

BUILDING WEALTH IN CHANGING TIMES



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# The Solari Report

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NOVEMBER 19, 2015

A 3D maze made of stacks of US dollar bills, with a path leading through the center.

**The U.S. Economy**  
with Robert Litan



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**C. AUSTIN FITTS:** Ladies and Gentlemen, it's my pleasure to welcome to The Solari Report Bob Litan who I consider one of the most accomplished economists of our generation. I think one of the reasons his breadth of experience is very unique. He's been a practicing attorney, he's an economist, he's been a government official – both at the Department of Justice and the Office of Management and Budget – and he has a very good understanding of the Federal budget and credit and how it intersects with the economy.

He's also been an entrepreneur, and I think most impressive to me is he has contributed to extraordinary research. For many years, he was head of the Kaufman Foundation research effort into the entrepreneurial process.

If you look at any discussion of the U.S. economy, particularly revitalizing or strengthening the U.S. economy, he's got the broadest of experiences and knowledge and can really think cross-sector in a way which I think is very unusual.

So, Bob, welcome to The Solari Report.

**ROBERT LITAN:** Thank you very much. That was overly generous.

**C. AUSTIN FITTS:** Sometimes I think that you work so hard and so fast that you forget what you've managed to accomplish. You know, I rarely deal with anybody who has dipped into so many different parts of the economy as you have. So how is it that you came up with such a unique background?

**ROBERT LITAN:** By accident. I think most people's careers develop that way.



I view a lot of the stuff that I did like baking a cake. That's the way I write books or write articles. I work just a little bit each day on writing, and if you write two or three pages a day, and if you're able to do that over 365, you've got 700 pages. So you can turn out a lot of stuff.

**C. AUSTIN FITTS:** Right. Well, we're going to talk about two of your books today. I just wanted to introduce them. The first is *Trillion Dollar Economists: How Economists and their Ideas have Transformed Business* and then *Better Capitalism: Renewing the Entrepreneurial Strength of the American Economy*. We're going to start with *Trillion Dollar Economists*, and I have to tell you that if somebody had said, "What's Litan going to write next?" I would not have predicted that you were going to write a book about *Trillion Dollar Economists*. So why don't you just tell us a little bit about why you decided to do it and how you came to it?

**ROBERT LITAN:** I spent most of my career writing policy stuff, and you're absolutely right. I wouldn't have predicted this four to five years ago, but I did it for several reasons. Number one, after the 2008 financial crisis I saw that a lot of economists were being blamed for not having foreseen the crisis.

In addition, during the course of my career, especially at Kaufman, I ran into many business people who charitably – I would say – did not have a great view of economists; they thought we were all ivory tower people and hadn't met a payroll. That rubbed me the wrong way.

Third, one of my terrific kids – who is now getting her PhD in biochemistry – took some undergraduate economics courses at the University of Rochester which were very mathematical and very high level economics, yet when she came back to me and would talk to me, she would show – like many other undergraduates who have gone through economics training – that they may not be able to read the *Wall Street Journal*. I mean, they could solve equations and know all the graphs on the boards, but they wouldn't have any practical application in economics.

So I decided to write a book for all three of these audiences – for college



people (for college students in particular), for business people, and for the larger public that has this unwarranted view of economists as forecasters when in fact a lot of economic ideas and the people who come up with them have contributed very importantly to business. I wanted to show in a concrete way, without a lot of equations and graphs, and I don't think I have any in the book, exactly why that's true.

If you add it all up, economists have contributed at least a trillion dollars to the economy, and probably more.

**C. AUSTIN FITTS:** One of the examples that you used that I don't want to get into too deeply but I think a lot of people know is the *Moneyball* example. You point out that the *Moneyball* phenomena in baseball has translated into a whole new field of sports economics.

**“If you add it all up, economists have contributed at least a trillion dollars to the economy, and probably more.”**

**ROBERT LITAN:** Right. In fact, the field actually has an academic discipline called Sabermetrics now. There's an annual conference every year at MIT that attracts all these sports geeks who know a lot about computers and analytics, and this conference at MIT attracts something like 2,000 people plus all the General Managers of a lot of the teams so that whether it's baseball or football or basketball, everyone is into analytics. It all started from a guy from Kansas where I'm from, Bill James, who wrote the bible on economics on sports statistics.

He also applied some very basic economic and statistical techniques to try to predict player performance. He did this in the 1980's, and now it's developed into a whole enormous field that is actually used by the teams.

