PETER HART ON THE WAYS WE'VE ALL CHANGED

Forward

Global Perspective From MSCI

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IT'S GETTING A LITTLE CREEPY OUT THERE

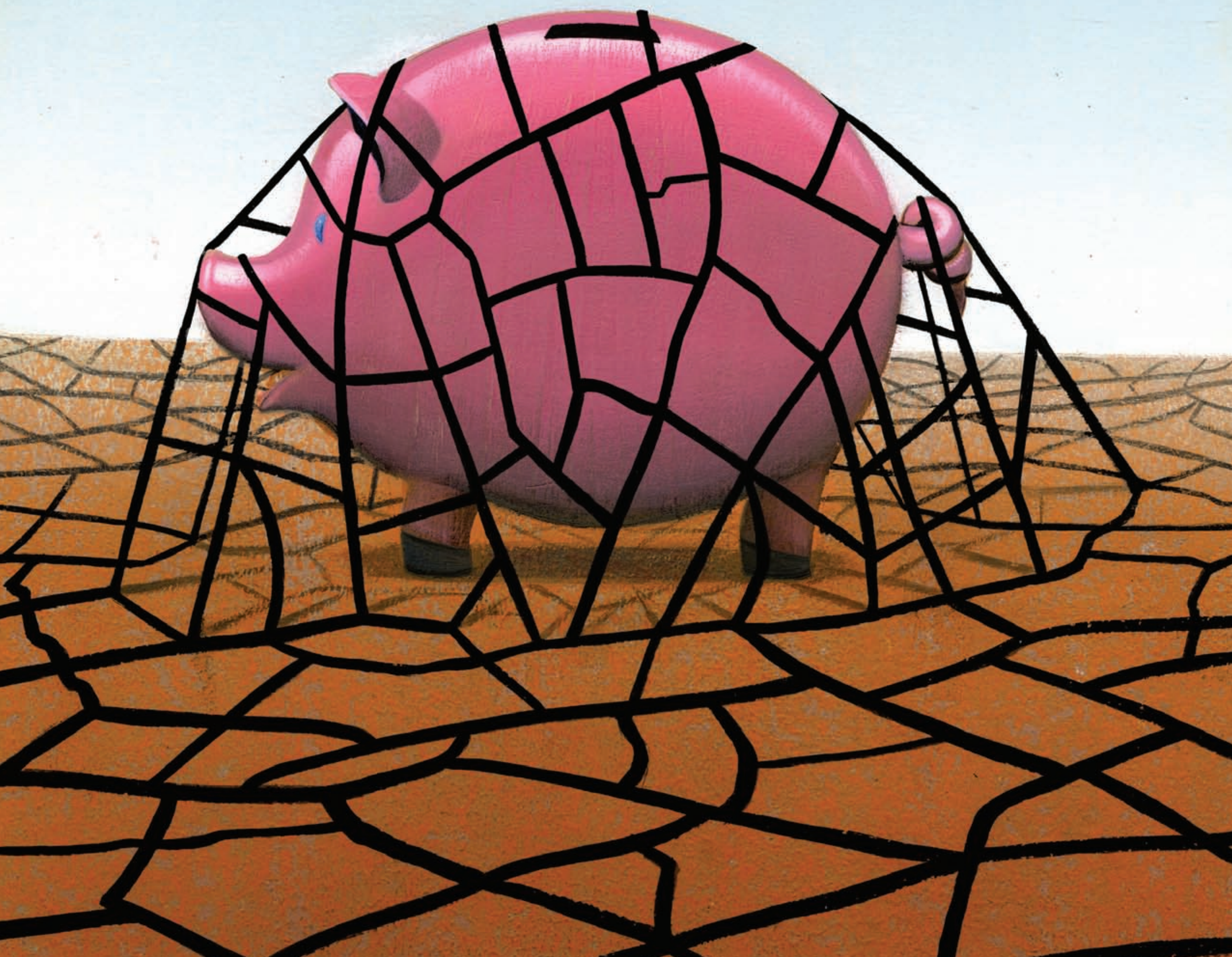
OUR PANEL REVIEWS ECONOMIC POLICY

A Supply Chain Theory/Practice Omnibus

America's Top Ex-Spy on Intelligence, Mistakes and Threats

Metals Service Center Institute

A group of four senior economists evaluates 18 months of economic policy and finds it bad. *Very bad.*



Net Losses

Introduction by Steven B. Weiner // Panel moderated by Margo Thorning // Illustration by Jon Krause

Forward magazine has a tendency to posture as a know-it-all publication, as befits any serious business journal that purports to offer thought-leadership to its readers. But, occasionally, we are forced to acknowledge that others know more than we do, and the best course is not just to interview, but to consult with our betters.

