The Lynde and Harry BRADLEY FOUNDATION

John B. Taylor's Acceptance Remarks
2010 Bradley Prizes
June 16, 2008

I am truly grateful to the Bradley Foundation for this honor. I'll never forget Mike Grebe's phone call, and our terrific conversation about the previous Bradley prize winners whom I admire so much. And I congratulate my fellow prize winners this year. I am honored to be on the same stage with them.

Tonight, I want to tell a few stories. I learned long ago that stories are a good way to illustrate economic ideas. Adam Smith told great stories. You may have heard that Adam Smith sometimes visits my lectures at Stanford. He speaks from the heavens of course -- actually through the PA system. He usually interrupts me in mid sentence. "Professor Taylor, Professor Taylor" he says in an exasperated tone, "You told your students about the benefits of free markets and you didn't even mention my famous story of the pin factory. Well, let me tell them about it." And then the students listen to him telling his famous story from *The Wealth of Nations*. Well, it's not really Adam Smith. It's a recording of me acting like Adam Smith.

Milton Friedman had a real knack for telling economics stories. My favorite is the famous pencil story about the power of the free market and the magic of the price system. With the pencil held in his fingertips, he points to the eraser from Malaysia, the wood from the state of Washington, and so on. That's now on YouTube by the way. Just type "Pencil Milton" and watch. I really wish Adam Smith were on YouTube.

Speaking of Milton, I remember a time when I was a member of President Bush 41's Council of Economic Advisers. Remember the "revenue-enhancements" idea? Well, I was given the job of calling some economists to muster support. They put Milton on my list, and I dutifully called him at the Hoover Institution. Before I could even ask the question, Milton said, "I know why you are calling, John. And the answer is no, and please come back home to Stanford. Washington is corrupting you."

Sometimes it helps to act out stories. When my children were young, they joined me on the lecture stage to illustrate the permanent income hypothesis. My son would find a $10 dollar bill on the stage, and then say he would only spend 50 cents -- only 5 percent of it -- because it was only a *temporary* boost to his income. I would then tell my daughter that she was getting a *permanent* raise for baby-sitting, and she would say that she would spend most of it. If only members of congress could have seen that lecture; we might have avoided the so-called stimulus idea of sending one-time checks to people rather than permanently reducing their tax rates. I am happy that my daughter Jen and her husband Josh now let my granddaughter Olivia join me on the lecture stage, acting out stories like the burden of our growing debt on future generations.

Economic stories are just as useful outside the lecture hall. When I was Under Secretary of the Treasury, I gave a dinner speech to a group of Russian visitors. Don Evans, then Commerce Secretary, spoke to the group at lunch the same day, and he warned me they were a tough audience, not very interested in economics. I was to talk about the importance of free trade between our two countries, and sure enough, as I was introduced and began speaking, the visitors just kept talking with each other, ignoring me much as Don had warned. When I came to the part of my speech which was a story about my children enjoying Peter the Great's trick fountains and a circus in Moscow, I announced "Now I want to tell you a story." As soon as they heard the word "story," they stopped talking and started listening. In fact, they were spellbound as I told them about my son laughing his head off at the Russian clowns and my daughter getting soaked after stepping on a trick fountain -- both examples of the gains from free trade by the way. But as soon as my story was over and I went back to free trade in the abstract, they returned to their food and talk.

Ronald Reagan knew the importance of stories for illustrating the virtues of freedom. One of his best stories was about a Russian and American arguing about their two countries. The American said, "Look, in my country I can walk into the oval office, I can pound the president's desk, and say 'Mr. President I don't like the way you're running our country.'" And the Russian said, "I can do that." The American says "You can?" And he says, "Yes, I can go into the Kremlin, to the General Secretary's office, pound his desk and say 'Mr. General Secretary, I don't like the way President Reagan is running his country.'"

I like to tell the story of how I started speaking out about the role of government in the recent financial crisis. I was asked to give the keynote address at a conference honoring David Dodge, the outgoing Governor of the Bank of Canada. I had been doing research on the crisis since before it began and after reviewing my work in preparation for the conference, I came to the conclusion that government not only caused, but also prolonged and worsened the crisis. I began to have second thoughts about presenting these findings in my speech for Governor Dodge's farewell, where he and other economic officials would be told bluntly that their actions were part of the problem not the solution. I asked my wife Allyn what she thought, and she said, "If this is what you believe, then you should go ahead and say it." So I did it. When I later expanded the speech into a book, I dedicated it to Allyn.

Family is an important source of support. My mother, who passed away in March, taught me to stand up and fight for what I believe, first by telling me to stand up to bullies on the streets or in the school yard. "I don't want to hear your complaining. Just go out and deal with them yourself." You know bullies are still out there, Mom. I like how Chris Christie calls the teachers unions bullies for harming students by perpetuating an unaccountable education system. I especially like his line to the bullies: "You punch them, I punch you."

I am very glad my father could be here tonight. He also taught me how to stand up, by example, by serving our country in the Pacific in World War II. And my son has inspired me too, again by example, by serving in the United States Marines Corps for six years fighting in the Global War on Terror. Just off this auditorium is a view from the west roof terrace of the Kennedy Center which brings to my mind President Reagan's first inaugural address. Speaking from the west front of the Capitol, looking over the mall and the monuments, he said, "Beyond those monuments -- those monuments to heroism -- is the Potomac River and on the far shore the sloping hills of Arlington National Cemetery, with its row upon row of simple white markers bearing crosses or Stars of David. They add up to only a tiny fraction of the price that has been paid for our freedom."

I want to finish with a story about government bailouts, which have become a threat to both our economic and political freedom. When I went to Washington to run the international division at the Treasury in 2001, emerging market countries were in the midst of one financial crisis after another. They were also plagued by a highly discretionary and chaotic bailout process. The creditors of Mexico were bailed out in 1995. Then some Asian countries were bailed out in 1997, while others were not. Russia and its creditors were bailed out for a while and then in 1998 the plug was suddenly pulled, causing worldwide contagion.

My goal coming into government was to end the bailout mentality. It was creating uncertainty and reducing incentives for countries to put their financial affairs in order. I did not find it easy. The bailout mentality was entrenched at the Treasury and, quite frankly, it is hard for government officials to say no to bailouts, because you worry that a sovereign default could cause widespread harm. So we looked for a way to make it easier to say no by finding alternatives to bailouts. The most workable alternative was to ask emerging market countries to add new clauses to their sovereign bonds, which would allow for an orderly market-based workout of their debt without a government bailout. I worked closely with my counterpart from Mexico -- Agustin Carstens -- now central bank governor, and the Mexicans led the way, putting the clauses in their bonds.

Next we pledged to help reduce collateral damage in other counties if a sovereign default occurred, and that's what we did, for example, by helping Uruguay when Argentina was not bailed out and went into default in 2001. As a result, there was virtually no contagion following the Argentina default in marked contrast with the Russian default. These changes led many emerging market countries, knowing that bailouts were less likely to dramatically change their policy by reducing government debt and inflation and by increasing their reserves. It should be no surprise that emerging market countries have fared so well in the latest crisis.

Unfortunately, the government bailout mentality is back, and it's right here in the United States. The on-again off-again bailouts of the creditors of financial institutions, which led to the panic of 2008, are reminiscent of the on-again, off-again bailouts of the creditors of emerging market countries in the 1990s. And last month, European governments resorted to bailing out the creditors of Greece and other European countries in an eerie replay of the 1990s crises.

The good news is that people are disgusted by the government bailouts. The challenge will be to channel that disgust into action. I hope this story, and my other stories, show that the task is feasible and the rewards are great. Thank you.