Good evening again. Did you all enjoy Freedom Rising? Good. Well now we get to the main part of our evening. As I said, my name is David Eisner the President and CEO at the National Constitution Center, and tonight we’re going to have the Eighth Annual John M. Templeton Jr. Lecture on Economic Liberty and the Constitution. Every year we look forward to hosting these discussions. We get to address the most important issues facing our nation economically, and what the Templeton Lecture exemplifies is what we at the Center can accomplish in terms of setting up a “town hall” kind of meeting, able to present leading minds and providing a nonpartisan forum for civil discussion and deliberation. We’ve had previous lectures that focused on topics ranging from healthcare reform, to immigration policy, to campaign finance, and while last year’s Templeton Lecture considered the causes behind the economic crisis, this year we have the opportunity to look forward and ask, perhaps with a little bit more optimism, “Where do we go from here?”

Joining us tonight is the leader of President Obama’s economic team, and some other distinguished guests, who will delve into the complex and multifaceted issues that surround these discussions. But before we welcome them to the stage, I’m delighted to recognize Dr. John and Pina Templeton. Over the past eight years, the Templeton’s generosity has allowed the Center to engage many eminent thinkers in public conversations illustrating critical issues with clear and measured insights. Without the Templetons, this series would not be possible, and we’re deeply grateful for their support. Dr. John Templeton began his career as a doctor at Children’s Hospital of Philadelphia. In 1995, he left medicine to lead the foundation established by his father, the late Sir John Marks Templeton. Dr. Templeton’s belief in the fundamental strength of America’s free enterprise system, and his belief in economic liberty inspired him to establish this lecture series, and we’re so appreciative of the relationship that has developed since then between the Templetons and the Center. Ladies and Gentlemen, please join me in welcoming Dr. John Templeton.

Well, good evening ladies and gentlemen, it’s a great honor to be with you again for the Eighth Annual Templeton Lecture on Economic Liberty and the U.S. Constitution. From its earliest conception under the guidance of Joan Specter and the Center’s first president, Joe Torsella, this annual lecture was established as a signature annual event to honor the lifelong labors and the values of my father, Sir John Templeton, in fostering the economic liberty as the irreplaceable foundation stone for freedom itself. Some of my father’s ideas on freedom and especially in regard to our topic of economic liberty include the following:
Freedom fosters competition which yields progress. When the creativity and ingenuity and competition of individuals was set free, the result was progress and prosperity beyond anything ever imagined before.

Second, he said that government competition with private enterprise was both self-defeating and always unfairly balanced. Given the power levers of government which, in regard to excessive taxes and regulations, automatically eliminated any prospect of a fair and neutral playing field.

Finally, Sir John strongly agreed with Thomas Jefferson, America’s first democratic president, who said, “A wise and frugal government which shall retrain men from injuring one another, shall leave them otherwise free to regulate their pursuits of industry and improvements, and shall not take from the mouth of labor the bread it has earned. This is the sum of good government.”

The overall context for these viewpoints of my father’s was best encapsulated by him when he met each year with thousands of Templeton Fund Shareholders and defined for them what he thought was one of the great revolutionary events in history, namely people’s capitalism. He used this term in the context of years of personal experience as an investment analyst. He pointed out that when he was a boy in the 1920s, perhaps only 3% of Americans actually owned shares in publicly held corporations. Increasingly, however, by 1985 and 1990, he would often point out the extraordinary change whereby, over time directly or indirectly, close to 70% of Americans owned shares in public corporations. He stressed that the phenomenon was indeed unique in human history, and that it offered the potential for breaking the deeply harmful psychological tendency in human nature, namely envy. It was his vision that as more and more Americans became owners of public securities that they would begin to think less and less of the classic model of envy, namely those others and myself, and instead see themselves as co investors in prosperity.