**C. AUSTIN FITTS:** Well, you used a lot of fascinating examples and case studies, but I have to tell you that the one that was nearest and dearest to my heart that I thought we'd talk about today was the 'Planes, Trains, and Trucks'. Part of the reason it's hard to understand the contribution of economists to the deregulation of the transportation infrastructure is you're talking about something that crosses the private sector. It crosses



the government. It crosses law.

Traditionally when you read descriptions of this, it's very hard to follow. Yours is very clear, it's very coherent, and it's very easy to begin to understand that deregulation just teed up an infrastructure platform that made an enormous difference to the economy and still is. Maybe you could just describe what happened and the contribution economists made. I think it's an excellent example.

**ROBERT LITAN:** A lot of our listeners probably won't have a memory of this, but before the 1980's every airfare and every truck fare and every route had to be approved by the Federal government – all the way from the Depression. The theory was that excessive competition in air and also in trucks would somehow make the industry non-competitive and eventually there would be excessive competition.

So we regulated these industries like crazy, and it lead to enormous inefficiency, to fares that were ridiculously high by modern comparison and to trucks that would go in one direction full and then come back empty. It was highly inefficient.

In the late 1970's and 1980's through the Carter Administration appointees were all economists. We eventually got rid of all of this and eventually economists persuaded not only the Administration but Congress to adopt a deregulation bill for both air and trucks. So today we have a totally deregulated industry. Now people may complain about airline traffic because the air industry is now, in my opinion, too concentrated because we allowed too many mergers, but before we got there – and certainly in the trucking industry – we have lots and lots of competition. We don't have the situation where trucks are going one way and then coming back empty, and we have very efficient national transportation companies called UPS and FedEx that are actually integrated, both air and truck, and we have 24/7 pick-up.

I make the point in the book that Amazon could not have gotten started if it had to rely on the Post Office to deliver all of its packages. I mean, just think about it. They would have never gotten started.



Amazon was able to take advantage of this highly sophisticated and developed transportation infrastructure – UPS and FedEx and other modes of delivery – that were all made possible by the deregulation of the truck and air industry.

**C. AUSTIN FITTS:** And Just-In-Time Manufacturing, too, things that are a lot less visible to the retail customer but had a very dramatic impact on the economy.

**ROBERT LITAN:** Yes, and that couldn't have happened without trucking deregulation because the roots would have been all regulated, and each time you had to go someplace different, you'd have to get approval. Of course, this is ridiculous. It's antithetical to the whole idea of Just In Time.

**C. AUSTIN FITTS:** Right. One of the things you point out towards the end of *Trillion Dollar Economist* is the revolution that's happening in economics. Before we go onto the renewal part, I'd just love for you to touch on that a little bit.

**ROBERT LITAN:** In the days when I was growing up, being an economist, the thing that was probably most valued was highly theoretical mathematical writings. They're the kinds of things that got Nobel prizes and so forth. I think the field sort-of exhausted itself of that.

We have a whole new generation of scholars today who are very facile with analyzing very large databases. This is the world of big data and economics. It's also true in the private sector with banks and internet companies and phone companies that have these huge amounts of data, and they apply analytics to it.

I think the future of economics lies in the very sophisticated analysis of all these large bodies of data. As a result we're going to have a merging of economics with statistics, computer science, and with other fields in social science. In a way, it really doesn't matter whether you're an economist or a social scientist or a political scientist or a sociologist. If you have massive data, what you do is you apply a hypothesis to how





that data is structured and you analyze what seems to be causing what.

I think that's the direction in which economics is headed, and there are some very well-known people. One of the best economists in this field is a guy named Raj Chetty. Raj is a professor at Harvard, and he just won one of the most prestigious awards in economics, the Clark Medal. He has made a career out of analyzing mobility statistics. In other words, he predicts the probability if you're born to a family of a certain income, what's the probability that you will rise in your income level over the course of your life? He's shown that that probability varies hugely, not only where you're born – what income class you're born into – but also by geography where you're born. There's a huge variation across the United States.

I could multiply those examples by manifold, but that's the future of economics it seems to me.

**C. AUSTIN FITTS:** One of the things I think is hard for many Americans to believe – but I've seen it happen and your book describes it – is that sometimes when a group of economists or researchers come up with a very grounded, sound analysis and present the facts, policymakers will really change things.

I mean, it's back to the trucks trains and planes for a second. You describe how remarkable it was that we got this kind of deregulation in a Democratic Administration, but what you describe is a group of economists bringing in the facts and literally the policymakers – whether in Congress or in the Administration – looking at them and it being sufficiently compelling that they decide to do anything.