Such was the case recently when, through the good offices of the American Council for Capital Formation (ACCF), a group of four senior economists who serve on the ACCF Center for Policy Research Board of Scholars, including one winner of the Nobel Prize for Economics, gathered to discuss U.S. economic policy of the last 18 months. The ACCF was a particularly good choice, not only because of its blue ribbon list of ACCF scholars, but because of its mission: To bring "the message to U.S. and international policymakers, the media, and the public that a nation's economic strength and stability depend upon well-thought-out economic, regulatory, and environmental policies to promote capital formation, economic growth, and a higher standard of living for all."

The view of our four economists (see their brief biographies in "Our Panel," Page 15) is gloomy. In their view, with almost no exceptions, economic policies adopted by the administration and Congress are seriously flawed and are undermining the basis for our long-term prosperity. While the Federal Reserve Bank is generally praised by the economists, the rest of the government is not.

Questions were posed to the panel by Margo Thorning, Ph.D., the ACCF's senior vice president and chief economist, and, in a few instances, by the editor of this magazine. Here's what the panel had to say:

Looking at Obama administration and Fed policies as a whole, have they been a net plus or net negative for the economy in the last 18 months?

ED PRESCOTT: The Fed is doing a fine job. Inflation is relatively stable. The serious thing is the way that government expenditures can depress the economy. That's an established fact. The U.S. economy is depressed, depressed 10% relative to normal, and it's not recovering.

DOUGLAS HOLTZ-EAKIN: I concur that the Fed has done a very good job of managing not just the financial crisis, it has provided extraordinary liquidity and credit channels that had started to fail. It has now started to execute an exit strategy, which thus far has been successful. The proof will be in the pudding going forward.

The Obama administration's plans are a disaster for the U.S. economy. If you look at the history of recoveries from financial crises, they are traditionally relatively slow and modest. They don't have V-shapes. They are characterized in this case by households with balance sheets that are badly damaged and their net worth has been really hammered.

The government sector is in a comparably bad state or worse, so real vitality is going to have to come from the business sector. Yet there is nothing in the Obama administration's plans that is good for business; might even be bad.

KEVIN HASSETT: I agree. I think that there are two things to consider. The first is that small business has really lagged in the recovery, especially this year, and that I think is clearly related to the coming tax increases. The right thing to do in a crisis is to try a little bit of everything, but this administration has been so Keynesian that they've been willing to load up on Keynesian policies at the same time that they're continuing to promise tax increases.

So I think that one reason why the recovery has been so weak is that they put all their chips on one number. The uncertainty going forward, of exactly which taxes are going to go up even beyond the ones that they've promised, and what the impact of the health bill will be and so on, that uncertainty is the fact that (small businesses) may consider. So I think that there's a specific policy error of promising tax hikes and trusting the Keynesian forces will be so powerful they can overwhelm them and, second, that they've introduced a kind of climate of uncertainty, especially with the deficits that came from the Keynesian policy that is also quashing growth right now.

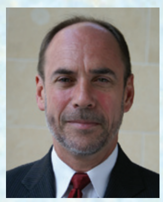
How about the magnitude of the deficits? How do you feel about where we stand vis-à-vis the rest of the world and should these be a primary concern?

DOUGLAS HOLTZ-EAKIN: I don't think you can overstate the importance of this problem. It is not so much the contemporary deficit as the outlook where under the Obama administration's budget we never run a deficit under $700 billion and it's $1.2 trillion 10 years from now and rising.