Sir John also pointed out the power of America’s instinctive capacity for common sense logic. America’s founders counted on this common sense logic to produce a legal, a moral and a virtue based system designed to maximize human energy, creativity and productivity. From such vigor and industry then freedom itself will be assured, including what Washington himself urged as the good of the people. Just as Washington was a substantial hero to people of his time, and for a few of us today, Sir John also loved and admired other heroes of integrity and humility. Heroes who, in the face of whatever adversity and challenges might arise, would remain undaunted and resolute. In his entire life, Sir John celebrated every moment of adversity and gave sincere thanks for those heroes who never stopped seeing problems and difficulties as actual blessings of opportunity. Thus, let me share with you just one of the many examples of hero models in dad’s mind. Thomas Elva Edison was a genius in science and discovery and entrepreneurship. It was his examples that, for the first 29 years of dad’s life, inspired him to the concepts of what could be done with economic liberty. In Edison’s life, there was a reflection of that American amalgam of a major inventor, a serious investigative scientist and a very successful entrepreneur. Dubbed “The Wizard of Menlo Park” he is credited with the creation of the first industrial research laboratory. His prolific creativity resulted in almost 1100 patents in his name. Thus Thomas Edison was an exemplar of the kind of out-of-the-box creativity and drive that Sir John sought when for over 50 years he was a global researcher for Deep Value Investing. In the case of Thomas Edison, however, Edison’s collective reach and truly transformative enduring impacts could only have occurred in a country, a legal system and a culture with a deep abiding passion attachment to economic liberty. Thus, my father’s sustained appreciation for Thomas Edison as a hero also included his recognition that Edison created and prospered
in a pervasive culture in America in which mind-numbing, restrictive regulations were inconceivable. Sir John especially loved the quote of Thomas Edison who said, “There ain’t no rules around here. We’re trying to accomplish something.” Sir John also knew that the only assurance of true liberty and the success of free enterprise was a passionate, innate understanding of an attachment to both private virtue and public virtue. As someone who grew up 80 or 90 years ago in rural Tennessee, he readily knew and absorbed the words of John Adams such as, “Public virtue cannot exist in a nation without private virtue, and public virtue is the only foundation of republics.”

In short, my father understood that the only real foundations for economic liberty and freedom itself occur when two critical cultural values burn fiercely in the breast of not only every citizen but even more so in the breasts of elected officials and their appointees. These two essential virtues were an abiding passion for honesty and thrift. Sir John himself did not trust that virtue would prevail in any faceless and even detached and wilfully confiscatory government. He felt that whatever virtues such government might claim, the only bastion of liberty is an acute jealousy to preserve liberty in the hearts of the people themselves. Thus, my father agreed completely with the unsurpassing wisdom of the man who founded this very commonwealth, William Penn, who said, “Right is right, even if everyone is against it. Wrong is wrong, even if everyone is for it.” In regard to each one of us, if Sir John could be with us today, he would convey deep concern about our ever fragile republic when daily government and others seek to unravel and even shackle economic liberty through crushing taxes and also through excessive mountains of regulations. Such shackling of creativity would truly have caused Thomas Edison and perhaps Einstein himself to pick up their notes and to travel to another land to find some haven of freedom of liberty and a real culture of untrammelled enterprise. It was, after all, Albert Einstein who said, “Everything that is really great and inspiring is created by the individual who can labor in freedom.” In regard to each one of us being jealous and vigilant for freedom, the Templeton Press has published and recently disseminated a book called New Threats to Freedom. Among many threats identified in this new book is the rapid ascendence of policies and plans to supplant the long dependent U.S. Constitution with a variety of insidious assaults known as transnationalism. Should policies of transnationalism become established through the American government, then in the end there will first be no real popular sovereignty, following which both economic and political liberty will wither away. Thus I would offer for your consideration, there is vastly more at stake in this evening’s discussion than one might have initially expected. So at this point, I would like now to ask Mr. David Eisner, the previous distinguished CEO of the Corporation for National and Community Service, and now as you know, the President and CEO of the National Constitution Center, to come forward and to introduce this evening’s program entitled: America’s Economic Landscape in a Post Recession World and all of our outstanding participants. Thank you Mr. Eisner.

David Eisner

13:10 Thank you Dr. Templeton. So here’s the way tonight is going to go. In a moment, I’m going to introduce Lawrence Summers to deliver his lecture. First, what I’m going to do is introduce George Priest and Glen Hubbard because, immediately following Mr. Summer’s remarks, Professor Priest will offer a response, and then Dean Hubbard will moderate a discussion between Dr. Summers and Professor
Priest, and then he will open the discussion to the floor for your questions. We’re looking forward to hearing from our web audience, our webcast viewers, and we’d like to thank the business news website, AOL’s Daily Finance—our media partner in presenting tonight’s program—for connecting this discussion with a larger audience.