I think facts sometimes can beat ideology.

**ROBERT LITAN:** Sometimes. I think it's true, and I think we have a history of that. Unfortunately, in the current political environment it doesn't seem to be true. If we look at both parties, I think we have so far a relatively economics-free or fact-free race on both the Republican and the Democratic side. They have moved to the extremes on both, and they



don't seem to be listening to the mainstream economists.

By the way, it's in part because of this very bad reputation that economists got for failing to predict the 2008 financial crisis, even though 98% of economists don't even pretend to forecast. That's not what they do; they try to figure out the economy.

**C. AUSTIN FITTS:** Right. Forecasting is not the job of an economist.

**ROBERT LITAN:** Right, but it's the popular perception of it.

**C. AUSTIN FITTS:** Let's talk about better capitalism because I'm convinced that quality economics and analytics can somehow intercede into the policy debate, even if it's only bottom up.

Talk a little bit about your research at Kaufman because that's the part of your work that I have found fascinating. We've published a lot of it on The Solari Report. Maybe you could describe why you went to Kaufman and what you oversaw and some of the research that came out of that effort.

**ROBERT LITAN:** Well, I went to Kaufman in my early 50's. I was there about a decade. Kaufman was not a big name in research before I got there, and I was fortunate to get there at a time when I had a president who was willing to tolerate and let me run loose and engage in a lot of very top tier economists to write about the contribution and the importance of entrepreneurship to economic growth.

Over the next decade, we published a lot of stuff and also funded a lot of stuff to prove this. Now it's sort-of mainstream.

By the way, this is common sense if you're an entrepreneur, especially all those high tech entrepreneurs. They know they're reinventing the world.

**“It's in part because of this very bad reputation that economists got for failing to predict the 2008 financial crisis, even though 98% of economists don't even pretend to forecast.”**





We went along and helped document it. We started tracking a lot of things, and one of the very disturbing things about the current U.S. economy is we've had a noticeable drop-off in what we call a startup rate. This would be the ratio of new firms that have at least one employee to all firms. That startup rate has fallen, especially since the 2008 recession.

If we want to have fast growth in the future, we have to find a way to get that rate back up again, and also encourage firms that seem to be starting encourage their growth. To me, that's one of the most important public policy challenges we have.

By the way, it's been briefly mentioned in the Republican national debates, there has been a lot of reference to this statistic, that we now have more firms dying than being started. That actually came from a paper that I wrote with Ian Hathaway for *Brookings* a couple of years ago. That number, by the way, has turned around a little bit. By the latest data, births now exceed deaths slightly, but the candidates are still making the fundamental point that we had this noticeable drop in births. It fell so far for a period of time where businesses were dying more often than they were being formed, and that is worrisome.

**C. AUSTIN FITTS:** Right, and I don't know necessarily what the statistics are, but I travel a fair amount, and we have subscribers all over the world. It certainly looks to me that there are economies around the world that are much more dynamic that way than we are. That's disturbing.

**ROBERT LITAN:** They've caught the U.S. model and they're learning to replicate what we did.

**C. AUSTIN FITTS:** Absolutely. Let's talk about some of the things we might do. We are coming into a period when a year or so from now somebody is going to ask, "What's the action? What do we do?"

In *Better Capitalism* you outlined a series of ideas of different things we could do. We certainly don't have enough time to go through all of them. I encourage everybody to get the book, but maybe we could touch on some of them quickly.



Reducing/removing double taxation. That's a big one of mine from long ago. I've been beating that drum for a long time, and it puts everyone to sleep.

**ROBERT LITAN:** Yes, and politically it's probably not possible, although there are a number of tax plans out there that would significantly reduce corporate taxes, which would help. Although that's meant largely to help established companies more than startups.

**C. AUSTIN FITTS:** I'm a great believer in equity financing, and you have a discrimination of equity versus debt. I think it continues to plague us. To me at some point we have to address it.

Research R&D credit. Maybe you could say a word or two about that.

**ROBERT LITAN:** I'd say in general it's a good idea, although it will probably not help startups because they don't have any income.

**C. AUSTIN FITTS:** Right.

**ROBERT LITAN:** In general, as you know, this credit has been in the tax code for probably three or four decades, but it lapses every year or two so they have to put it up for renewal, and that's an uncertainty. Of course, we know the reason why Congress writes it so that it lapses; that way they can perpetually hit people up for campaign contributions. I mean, that's the reason it's written that way and it's shameful.