There are some things that I think are very important to recognize. This is a spending problem, period. We are running a $1.2 trillion deficit because spending is $1.2 trillion higher than would be typical in the U.S. We have to get a grip on spending. We endanger the creditworthiness of the U.S. government in the process because in 2015, under the Obama administration's budget, we will meet Moody's technical criteria for a downgrade as a solvent borrower. We will be devoting more than 14% of our revenues to debt service, so this is a dangerous path and one that we should simply alter as quickly as possible.

OUR PANELISTS

EDWARD C. PRESCOTT holds the W.P. Carey Chair of Economics at the W.P. Carey School of Business at Arizona State University. He was awarded the 2004 Nobel Prize in economics (together with Finn Kydland of Carnegie-Mellon University) for a lifetime of original thinking about some of the most important long-standing macroeconomic questions. These include policy analysis, business cycles, economic development, general equilibrium theory and finance. Dr. Prescott is in demand as a consultant and speaker worldwide. His work has been recognized by numerous universities, among them the University of Rome, Northwestern University and the University of Minnesota. He is a fellow of the American Academy of Arts and Sciences, the Econometric Society, the Brookings Institution and the Guggenheim Foundation.



DOUGLAS HOLTZ-EAKIN was chief economist of the President's Council of Economic Advisers from 2001 to 2002, where he helped formulate policies to address the 2000-2001 recession and the aftermath of the Sept. 11, 2001, terrorist attacks. From 2003 to 2005 he was director of the Congressional Budget Office, involved during his term there with the 2003 tax cuts, the Medicare prescription drug bill and Social Security reform. Dr. Holtz-Eakin was also director of domestic and economic policy for the John McCain presidential campaign during 2007 to 2008, and is now president of the American Action Network Forum for Issues, Ideas and Innovation. He is also a commissioner for the Financial Crisis Inquiry Commission, established by Congress. Other positions have included serving as a senior fellow of the Peter G. Peterson Institute for International Economics; director of the Maurice R. Greenberg Center for Geoeconomic Studies; and the Paul A. Volcker Chair in International Economics at the Council on Foreign Relations.

KEVIN A. HASSETT is senior fellow and director of economic policy studies for the American Enterprise Institute for Public Policy Research. He previously was a senior economist with the Board of Governors of the Federal Reserve System; an associate professor of economics and finance at Columbia University's Graduate School of Business; and a policy consultant to the Treasury Department during the Clinton and George H.W. Bush administrations. Dr. Hassett was chief economic adviser to the 2000 presidential campaign of John McCain.

WILLIAM M. GENTRY is a tax policy expert and associate professor of economics at Williams College. Dr. Gentry taught previously at Duke University and Columbia University. He has been published extensively on such topics as public finance, the economic effects of taxation and corporate finance.

MARGO THORNING is senior vice president and chief economist of the American Council for Capital Formation. She is also director of research for its public policy think tank, and managing director of the International Council for Capital Formation. Dr. Thorning is an internationally recognized expert on tax, environmental and competitiveness issues. She writes and lectures on these issues and is frequently quoted in such publications at the *Financial Times*, *The Wall Street Journal*, *The New York Times* and *Süddeutsche Zeitung*. She has testified as an expert witness on capital formation and environmental issues before numerous U.S. House and Senate committees, and presented to a meeting of the United Nations Commission on Sustainable Development. Dr. Thorning is also co-editor of books on tax and environmental policy. She previously served at the U.S. Department of Energy, U.S. Department of Commerce and the Federal Trade Commission.

BILL GENTRY: I echo what Doug said. The financial crisis came along and piled on a lot of short-term spending at a time where we already had a long-term fiscal gap driven by entitlement programs. Doug is right, it's a spending problem, but in the coming decades it will be hard to use cuts in discretionary spending to solve the problem given how much of the expected spending will come from entitlement programs.

ED PRESCOTT: I'd like to emphasize that. The problem is the spending. Raising tax rates does not increase tax revenue given the current levels. You can't focus too much on deficits because governments can be every bit as creative in their accounting as Enron and make deficits appear to be anything they want. Spending is the key thing.

Where do we cut the spending?

DOUGLAS HOLTZ-EAKIN: I think it's a two-part recipe. Step one is literally rollback some of the discretionary spending increases we've seen since 2008. You can; there's a lot of fat in the discretionary budgets right now. There have been extraordinary increases. That can be done much more quickly and easily than changing entitlement programs.

