

Taylor: I think it was, as these things go, pretty good. It also had sort of a longer term enforcement act as part of that. I think that was constructive, absolutely. In fact, of course, we did get the deficit down and ultimately into surpluses by the end of the decade. So you had some help. I think in the nineties, the
decline of defense by roughly three percentage points of GDP was huge in terms of getting a hold of this problem. And in the eighties we got other parts of discretionary spending as a share of GDP down and then in the nineties it was mainly defense. So the plan came about. It was part of the reason why the nineties were good.

Meeker: Okay. Very good. I think I’ll stop there and hand it over to you to ask a few questions about the international context. Thank you.

Sharma: So let’s skip ahead to your service in the George W. Bush Administration. I know you’ve written a lot about it. You wrote your book that came out recently about it. Can you just start off by—and if this is repeating what you’ve written—just indulge us for a little bit. How you got involved with the Bush Administration, the second Bush Administration.

Taylor: I worked in the campaign pretty actively. Went down to see him in Texas when he was thinking about running and spent a lot of time in the campaign. And so when he was elected, there was an opportunity to work in his administration. The position I ended up taking was the undersecretary of Treasury for international affairs, which I had always found to be a job that would be interesting. I mentioned I think previously in this interview, David Mulford had that job before. In the Clinton Administration. Larry Summers had the job for a while. In terms of actually doing things, operationally, I think it was a very good job that I wanted to have.

Sharma: And talk a little bit about the initial issues you faced there. I know that dealing with the tracking and shutting down terrorist financing was a major issue.

Taylor: Well, yeah. So when I went into the job I had all expectations of flying to Paris and doing negotiations on this and that, but then 9/11 hit. Things changed completely because of 9/11. And the first way things changed is we were called on to build an international coalition to try to freeze bank accounts of terrorists or people associated with terrorist groups. And so we very quickly put together an international agreement to freeze assets. We started with the G7, which is where I would normally begin my conversations, because I’m pretty close to my counterparts in the other G7 countries. But then it expanded very rapidly to freeze assets. That was the first thing that happened after 9/11. I was constantly going to the White House for NSC meetings and finding out about the threats of poison in the reservoirs and airplanes flying into nuclear power plants and things like that. It was a very scary time.

Sharma: Was that normal? This is sort of an aside, but normal? You start your book by mentioning how you could have titled it Adventures in the Situation Room and
you were a regular participant in those meetings. Is that something that was
the norm for people in your position or is it—

Taylor: I think it varies over time. That particular period got so busy with the 9/11
kinds of things that I just had to play a bigger role. There’s now an
undersecretary at the Treasury that specializes in financing and issues related
to terrorism. Stuart Levey took that job. He actually just recently stepped
down. So he stayed into the administration of Obama. On 9/11 they didn’t
have a position like that and so as a result I was doing a lot more. Plus the
regular jobs. Financial crises were brewing in Brazil, and Argentina. We had a
recession which was still ongoing. So there were a lot of things to do and I
ended up doing more than probably normal. And, of course, later on you have
Afghanistan and Iraq, where there was a lot of international stuff.

Sharma: Right. And you’re directly involved in sort of the financial rebuilding, the
economic rebuilding of those countries. One of the interesting issues,
international economic issues from the early Bush years, was the debate over
steel tariffs, right, and this is the famous instance of the Bush Administration
overriding the advice of the economic policy advisors and adopting steel
tariffs in 2001. Were you involved in those negotiations at all or—?

Taylor: Not that much, actually. That’s as I was just coming in. So I know what
you’re saying about the economic advisors, but it was just at the very
beginning of the administration. I was sympathetic with what my boss was
saying. It was Paul O’Neill at the time. But I was not directly involved in that.

Sharma: Let me ask you a little bit, to get back to our topic about fiscal policy and
deficit politics. Were other nations, other advanced nations, concerned about
mounting US deficits, especially as they became larger over the course of the
early 2000s?

Taylor: Yes. I would say that in discussions internationally that I’ve had, and this goes
back actually to the conversation about the Structural Impediments Initiative
with Japan in the late eighties, early nineties. There’s always been a focus on
the U.S. deficit. It’s like if we complain about something in Japan, they’ll talk
about our deficit or sometimes our low savings rate. And so the same thing
was true when I was back in government as undersecretary of Treasury. It’s
kind of the main thing that people focus on in other countries about the U.S.