**C. AUSTIN FITTS:** Right. I think one of the most important is the idea of what you bring up of diploma visas for graduates or easier rules in terms of green cards because there's no doubt that so much growth comes from talented entrepreneurs.

**ROBERT LITAN:** Yes. Let me talk about that. That is probably the most important recommendation, and the current political environment is the one that needs to be stressed the most.

There is research that Kaufman funded and has since documented that



immigrants account for a disproportionate number of our high-tech startups and a disproportionate number of our patents. So common sense would tell you that all those immigrants who are coming here to get STEM degrees, for example, at U.S. universities who are being sent back is cutting off our nose to spite our face. I mean, it's basically malpractice. We're basically taking people and sending them home.

**C. AUSTIN FITTS:** Right.

**ROBERT LITAN:** First of all, we've got to keep these people. Secondly, we ought to have much more liberal rules for immigrant entrepreneurs. Unfortunately, these two ideas – which would do more in my opinion to contribute to a turnaround in the startup rate than anything – are probably politically dead because of all the hysteria over immigration in general. So they've gotten swept up in the fear about refugees and the fear about Mexican immigrants, and the so-called 'wall' that Donald Trump wants to put up and so forth. As a result, this is the worst possible political environment for trying to correct something which should have been corrected 10-15 years ago.

**C. AUSTIN FITTS:** It looks as though Paul Ryan is focused on this and is trying to at least loosen up some of the visa requirements.

**ROBERT LITAN:** Yes, but even he has said more or less that he's probably not going to tackle immigration reform until they do something on the border.

**C. AUSTIN FITTS:** It's too dangerous.

**ROBERT LITAN:** Yes. He probably won't do it until they do something on the border, maybe in 2017, and who knows how long it will be after that.

In my opinion, we've lost at least a decade. Kaufman research has since documented that GDP growth would be much higher if we'd had more liberal policies allowing these people in.

By the way, I think even before all this hysteria, if you asked the average



person on the street, “Should we let in entrepreneurs from other countries, and should we basically keep our STEM graduates here so that they could start new businesses?” I think most people would say, “Yes, those are the people we want.”

Of course they are.

**C. AUSTIN FITTS:** Exactly.

**ROBERT LITAN:** The notion that we would kick them out is ridiculous.

**“The notion that we would kick them out is ridiculous.”**

**C. AUSTIN FITTS:** It’s funny. After I read your book I went in to see Graceland with some tourists. You know, if you live near Memphis you go to Graceland a lot, which I love, because I love Elvis Presley.

What I realized is I was tootling around Memphis and I realized that if it wasn’t for Elvis Presley and Fred Smith, I can’t imagine what would have happened to Memphis. So as I was reading your discussion of growth economics I thought, “Okay, to get Elvis Presley and Fred Smith and the guy who started Sun Records, you need to get about 2,000 to 4,000 potentials. How do you do that?”

That’s why this is a no-brainer, as you said.

One of the things you talked about was the role of education. I think part of the politics of letting entrepreneurs coming here stay is fairness to the people who are here. To me, that comes down to a great education. You have some great ideas for education. In my opinion, education is going the opposite direction since you wrote that.

Education reform. I don’t know what there is to say other than it’s unbelievably important, and if anything, it’s going the wrong way.

**ROBERT LITAN:** I will say a word about one thing, and that is choice in schools at the K-12 level. We have a number of states now that have relatively good laws on charter schools which operate unburdened of



local bureaucracies. There are a number of very, very good national networks in charter schools that are the good ones.

I'm not saying that every charter school is great – because they aren't – but there are some excellent ones, and they do a much better job educating, especially kids from low income and minority backgrounds who are at regular public schools. And charter schools, by the way, are public schools.

I think one of the things that we could do that would do more to help income inequality and address all this anxiety about unfairness is to have a lot more competition in K-12 education. It's something that's been bipartisan until recently. Namely, Bill Clinton and Barrack Obama have both supported charter schools. A lot of Republicans support charter schools. I was very disappointed to see Hillary Clinton move backwards in this direction recently, and I'm hoping that at least Federal policy will continue at least after 2017 in encouraging charter schools.

In the meanwhile, states can do this on their own. Alabama, for example, just recently passed a law that would make it much easier to start charter schools. If Alabama can do it, certainly other schools can do it.