The second step is obviously to put entitlements on a sustainable track. You can change the Social Security retirement formulas in ways that lower the gross rate of spending there and do not serve any sort of unpleasant news to current retirees and people who get a higher retirement in the future than they got in the present. So that's not hard.

The real issue has been the health care issue and the Obama administration has set up two new health care spending programs that grow at 8% a year as far as the eye can see. That's why repeal is essential. And then real Medicare and Medicaid reform are imperatives.

KEVIN HASSETT: I think one other thing to add is that if you look at the countries that have had significant deficit problems and then had successful fiscal consolidations, very often they get a good bit of progress out of government employment. They'll reduce government employment and reduce government salaries, and I think that that's clearly something to do in this case as well.

Is the new financial reform law adequate to address future financial crises?

DOUGLAS HOLTZ-EAKIN: No. The financial crisis had its roots in a housing bubble. This does nothing about housing bubbles. It had a torrent of bad mortgage origination and unqualified borrowers, and so this was a mortgage finance problem at its heart. The bill took a pass on reforms to Fannie Mae and Freddie Mac, and it instead focused on some of the knock-on effects of the collapse of the housing bubble. There, the tiny amounts of progress that I think made sense, some exchange trading and clearing houses for derivatives, are swamped by unnecessary intrusions in consumer protection, essentially codifying "too big to fail" and the ability of the government to step in and take over private enterprises. So benefit cost has this one swamped.

ED PRESCOTT: I'm going to Singapore in a couple of weeks, and this reform bill is great for them. Their financial sector is booming. Americans are moving there. Their moving vans are full with bright young MBAs. This is going to be bad for a small sector of the economy, the financial sector, and it's going to drive business abroad because it will make transactions more expensive.

Our financial system, most of it is pretty good. Transactions are very fast and cheap. We can buy and sell and get diversified portfolio savings for retirement, encouraging capital formation so cheaply, for just basis points. Any time the government gets in there and regulates, some group is going to get control, some special interest group, and it's going to be used for political purposes and not for economic efficiency.

If you had the option, what are the three things you would most like to see changed in the tax code?

ED PRESCOTT: First thing, get rid of the taxation of capital income. All students of public finance agree it is costly and socially wasteful. What we want is to have good savings opportunities for our retirement and with more capital around, wage rates are going to be higher. Everybody benefits.

The second thing is I would reduce effective tax rates. The social welfare state can be financed through mandatory insurance and mandatory savings. Some countries do that. Australia, for example.

DOUGLAS HOLTZ-EAKIN: I think we should be looking to integrate the corporate and individual income taxes, move them to a consumption base exempting the return to capital, and committing us to be much more internationally competitive. I mean, this is the most important tax policy issue we have. Everything we're doing in Congress right now goes the wrong direction from tax reform. Tax reform is broad-based; get the base broad and choose it correctly for low rates. They're preserving narrowness and special features in the base and raising more general rates and that's a disaster from the tax reform point of view.

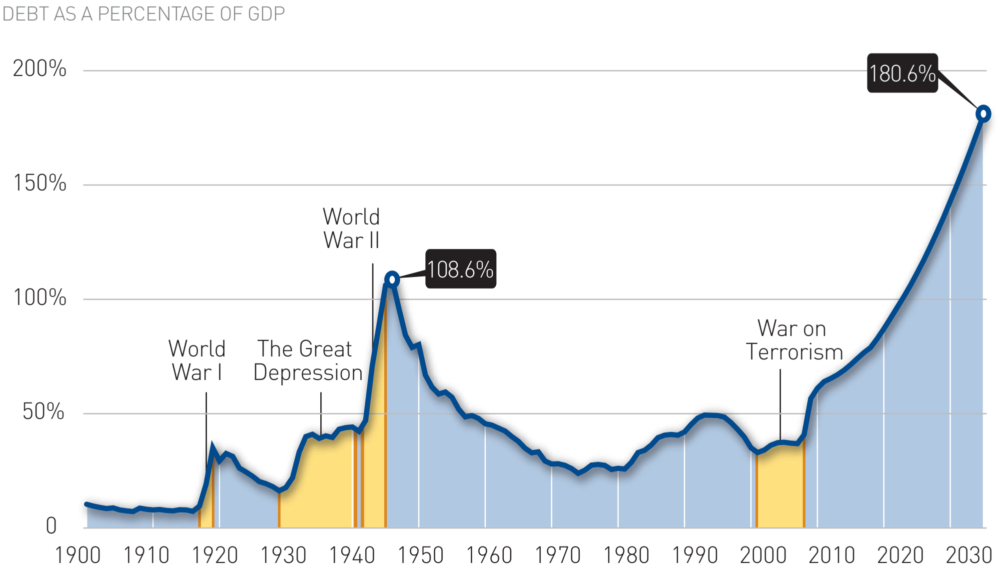
KEVIN HASSETT: The other thing to remember, too, is that the rest of the world has been moving toward a consumption base for taxation gradually. Value-added tax is a consumption tax. Other nations tend to have international tax systems that are vastly superior to our own in terms of the tax treatment of foreign income, with