George Priest is a Professor of Law and Economics at Yale Law School and a Kauffman Distinguished Research Scholar in Law, Economics and Entrepreneurship. He’s an internationally recognized expert in the fields of antitrust and regulation. He’s interested in how legal institutions can promote entrepreneurship, and over the past two decades, his research has focused on the determinates of economic growth. Before joining Yale’s faculty in 1981, Professor Priest taught at the University of Chicago, SUNY/Buffalo and UCLA. Glen Hubbard is Dean of the Columbia Business School. Serving on Columbia’s faculty since 1988, he is the Russell L. Carson Professor of Finance and Economics with a dual appointment in the University’s Graduate School of Arts and Sciences. Dean Hubbard is a specialist in public finance, managerial information and incentive problems in corporate finance and financial markets and institutions. He has applied his research interests in numerous capacities including as a consultant to many corporations and as deputy assistant secretary of the U.S. Treasury Department. We are very pleased to have both of these scholars here with us this evening. Please join me in welcoming Dean Glen Hubbard and Professor George Priest.

15:57 And now, it’s my honor to make a very special introduction. Lawrence Summers is Director of the White House’s National Economic Counsel and Assistant to the President for Economic Policy. Stepping into this role in the middle of the worst economic crisis since the Great Depression, it’s unsurprising that Dr. Summers has found himself at the epicenter of many heated debates over what is needed to facilitate economic recovery and prevent another financial crisis. Many view him as having helped saved the global economy from collapse. He is sometimes portrayed less generously by others, who are concerned about government intrusion into a free market. While matters of fiscal policy can be debated endlessly, one thing’s been clearly established. At this important moment in our economic history, Dr. Summers continues to act with calm insight and reason exhibiting his characteristic blend of expertise in academic, political and business acumen.

Prior to joining the Obama administration, Dr. Summers was the Charles W. Eliot University Professor at Harvard serving as the university’s president from 2001 to 2006. From 1999 to 2001, he served as the 71st U.S. Secretary of the Treasury following his earlier service as Deputy Secretary and Undersecretary of the Treasury, and from 1991 to 1993, he served as the chief economist at the World Bank. Dr. Summers has had a distinguished teaching career, and his research contributions were recognized when he received the John Bates Clark Medal, given every two years to an outstanding economist under the age of 40. He was also the first social scientist to receive the National Science Foundation’s Alan T. Waterman Award for outstanding scientific achievement. And now, it’s my great pleasure to introduce him kicking off what I’m sure will be a stimulating, thoughtful and respectful conversation. Ladies and gentlemen, please give a warm welcome to Dr. Lawrence Summers.
Lawrence Summers

18:40 Thank you very, very much for that generous introduction. It was much more generous than we economists usually receive. It wasn’t so long ago that I was introduced by the guy who said, “Larry, do you know what it takes to succeed as an economist?” and I said, “No.” And he said, “An economist is someone who’s pretty good with figures but does not quite have the personality to be an accountant.” That was in Moscow, and no one got the joke, and that tells you something quite profound about the United States. The introduction was very generous, but it left out what is perhaps my most important qualification for being here tonight. I am the son of Philadelphia’s own Anita Summers and the brother of Philadelphia’s Dr. Rick Summers, and I also can claim—after my experiences at Harvard—to be one of the very few people in American history who have left politics and gone to work in government. Think about that. Some of you will get that.

I want to reflect tonight in the spirit of the National Constitution Center’s emphasis on history, on the Constitution, on the kind of large questions that frame the republic about the animating philosophy that is guiding your government’s efforts through this period and its application with respect to fighting the recession with respect to financial reform and with respect to reform of our healthcare system. People asked me when I first made plans to go to Washington and advise President Obama on his economic strategy, “How would you define success? What was your objective? What were you trying to do?” I am never quite sure how to answer that question and then, one day a kind of answer struck me. I remembered back to my twin daughters’ study of Advance Placement American History, and I had helped them review for the Advance Placement Test, and so I had a sense of what was in their course. What I was struck by, as an economist, was that all kinds of events that seemed very important to me—the 1987 stock market crash, the 1982 recession, the inflation of the 1970s—were barely mentioned in their course. In contrast, the course seemed to go on and on and on about the Depression of the 1930s, what it had meant to the American people, and what it had ultimately meant globally, and I vowed that a first definition of success for us would be this: Let’s make sure that this economic crisis is not studied by students of history 25 years from now or 50 years from now. Let’s do everything we can to make sure that this economic fluctuation falls in those ones like the ones in the 80s that were critical, but not historic.