**C. AUSTIN FITTS:** But can that choice come without the common core and the testing requirements?

**ROBERT LITAN:** Yes. You still need the testing requirements. We need the testing requirements only because we have to track kids to know how well they're doing, but the short answer is that with good charter schools like KIPP or Success Academy and other chains do a better job of this than conventional public schools because they don't live by the rules that burden conventional public schools. Plus, they make their kids attend more hours of school than regular schools. More time on task is eventually going to produce better results, and these schools have a record of doing that.

**C. AUSTIN FITTS:** It's a rabbit hole, and I don't want to go down it today, but clearly without excellence in education I don't see how you get there.



I won't go into healthcare, but I do think one of the things that has shocked me the most – once upon a time I lived in New York and Washington. Now I live in a rural Tennessee community – is the deterioration of the food and nutrition. That's for many different reasons, but without a healthy population, without a strong body and a clear mind, a kid can't get a good education. There is clearly a connection between healthcare and education.

**ROBERT LITAN:** I just want to spend 30 seconds on that. All I want to say is before Obamacare was passed, one of the big complaints of a lot of entrepreneurs I ran into – people in their 30's or 40's – was that they left their company to start a new company and they had a preexisting condition and they couldn't get health insurance. So at least Obamacare fixed that.

You may or may not like Obamacare, but all I can say is: If you replace it with something, we've got to keep the provision that it does not allow discrimination on preexisting conditions. But if you do that, you have to find a way to make it economical. The Obama Administration, like Massachusetts, said, "We'll have an individual mandate to say that everybody has to be in a pool."

If you don't have something like that or you don't subsidize the insurance companies for taking on high-risk patients, then you won't be able to have insurance companies provide healthcare without preexisting conditions. So the message to those who want to replace Obamacare is: You've got to keep the preexisting condition prohibition in there, but you have to find a way to make it work economically. Otherwise we're going to go back to a world that is going to really hurt entrepreneurship.

**C. AUSTIN FITTS:** I agree. Reducing consumption, increasing savings.

If you look at any of the statistics, have you ever read Steve Roach's book *Unbalanced* about the U.S.-China relationship?

**ROBERT LITAN:** Yes.





**C. AUSTIN FITTS:** It's one of my favorites from last year. If you look at any of the statistics – and I'm thinking of the ones Steve used – the imbalance in the United States between consumption and savings is extraordinary. The question is: How do we improve it? That is not only part of how we readdress the balances with China and other countries, but how do we come back to an economy which is productive in building?

Any thoughts on how you think that is going to happen? So much of that works through the Federal budget.

**ROBERT LITAN:** Fortunately, and this has been sort-of a side effect of the financial crisis, the savings rates have gone up since the financial crisis.

**C. AUSTIN FITTS:** Right. They have.

**ROBERT LITAN:** That's because people aren't spending. They don't have confidence in the economy. So we want people to save for good reasons, not for bad reasons.

I think more financial education will help. And actually, I also think that moving more toward consumption taxes – which some Republicans have advocated, moving more in the direction of either a VAT or something that taxes consumption rather than income – would drive us in the direction of having more savings.

**C. AUSTIN FITTS:** I agree with you on that one. I live in a state with a very high sales tax and no income tax, and, boy, people are much more economical here. It works.

One of the things near and dear to my heart is equity financing. I notice you said a few words about the JOBS Act and crowdfunding. Maybe you could touch on that.

**ROBERT LITAN:** Crowdfunding was actually just approved about a month or two ago. There was a provision in the JOBS Act that would allow these platforms like Kickstarter to go into equity financing, not just give away trinkets and be the first in line, but you could actually have a share of the



company.

It took the FCC three or four years to write the rules. It took them too long. And by the way, the rules may be too strict.

**“It took the FCC three or four years to write the rules. It took them too long.”**

**C. AUSTIN FITTS:** I think they’re too strict.

**ROBERT LITAN:** I think they are too strict, but the crowdfunding has tremendous promise if it were allowed. I think that’s one area where basically people say, “No pain, no gain.”

Well, in the world of entrepreneurship and growth, no risk, no reward.

**C. AUSTIN FITTS:** Right.

**ROBERT LITAN:** People are so obsessed and so worried about people losing their money in investments that you write very, very tight rules to try to prevent people from losing money. Well, they also prevent people from raising money to finance their companies.

I would rather err on the side of allowing more of this activity to take place and maybe some more people losing money than having a world in which basically there is no risk and no reward.

**C. AUSTIN FITTS:** The way I say it, in very short order I can leave my home and spend my life savings on the lottery. I can spend my life savings on hard narcotics. Neither of those are a problem. I can’t invest in a venture pool for my community.