"We are running a *$1.2 trillion deficit* because spending is $1.2 trillion higher than would be typical in the U.S. We have to get a grip on spending." *—Douglas Holtz-Eakin* much lower corporate rates. So they've been reducing the tax on capital and increasing the tax on consumption gradually.

If you had to pick the No. 1 reason why manufacturing output in the U.S. is declining so much and there's such disappointing job growth, you'd have to say the tax difference between the statutory rate in the U.S. and the rate abroad, factoring in both the different rate and the different treatment of foreign income, makes it essentially crazy for a firm to locate an operation in the U.S. at the margin. The tax advantage of being abroad is so enormous and the tax advantage of our foreign competitors is so large that it's no surprise the activity in the U.S. is disappointing. And I can tell you that I think the reason why this continues, even through the great crisis that we've seen, is that there's this clear-cut ideological opposition to reduce the corporate tax.

NATIONAL DEBT RISING

Projected debt grows dangerously high



Source: Heritage Foundation compilations of data from U.S. Department of the Treasury, Institute for the Measurement of Worth (Alternative Fiscal Scenario), Congressional Budget Office, and White House Office of Management and Budget.

BILL GENTRY: Moving toward consumption taxation is probably where I would go, but I think the political process will get in the way. So maybe some lower-brow ideas would echo what Kevin said. The corporate tax rate in the U.S., compared to our competitors, is far too high. We need lower corporate tax rates. A zero tax on capital would be great, but if you can't get there, then at least cutting back the corporate tax rate from 35% down to something more reasonable like 20%.

The fact that we have the alternative minimum tax to me is a statement that the income tax is a failure; it needs to go. Figure out a smart tax base and a sensible rate structure and go with it and not bother with the alternative minimum tax. It makes tax planning a nightmare. On the flip side, some of these things will cost money. If I were looking to raise money, as Doug said, broader bases are good. I might put some deductions on the table, such as the home mortgage interest deduction. We saw in the financial crisis that we had a housing bubble. We had a lot of unqualified lenders and borrowers. We learned that increasing the home ownership rate might not be the world's greatest thing and if the mortgage interest deduction is increasing the homeownership rate, then curtailing it would not be the end of the world. One possibility would be to convert it into a modest tax credit. Reducing the size of the tax subsidy for mortgage interest would raise revenue and allow us to keep marginal tax rates low, which I think is critical.

Martin Feldstein has suggested that the best course for reducing government expenditures would be to reduce "tax expenditures," or special tax credits and other tax-related breaks that are the equivalent of government expenditures. Is this something that should be considered?

DOUGLAS HOLTZ-EAKIN: I think that's exactly right. We have a lot of spending through the tax code, taking the form of refundable credits. These have two big implications at the moment, three probably. No. 1, they are an important part of the budget deficit and the spending that goes on. No. 2, they are a part of a tax code that is riddled with inefficiency. And No. 3, the phasing out of those refundable credits imposes very large effective marginal tax rates on relatively low-income people. It's very damaging tax policy.

What about the potential impact of the expiration of the Bush tax cuts on capital gains and dividends?