There was a second lesson, in a way a deeper lesson, that I drew from their study of American History and it was this—and these kinds of theories come in many forms: That there were moments in history when the American people thought their greatest threat and risk came from government. It came from interferences in their liberty, and their focus, their demand was for officials who would stop the growth of government. Who would roll back excessive intrusions of government, and that those were many moments in American history. That there were also moments—the 1930s had been one, the first decade of the twentieth century had been one, the 1960s had been one—when the American people thought that the greatest threats they faced came not from government but from lack of an ability to mount a collective response. It came from the free force of an unchecked market, the spreading bank failures that produced 25% unemployment in 1933, the ravages associated with unchecked and unregulated industrialization that called forth the antitrust laws, that called forth the first laws regulating child safety or regulating food safety in the first decade of the twentieth century. The unacceptable pervasiveness of poverty emits plenty and especially of poverty amongst the aged that called forth the Social Security program and then
in the 1960s called forth the Medicare program and the War on Poverty. And that in a sense, periods of concern about too much government and periods of concern about the most pressing problems in people’s lives came not from the center but came from the lack of structure. These periods alternated in American history. It was my judgement that in important respects, this was a period of the second kind. That, yes, we have much to fear from excessive government, but that it was my judgement that the largest challenges we faced came from the concern that government would do too little. That government would not seek to restore stability in our economy. That an unchecked financial system would too often be a source of instability rather than stability, and that the needs and potential of modern science to improve health would not be brought effectively to American citizens without collective action. That more generally not just healthcare but the great systems of our society—education, energy, transportation—each required collective action, cooperative action and were not working well enough. And that beyond lifting the economy out of the rut of recession, the challenge of this moment was to restore the public capacity in each of these areas. What I want to do is just speak briefly about each of these three areas, and then I’ll offer a concluding thought.

28:39 Economic Stability: The most important thing that a student learns in an introductory economics course is that markets are these remarkable self-equilibrating systems, and students go through many examples. When there’s too much wheat, the price of wheat falls, people eat more, people plant less and equilibrium is re-established. When there’s too little investment, the interest rate falls, more people decide to invest, fewer people decided to save and equilibrium is restored. And that is how it is—most of the time. The free market is a self-restoring system. But perhaps three times a century, that self-restoring system breaks down. This was Keynes’ central insight. Vicious cycles take over. Prices of assets fall, people face margin calls, they’re forced to sell them, and they fall more. Bank’s capital goes down, they lend less, assets go down, people can’t repay banks, bank’s capital goes down more. A flawed financial system means a weaker economy, means a weaker financial system. Less income means less hiring, means less income, means less hiring. An economy that is normally self-stabilizing ceases to be self-stabilizing, and there is no alternative to public action. The 1930s were such a time, and 2008 was such a time. General Electric was not able at one stage to borrow money for five days. It was only able to borrow money for one night. Fortunately, it was able to borrow money the next night as well. There was no alternative to strong public action to stop those vicious cycles. We’ve got a long way to go, but people are no longer talking about the possibility of depression. People no longer fear financial collapse. We no longer worry about whether the largest financial institutions in the country will fail. That is not because a market self-equilibrated. It is because a government took strong actions, strong fiscal actions to spend large amounts of money and cut taxes substantially to stimulate demand, strong financial actions to force transparency and force financial institutions to raise capital, strong action to stop cascading failure at a moment when the market would not work through the support that enabled the automobile companies—yes two of the major automobile companies, General Motors and Chrysler—yes, to pass through bankruptcy, but to continue to function, to continue to produce and to continue to sell. That was the approach, and I would suggest to you that the prospects that we will succeed, the prospects that this is not going to be remembered in the way the depression is are far greater than they were fifteen months ago.