**ROBERT LITAN:** Exactly. So we may have to revisit this. Actually, I think in 2017 maybe a new President could revisit whether or not the crowdfunding rules are too strict. If they are, they can lighten them up a bit.

**C. AUSTIN FITTS:** One of the things that I had not thought about until I read your book was open fuel platform. Maybe you could say a few words to



that. I found that very intriguing.

**ROBERT LITAN:** I wrote it at a time when oil prices were very, very high. The idea was there have been some people who have suggested that we have a mandate that new car engines be able to operate on multiple kinds of fuel so you're not just locked into gasoline. You could run on natural gas, you could run on hydrogen, etc.

That hasn't gone much anywhere because oil prices have dropped so rapidly. This ought to be a good time to think about perhaps mandating something like this so that when oil prices do rise again people can switch, but it hasn't gotten traction yet.

**C. AUSTIN FITTS:** Finally, one that you didn't bring up but it has really come to the fore. That is how to deal with student loans. This gets back to the fairness issue of bringing in foreign kids or giving them visas or green cards. Our current generation of young people is loaded up with student loan debt. If you look at the terms and conditions of that debt, it's clearly unfair relative to what we're offering banks that get into trouble.

What do we do about the backlog of student loan debt?

**ROBERT LITAN:** That's a very good question. I've been more worried about what we do for the new students. I mean, I'm a big supporter of what's called the Income-Contingent Loan which the Administration has pushed. I had an Income-Contingent Loan when I went to law school, for example, where basically your repayment is contingent upon your income, and it would be capped so that if you ended up paying more than 150% of your loan balance, you wouldn't have to pay any more.

That in effect has the lender take an equity position to the students. Marco Rubio, by the way, has a very innovative proposal. He would let private individuals finance other people and take equity interest up to a certain limit in other people's education. It's a very interesting idea.

I think the more we move in an equity direction so that people who, for example, fall on hard times and then basically are facing these huge



student loan commitments, in an income-contingent world they wouldn't have to pay back so much when they're unemployed or they have low income periods.

**C. AUSTIN FITTS:** Right. Are there any policy options that have been floated that would refinance current students to lower rates?

**ROBERT LITAN:** Not that I've seen. I mean, you could imagine a world, for example, where you converted the existing loans into Income-Contingent Loans. But if you did that, you may have to have the money because you can't confiscate the loans; you can't just simply force somebody to change the loan. So you may have to have some Federal sweetener money that would go in.

I think most of these loans are all securitized. They're all bundled up, so it's not as if they're held on bank balance sheets; they're held by pools just like the mortgages.

**C. AUSTIN FITTS:** Right. It would have to be a refinancing option or a refunding option.

**ROBERT LITAN:** I think, though, if it did and somebody elected to go from a fixed loan into a contingent loan, the lender – as I said – may be hurt by that. You would have to find a way to compensate the lender. It would be complicated to do.

**C. AUSTIN FITTS:** Right. Absolutely.

Okay. Wild cards. I certainly am watching in businesses that I'm connected to extraordinary rollout of new automation, including robotics. It's happening at high speed, and the impact on productivity is very positive and very dramatic.

So we hear all sorts of discussions of what is this going to mean to employment, to the economy. Any thoughts on that?

**ROBERT LITAN:** I'm not so worried about the employment impact as I am on



the wage impact. Eventually if IT and robotics make a lot of things cheaper, it means that the price of all kinds of things will fall, and we as consumers will have more money to spend so we'll spend it on other things.

So people will end up getting jobs in other fields; it's just that those other jobs may not pay as much as the ones we had before. So really, to me, this is an income issue.

There's a great book written about this called *Average is Over* by Tyler Cowen. It's a very disturbing book because it implies an 80/20 society where the 20% of people who know IT and are very facile with it get all the money and the people at the bottom 80% don't. That is the world, I fear, that we're headed toward. The only way to avoid that world is through education and making sure that as many people as possible are facile with IT. That starts from the first grade, and I actually think our school system ought to be overhauled where kids learn how to code computers and they learn how to be facile with computers from the very earliest time that we teach them how to read and write.

**C. AUSTIN FITTS:** Well, in the 1990's I really believed that technology was one of the great creators of inequality, but I've come to believe – and it's a much longer conversation, not for today – that a tremendous amount of the equality comes out of privileges created through the budget and Federal mechanism, which gets back to: How do we keep the policy mechanism really focused on optimizing the whole economy and obeying all wishes. This gets us to this question of: How do we rebuild trust in the system?