DOUGLAS HOLTZ-EAKIN: I'll just point out the obvious. If this is allowed to go through the way that has been proposed, you will have differential taxation of dividends and capital gains. Capital gains will be at 20%; dividends

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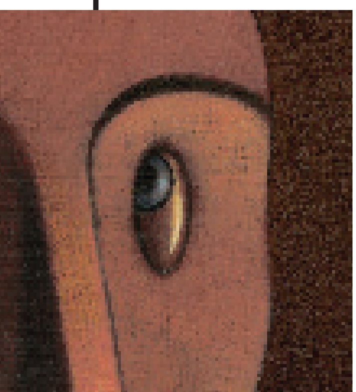

will be essentially at 42% given phase-outs, so that’s a classic invitation to stop paying dividends and retain earnings. I don’t think any policy that encourages a lot of cash to be hoarded on corporate balance sheets is a good policy. Rewarding financial engineering has nothing to do with real investment and economic growth, so the rate should be equalized. Zero is the right place to equalize them, and you should have low rates on these things to promote the return to innovation and investments.

BILL GENTRY: I certainly agree with Doug that one of the big steps forward in the ’01 and ‘03 tax bills was dividends getting a lower tax rate as a form of corporate tax integration. I also think that the higher capital gains tax rates could have negative effects for entrepreneurs. People often think of capital gains as coming from publicly traded stock. While these investments do generate capital gains and the capital gains tax can create distortions in investors’ decisions about corporate stock, the distortions may be even more costly for small businesses. The capital gains tax can lead to small businesses that don’t get started, don’t get sold as quickly, and don’t get the capital that they need to expand. The capital gains tax is not just an issue for investors in publicly held firms.

KEVIN HASSETT: The one thing we do know is that the dividend tax cuts had a really big effect on equity values and dividend payouts. Right now, if nothing changes, that dividend tax rate is going to go all the way up to 44.6% from 15%. I don’t think in my knowledge of tax history that there’s ever been a tax hike with that much significance for equity markets. If you’re wondering why everybody is anxious, I think the uncertainty over that is a key factor.

Another big weighty issue is the future of U.S. productivity growth. There’s been some recent work by some of the top people in the field, like Harvard’s Dale Jorgensen and others, suggesting that we should be concerned about how we’re going to stack up vis-à-vis the rest of the world. What should we be doing to try to improve?

DOUGLAS HOLTZ-EAKIN: We don’t have a climate for investments that would lead to what I think of as robust capital deepening. We have, as Kevin and others mentioned, higher taxes on the returns to capital that aren’t going to help entrepreneurs get into business. That’s bad news. On other aspects of productivity growth, there are a lot of regulatory initiatives that come out of the Obama administration. You look at what they’re doing with the health care bill, financial regulation and the Labor Department initiative. It’s hard to imagine that this is going to produce the kind of economic flexibility that has been the hallmark of the U.S. and lead to the kind of productivity growth we’ve seen in the past. So I’m pessimistic about the outlook.

ED PRESCOTT: I share that pessimism. Japan had bad policies in the ‘90s and productivity growth virtually stopped. They lost a decade of growth. Europe and the U.S. did well in that period. Why did Japan have problems? They were subsidizing inefficiency through the bureaucratic regulatory system. That’s what the U.S. is doing now. Unless the U.S. changes, we too are going to lose a decade of growth.

One of the first things done was to get rid of cost-benefit analysis by executive order. Cost-benefit analysis had been used since 1981. The administration seems to be catering to the special interest groups, and that adversely affects productivity growth. So I’m worried about the long run.

One of the other keys is energy policy and climate change policy. I just want to mention that today the ACCF and the Small Business and Entrepreneurship Council are releasing a new analysis of the Kerry-Lieberman American Power Act. Where do you see U.S. energy and climate policy heading? What would be your preference among the different policy options? For example, cap-and-trade?

KEVIN HASSETT: If you were going to pursue a climate policy, the way you should do it is with a carbon tax, not with a cap-and-trade system. Even if you’re a little bit unsure about exactly how big the potential risks are from global warming, you could make a pretty strong case the sort of (consequences) associated with the consumption of, say, gasoline is larger than the current tax. So there really is room for reducing taxes on things like capital and increasing the coal and petroleum tax, or for something like a carbon tax.