Sharma: My hypothesis that this is born of a bit of jealousy, the fact that the US has
been able to run deficits because it can borrow relatively easily. Is that sort of
jealousy behind this?
Taylor: Could be. I’ve never thought about it quite that way. It’s something that people think should be fixed. You’re looking for various ways to get your own position. You might not want to be criticized for this so you’ll find something to criticize the others for. And by the way, that means that, say, if you representing the US, you’re going to automatically downplay the significance of the deficit, right, because it’s going to be like a point of negotiation. So it’s a natural way that the international things took place but I never sensed the jealousy aspect to it but could be behind the thinking.

Sharma: Can you help me think about this a little more because one of the things that we’ve been grappling with, especially trying to understand our current situation, is that the US has this large structural deficit and it’s had it for a while. There doesn’t seem to be a political solution to this. Doesn’t seem like anything’s credible. It’s amazing in a lot of respects that the US is still rated a AAA—T-bills are still a AAA investment.

Taylor: We’ve respected our obligations since the founding of our country, so it goes back a long way.

Sharma: We have. Right, right. Especially the fact that interest rates have remained so low, and there’s this theory out there that one of the reasons that, theoretically, with large government borrowing, interest rates should rise, right? That US has been able to borrow so cheaply because the pool of capital, global capital, has risen so rapidly. I’m not phrasing this properly but that basically the US has found more creditors.

Taylor: The economy is weak and so that generally makes interest rates lower than they otherwise would be. And even globally, although we got very strong growth in emerging markets, globally it’s still weak. So I think that’s one of the reasons why rates are low. Of course, they’re picking up now pretty sharply as the economy recovers and other things are happening. Inflation concerns are beginning to rise. So in a way, I think the concerns I would have about this gigantic debt, which is—by the way, it is an order of magnitude different from the periods that we’ve discussed in this interview so far. You’ve got government spending jumping from twenty-one to twenty-five. Actually, in 2000, government spending as a share of GDP was 18.2 percent. 2000. That’s the end of the Clinton Administration. 18.2 percent. It’s now hovering around twenty-five percent. That’s the reality. There’s no projection there. So it’s a gigantic problem. And, of course, the deficit, with optimistic assumptions, is extrapolated to rise quite a bit. So I’ve never really seen it like this in my experience in government. This must have been what it was like in the late forties when the people I spoke about at the beginning of this
interview were saying it’s a moral issue. So it’s unlike anything I’ve ever seen before. Much different.

Sharma: And as someone who has dealt with developing country debt so extensively, are there certain parallels or points of comparison that you can draw?

Taylor: Unfortunately yes. The fear you have is this gets away from you. You see what happened in parts of Europe. It’s very similar. It’s so ironic. The emerging markets used to have this problem. In the period of maybe 2001, ’02, ’03, after Argentina, they sort of got their act together, it seems to me. Brazil started following sensible policies and I think India and China, Turkey even. So they have performed better. In the meantime, we performed worse. So it is a concern. We can get our act together if we focus on it and I think there’s some promising developments that are working in that direction. But it’s still a long way to go. If you believe as I do, you shouldn’t be raising taxes much because that’s not really the problem. You’ve got to somehow get spending back to 19 percent of GDP.

Sharma: And to do that really means tackling the non-discretionary portions of the budget, right? The Social Security, Medicare and Medicaid.

Taylor: Yeah. It does. I would say the first thing is to deal with the budget that’s there right now; the 2011 budget is not finished yet. So we were talking about making something credible and stressing the advantages that a credible plan to reduce the deficit will bring. So one of the ways to get credible is to start with it now. And really what’s the discretionary spending that has increased so much in the last couple, three or four years, really? It has increased a lot. And so I think it’s important to start there. People rightly say it’s only part of the problem. But you’ve got to start with what you can do and that’s a very visible, demonstrable thing to do.

Sharma: I see. From your perch at Treasury during the Bush Administration, were you concerned about the mounting debt and specifically some of the expanded spending of the Bush years? Was this something you—

Taylor: Well, yes. Yes, definitely. The spending was beginning to rise. I was in favor of the tax cuts. Argued for them in the administration and helped in the campaign where those tax cuts were first proposed, the 2001 tax cuts. So I was very supportive of that. But you just can’t do that and not deal with spending, let spending go up. There were, of course, pressures, legitimate pressures on spending because of 9/11 and the extra expenditures associated with that, the so-called security expenditures, including defense. But I think other things
could have been done to control the growth of spending more than we actually did.