I think if you said to me, "What's the number one cause of deflation?" I would say it's literally – whether it's big business or small business or entrepreneurs doing start-up – the average American has very little faith left in the general system, whether it's business or government.

**ROBERT LITAN:** I know, and it's a huge problem. That's one of the reasons why we see people moving to both extremes in both parties because they've abandoned what they view as the establishment conventional



wisdom. It's very unhealthy for a democracy.

**C. AUSTIN FITTS:** So the question I'm always big on is: What's the action? What are the actions that we can take to rebuild the middle? I propose we talk about some here.

**“What's the action?  
What are the actions  
that we can take to  
rebuild the middle?”**

One is the more we can get transparency and accountability and accessibility in government budgets and finances and the policy process. So if you look at the policy process you described in the transportation example, you're talking about a fairly open process and a lot of open discussion among very smart people.

We can't do that without the analytics. I've been beating the drum for 20 years for place-based disclosure of the Federal budget and Federal credit and all sorts of Federal financial information because what I've found is if you're going to reoptimize and reengineer the economy in Hickory Valley, Tennessee, it's totally different than what you're going to do in Kansas or New York. There are approximately 3,100 counties, and everyone is unique. It really comes down to: Who are the Fred Smiths and Elvis Presley's in your county, and how do you reengineer things so that they can just fly?

**ROBERT LITAN:** You make a really good point about having disclosure and transparency. A perfect example is not only show the aggregate impacts in terms of total spending and what it's going to do on the budget, but the distributional breakdown.

So there are organizations like Brooklyn's Urban Institute Joint Tax Center which shows the distributional impacts of various tax changes, but we ought to break these things down to very specific things like mortgage interest deduction which really benefits disproportionately the wealthy who have the highest tax rates.

You were talking, for example, how we perpetuate inequality with one generation to the next. Well, if you grow up in a rich neighborhood, you're going to go to better schools and obviously you're going to have a





better chance in life.

Well, Federal policy is tilted towards helping people who live in high income areas because we get larger tax deductions.

**C. AUSTIN FITTS:** It's interesting. In 1996 one of the guys who I had worked well with on Wall Street was a guy named Luis Mendez who built the trading for Morgan Stanley and then came over to Dillon Read and ran our capital markets. I was trying to talk him into coming and doing some things at Hamilton. He came down and he was bemoaning the fact that the Federal government was hopeless for one reason or another.

I told him my hopes for place-based financial disclosure and he said, "Oh, it's a complete waste of time."

So I said, "Okay, Luis, where do you live?"

He said, "Bronxville." So we pulled up the consolidated financial reports and some of the other data for Bronxville. Instead of letting him see it in numbers we had GIS software. He became fascinated and he started to dig in and look at the sources and uses of government Federal money in his place.

He lobbed onto flood insurance and he said, "Four million dollars for flood insurance! This is ridiculous! Bronxville is on a hill. I've lived there for 30 years. There are no floods."

So I had a conference call with him the next morning. He flew back to New York, and he was late – and Luis is never late; he's always on time. I finally got through to him two hours ago. I said, "Luis, where have you been?"

He said, "I've been on the phone with the Deputy Mayor of Bronxville for four hours going through all these numbers. All this waste and corruption is going to stop."

I said, "I thought you said it was hopeless."



He said, “That was before I had the numbers on my neighborhood.”

So I don’t know if you’ve ever seen participatory budgeting, but what I find is that if you give somebody all the statistics on the sources and uses of governmental funds within their place – ideally Federal, state, and local – and you ask them to reoptimize, it will be very quirky and unique what tradeoffs they will do, and part of it has got to be cross-sector.

So when I said that your experience is so good for this time, you’re talking about mind-boggling cross-sector decisions and ideas that have to be considered. That’s the advantage of letting local guys start to grapple with, “Okay, how are you going to make these choices?”

I don’t see how they start to come back with proposals. I think there are a lot of proposals where if small business got together and said, “Okay, how could we lower the burden on the taxpayer, particularly in an environment of cuts,” I think they would start coming up with a lot of ideas. But that’s not going to happen unless they feel safe to do that and the analytics are available.

**ROBERT LITAN:** Yes, you’re absolutely right. Information is power. Yes.

**C. AUSTIN FITTS:** Right. Well, that’s why I think this idea of the revolution in economics is so interesting. If you apply that revolution to the statistics and analytics we have bottom-up on the economy to how we reengineer the Federal budget, I for one think there’s a lot more money and growth potential than a lot of people just sitting in Washington saying, “How are we going to cut, cut, cut?”