The reason why cap and trade is so popular is that the politicians prefer it. They don't have to call it a tax. If cap and trade is actually designed so it would work, then it mimics the carbon tax. The other reason why they want cap and trade as opposed to a carbon tax is that the politicians get to hand out the permits and bills that we've seen up on the Hill. There's more than a trillion dollars' worth of permits that are being handed out by politicians to their friends and campaign contributors. So I think that it's really crucial that (the solution) may turn toward one where everybody agrees that if you're going to do something, it should be a carbon tax.

BILL GENTRY: I agree with Kevin on the demand side. Consumption taxes are good, but they don't have to be uniform. Consumption taxes can depend on the carbon content of the good. The revenue raised from such taxes can be used to reduce other taxes. Certainly Kevin's analysis (of the problems with cap and trade) of giving away the permits, and getting the consumption price effects without the government getting the revenue that would enable it to change other policies, is a bad idea.

I think we should also think about the supply side. Improved technology and innovation needs to be a part of the story. We should try to come up with ways in which the government can foster innovation on new technologies, such as improved solar technologies. Accelerating the learning curve for of new technologies could be useful.

What about impediments to expansion of nuclear energy?

DOUGLAS HOLTZ-EAKIN: We have a clear problem with waste disposal in the United States and a clear problem with not recycling spent fuel. Both of those are strictly political in nature. I find it difficult to think the U.S. is a proliferation threat on the latter, and scientific panel after scientific panel has OK'd Yucca Mountain. This is about Harry Reid. So, for those who want climate policy, they know it's about technology and that nuclear power is the only known technology with zero carbon emissions. Yet they stand in the way of it. So it's a really frustrating situation.

Another key issue that policy makers are concerned about is retirement policy and Social Security. What should we be doing to try to strengthen retirement policy? Is this a significant problem?

“We need to educate people. ...I think this is one area where lessons from behavioral economics could help get people to make better decisions.” *—Bill Gentry*

ED PRESCOTT: I’ve been working on this area. The big shortage now is lack of good savings opportunities, and this is due to the taxation of capital. There’s a huge amount of capital, but over half of it is owned by the government. The government owns the share of capital that results from the stream of earnings or distributions. There’s going to have to be some fundamental changes made.

Some places in Europe have started. France and Sweden have made important changes. It’s a necessity. We’re having more retirees for each working-age person. People are living longer. They’re starting to work a little bit longer, but that’s not enough. Population growth has fallen. This increases the number of retirees per worker. So a lot of retirement consumption has to be done through savings. That’s the only choice.

Well, most people don’t save up to the limit allowed under the law. What can we do? Should there be mandatory saving? Most people simply won’t be able to live very well on what their projected Social Security income. So how do we incentivize and strengthen private saving?

ED PRESCOTT: A 10% percent mandatory savings rate would provide much higher levels of consumption for retirees. The Australians require that and they require people to annuitize that part of savings when they retire so that they cannot outlive their savings. We’ve got to move in that direction.

BILL GENTRY: There are really two issues here. One is the adequacy of the level of savings, which varies across households. Some people are not saving enough, but others are saving sufficiently. The second issue lies in the decision to annuitize wealth: Are people insured against outliving their assets? Both of these issues have been adversely affected by the move from defined-benefit pension plans to defined-contribution plans. This shift has moved us away from people automatically having a substantial portion of their retirement wealth annuitized.

We need to change people’s mindsets about retirement and annuities. Working a little bit longer, given that people are living a lot longer, can still lead to a pretty lengthy retirement. An extra year or two of work can change the financial planning for retirement. And then on the annuitization front, I think that financial markets have a great deal of unused capacity for helping with this problem. They can create products that would insure against outliving one’s assets. We just need to educate people and maybe give people nudges. I think this is one area where lessons from behavioral economics could be help get people to make better decisions.

How do you see us with respect to trade policy? Are we becoming more protectionist? What can we do to help protect our lead in high-tech industries?