Sharma: And so with respect to those tax cuts, did you have concerns about the potential fiscal impacts of this as far as reducing the flexibility for dealing with a budget deficit in the future?

Taylor: Well, if we had been able to hold spending to eighteen, nineteen percent of GDP, where it was in 2000, then no. But that didn’t happen. Now, to be sure, by the end of ’97, look up the numbers—sorry, by 2007, look up the numbers, it probably had revenues over eighteen, close to 19 percent of GDP. So you’re basically there. You had the recession which brought revenues down and that was the main reason why the deficit increased then. So by the time the end of the Bush Administration came about, before the next recession, the great recession, we were pretty close. One and a half percent deficit.

Sharma: I see.

Taylor: So it was sort of working but the problem is spending was going up and it’s continued to go up even more than I could possibly have imagined.

Sharma: Right. And the economy experienced such a downturn after the dot.com crash.

Taylor: Yes, absolutely.

Sharma: Alan Greenspan was on record when surpluses emerged in the late 1990s, talking about the—he became concerned that a surplus could be destabilizing, just as a deficit can be financially destabilizing. Did you have any of those sort of concerns?

Taylor: No. Again, defense spending had come down pretty rapidly in the nineties. The last part of that was a pretty good boom and you had income distribution shifting towards people paying a lot more taxes and so all those—a lot of capital gains were coming in. So it didn’t look like that was something you could count on. But so often in these projections—I think the CBO was projecting the debt to GDP ratio would be like six percent now, right now. Their ten year projection back then basically would have eliminated the debt. So you probably should be thinking about it as a contingency plan. What is the Fed going to buy if there’s no government debt, for example.

Sharma: I see. Yeah.
Taylor: I believe that’s what Al Greenspan was thinking about. So turns out they have bought a lot of other things besides government debt anyway, so—

Sharma: So can you, in a broad sense, assess George W. Bush’s fiscal legacy? How do you think about it?

Taylor: Tax cuts were very good to do, and, in fact, it brought rates back to where they were, closer to where they were at the end of the Reagan Administration. I think reducing the tax rates on capital investment was important. Most economists argue that as a matter of efficiency and growth you shouldn’t have taxes on capital at all. We brought them down quite a bit. That was in 2003, of course. I think on the international side, there was a lot of good progress on the IMF and the World Bank and dealing with emerging markets. I think that President Bush deserves a lot of credit for that, as well. I think on the trade side, there was the steel tariffs, but basically there were a lot of free trade agreements which were opened up and pursued and that’s kind of stopped at the end of his term. So those are all quite important. And that leaves you probably your questions about spending and spending just grew too rapidly.

Sharma: Yeah. Do you remember any debate? The major spending bill being the Medicare Part D expansion.

Taylor: That’s something I was not involved with even remotely. My job was completely in a different area. Maybe I had some conversations about it with the Secretary of Treasury or others. But not very much.

Sharma: Okay. And then I just have one last question. As someone who was involved, who has been involved in Republican politics over many decades, have you seen changes in the Republican Party’s view on fiscal policy? And I’m thinking here specifically of what I see as a shift from Republican Party in the forties, fifties and through the sixties that was primarily concerned about balanced budgets to one that today is primarily concerned about tax cutting. Is this a fair assessment of the change or how have you seen things change, if at all?

Taylor: Well, I think right now, especially after the November election, last November election, you’re seeing some changes. And you’re also seeing the frustrations the Republicans have had with themselves for the spending that you just asked me about. So I think there’s a major shift back towards, if you like, fiscal responsibility in the party. It’s not clear that’s going to actually take place. I’ve seen a lot of the new members; they are enthusiastic and they ran to deal with this problem. Washington’s a tough place to survive in and so it remains
to be seen if they’ll be able to pull it off. But I think it is a change. We got off track in terms of concerns about spending, I would say, spending and debt and deficits, which goes back to the late sixties and seventies. It seems to me you saw some changes there. Less concern about deficits and debt, less concerns about spending, and so I think they’re getting back to that as far as I can tell. Hope so.

02-00:28:55
Sharma: I see.

02-00:28:56
Taylor: But it remains to be seen.

[End of Interview]