If we loosen the rules, we can change a lot of things.

One quick thing I wanted to bring up before we close is environmental stress. To me that’s one of the wildcards. I’m one of those people who believe you can’t trust the system to implement cap and trade.

**ROBERT LITAN:** I agree with that. I think it will get politically distorted. By the way, it probably won’t happen in any event.



**C. AUSTIN FITTS:** That's good news.

**ROBERT LITAN:** Well, look. The economist solution to all of this, of course, is having a carbon tax and then letting the market figure it out. In theory you can get rid of a lot of regulation if you just put a price on carbon. Then the markets will settle this out. You'd have more incentives for clean fuels and disincentives for dirty fuels, but we know the politics in the carbon tax. Even with a rebate, for example, for low-income people, they get hurt by it. Still, the politics are terrible.

My own personal view is that if climate change gets to be so bad that people are still upset with it – don't laugh – I actually think we're going to end up with one of these geo-engineering solutions. You know, these ideas of putting Sulphur in the air and that way deflecting the sunlight and so forth. I know there are a lot of risks to it, but it's also very cheap.

I think the world will not spend the massive amounts of money that conventional analysis holds to reduce carbon. I think what we'll end up using is a stop-gap measure, but we're probably years away from that.

**C. AUSTIN FITTS:** Let me also make a pitch. I absolutely believe that if you have equity-based place-based vehicles – this is one of the reasons I was so interested in venture funds and reads for your place – then you've created an enormous equity incentive for people to significantly reduce consumption and integrate new technology. So you could have something a lot more market-based than cap and trade would end up being.

So let me make a pitch again for all the good things you've tried to do for equity financing because the more the economy finances with equity, particularly on a place-based basis, the more the environmental stress makes sense to heal. You can make money reducing consumption. Anyway, that's my pitch.

Okay, so what about Bob? How do we follow you? How do we get your books? You've got a Twitter feed. How do we follow your work?



**ROBERT LITAN:** Well, I'm @BobLitan on Twitter, and I irregularly have a blog for the *Wall Street Journal* on their Capital Finance page. It's their online thing. I occasionally produce more new stuff. I'm currently working on a short book on the history of the financial system over the last 30 years for the American Enterprise Institute. Hopefully it will be out in 2016.

**C. AUSTIN FITTS:** Fabulous!

**ROBERT LITAN:** The future work that I'll probably be spending a lot of time on is how cities in particular can encourage more entrepreneurial behavior by their residents. That interests me greatly because a lot of my work at Kaufman was about entrepreneurship, and cities all over the world were built on the strength of entrepreneurs. If you have an entrepreneurial community, you've got a great city. If you don't, you don't.

Finding ways to harness entrepreneurial energy and talent at the city level, to me, is a promising line of research.

**“Finding ways to harness entrepreneurial energy and talent at the city level, to me, is a promising line of research.”**

**C. AUSTIN FITTS:** There's a great DVD called *New York, New York* on the history of New York. My firm in New York used to do a lot of underwriting for Bob Moses, and one of the things they show is how Moses – with a lot of these big projects – would generate enormous fees for his friends but would shut down the entrepreneurial economy. At one point in the 1970's he just really hammered it. They've got Jane Jacobs on making her brilliant presentation about the economics of cities and the entrepreneurial strength of cities and what this was all doing.

It really shows you in a very fun, dynamic way the conversation about that topic.

So my last question for you was going to be: If money was no object and you could spend whatever you wanted on research and do whatever you wanted, what would the research you would next do or serve as the



patron for?

**ROBERT LITAN:** Oh, wow! That's a tough one. I'm biased towards entrepreneurship. It depends heavily on the data, but I guess as a general point I want to know a lot more on how to encourage more entrepreneurial behavior and what makes for entrepreneurial success if we could more identify that relationship. So if I know your characteristics, what is your probability to become a successful entrepreneur, and especially to what extent will your business contribute to growth in the economy?

All those linkages, to me, are vitally important for the future of the economy.

**C. AUSTIN FITTS:** Right, and very helpful for the educators.

**ROBERT LITAN:** I would hope so.

**C. AUSTIN FITTS:** Okay, Bob Litan, it's always a pleasure. Thank you for joining us on The Solari Report. You have a wonderful day.

**ROBERT LITAN:** Thank you so much.

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