DOUGLAS HOLTZ-EAKIN: This is a fairly inauspicious period in world trade policy. The U.S. has a tradition of being a leader in efforts to lower barriers to trade, but we’re on the sidelines at the moment. From the narrow perspective of the U.S., we do some extremely perverse things, such as allow complete duty-free access to U.S. markets from countries like Columbia, but at the same time fail to ratify the Columbia free trade agreement that would allow our workers and firms to sell into those markets without tariff barrier.

The administration and Congress have been on the sidelines for years now. So I’m not very optimistic about the way things are at the moment. If you look back, some of the big tech innovations have followed reductions in barriers to trade, semiconductors in the late ‘90s being a big one. We should replicate that model and really aggressively move on the trade front, but the political impediments are huge right now.

KEVIN HASSETT: I think this is another area where the current administration is just captured by organized labor, which is really harming the recovery. One of the areas where we could clearly make up some ground is trade. We’ve got a number of free trade agreements that are very, very close to the finish line, but not really making it there. I think that Obama recently, when meeting with other heads of state, has been embarrassed by his own trade policy and surprised a lot of his own people by saying that we need to move forward with those things. But I think that what he's really likely to be doing is just paying lip service to the progress that we need to make. And right now, the recovery is very tenuous and putting all of this stuff off for political reasons is a very, very risky thing for a nation.

ED PRESCOTT: Openness is so important. Our largest corporations get over a third of their profits from their wholly owned foreign subsidiaries. They use American technology and know-how. We're the leaders in that. We have great research centers.

Even foreign businesses are locating in the United States and creating jobs. The Chinese in South Carolina, for example; the Brazilians or the Mexicans as well as the obvious Korean and Japanese and Germans companies. This is openness.

We also use our technology abroad. GM is doing great in Brazil. GM is doing great in China. But GM is doing terribly here because labor rules have made it impossible to do better. It's not that they lack the ability to do better, it's just that the parties involved are constrained in their efforts to exploit all that talent and knowledge. There are huge gains from openness empirically, but economic models that look at trade per se don't find them. They don't see the distribution of knowledge about how to do things better, or how international competition leads to dramatic gains in productivity. Industry has to do better in the world when faced with foreign competition. I hope we stay open.

As you review your thoughts on our conversation today, what you would say are the biggest threats to our long-term economic well being?

ED PRESCOTT: The big threat is the lack of productivity growth or slow productivity growth. Every generation's living standards have been doubling or maybe more than doubling. Most of the world is catching up. Most of the world is doing well. The U.S. seems to be the one laggard.

DOUGLAS HOLTZ-EAKIN: I think the preeminent threat is the loss of discipline between what is the appropriate confined role of government and what the private sector can and should be doing. The manifestation of that is things like takeovers of car companies, massive amounts of spending. All this will threaten the productivity growth, as Ed mentioned, but the vitality of the private sector is ultimately the future of America.

KEVIN HASSETT: One of the risks again is that we're gradually allowing government to take over more and more of the economy both in terms of allowing entitlements and so on, but also in terms of having government put straightjackets around industry as we see in the recent financial reform bill.

I think the ambition that these people in the White House have, their belief that they are so clever that we should just let them have the reins of the economy, that conceit is maybe the most dangerous risk facing our nation right now. As I think about the terrible expansion of "too big to fail" that was part of the financial reform bill, and then think about what other plans they might have, I'd have to say that that's the risk that has me most concerned.

Are there any bright spots that you see economically speaking, short-, medium- or long-term, in the current policy situation?

DOUGLAS HOLTZ-EAKIN: No.

ED PRESCOTT: Not for the U.S.

KEVIN HASSETT: Yes, I guess the bright spot is that right now the policy is so indefensible and so stupid that it seems like it has only up as a direction that it could possibly take. And so, I'd be even more depressed if I thought that we were pursuing reasonable policies and the economy wasn't growing because I wouldn't quite know what to do.

But I think that the one bright spot is that it's kind of easy to fix this stuff for an economist, maybe not for a politician, that you can actually see policy error heaped upon policy error and that gives one hope that at some point the errors can be reversed.

BILL GENTRY: Well, we started off by talking about monetary policy and we decided it wasn't so bad, so maybe the overall situation could be worse. We could have bad monetary policy, too.

DOUGLAS HOLTZ-EAKIN: Well, I think Kevin had it right. There's nothing left to go wrong, so good.