32:51 Second, Financial Reform: You think about it. The last generation has seen the 1987 stock market crash, the S&L debacle of 1990, the commercial real estate difficulties of the early 90s, the Mexican
financial crisis, the Asian financial crisis, the Russian LTCM financial crisis, the bursting of the tech bubble, Enron and now the disaster of the last two and a half years. One crisis every three years, on average, when a financial system—whose function is supposed to be to allocate capital, to bear risk, to distribute risk, to provide insurance—it self-proved to be a source of major instability resulting in the unemployment of hundreds of thousands, if not millions, of people. I suggest to you that relying on that system to stand alone and to restore itself is not the way forward. Rather, I would suggest to you that that financial system is in need of twenty-first century regulation. It has probably been in need of twenty-first regulation for some time. That is not an agenda of saying as some would have it that if the government—there are those, there are those who argue—that if the government simply says, “No matter what, we’ll never provide any support.” Yes, General Electric may only be able to borrow overnight. Yes, the depositors may be lined up out the door. But if the government just says, “That will never happen.” everybody will be so scared that they will never allow a financial institution to get into trouble. It’s view, but as one who lived through the events of the last two years, it’s not a risk that I would choose to take. There are others who would say that if you just didn’t have large financial institutions, if you just didn’t have any financial complexity that all would be well. All wasn’t well in the 1920s when we didn’t have this kind of financial complexity, and we didn’t have institutions on the current scale. Rather, the right approach is to recognize that a modern financial system—like a modern transportation system—brings substantial benefits that one wouldn’t realize without it, but that it requires sophisticated regulation. How can it be right that trillion-dollar balance sheets, with the capacity to bring the economy to its knees, are not comprehensively regulated by anyone? That will be changed in the financial reform legislation now under discussion. How can it be right that financial institutions can, without telling you anything, charge you a $35 overdraft fee for taking $15 out of your ATM and nobody says anything? That it’s considered to be good strategy. Or that mortgages can be provided with terms that are designed to deceive? That’s not right either, and we’ve learned things about the structure of regulation. We do not allow the same regulator to be in charge of the profitability of the airlines and the safety of the airplanes, and we shouldn’t allow the same regulator to be in charge of the profitability of the banks and the safety of their lending practices, and that’s why a consumer financial regulator is such a priority. We need in other ways to control the risk taking of financial institutions. Some of it goes to the full structure of their activities. Some of it goes to the idea that just as our financial market started to work much better and has gradually worked better over 200 years because we put stocks on exchanges where everybody can see prices, and you don’t have to trust the individual you’re dealing with, but it can instead rely on the clearinghouse or exchange. Now when we’re trading trillions of dollars of derivatives, similar kinds of changes are needed. There is much that could be discussed about the financial reform bill. But part of what makes this a distinctive moment in American life is that after the affairs that we have seen, there’s a compelling case for controlling risk taking when risk taking by one institution can create enormous problems for other institutions. This is not something that’s antibusiness. It is something that is pro prudent business. How else can you reconcile profitability with prudence? If I present my product honestly, and you present your product dishonestly, you will outsell me every time. If I keep a reasonable reserve, and you do not keep a reasonable reserve, you will out profit me every time. If we want to have good, honest, profitable business we need to strengthen our system of financial regulation.

39:00 A third area I want to touch on just briefly: Healthcare. There is a view, and it has a logic, that this too can just be left to Adam Smith and to the free market. And if everybody’s healthcare needs were
roughly the same that would work. But in fact a relatively limited number of people unfortunately incur a rather large share of the illness. They are unable to pay themselves. That’s why it’s natural to look for health insurance. You pay a premium, and if you’re unlucky, you’re assisted in providing the cost.

That’s a great idea if no one knows and no one will be able to tell who is going to get sick. But if individuals do know who’s going to get sick, if insurers can figure out who is going to get sick—and by the way with the kinds of progress we’re seeing in genetic testing to an extent that is unimaginable 15 years from now it will be possible to forecast who will get sick with what when—who will provide the insurance to those who are sick or those who are likely to get sick? That is why a system based on volunteerism simply will not work to provide benefits for all. A system based on volunteerism also won’t work in a generous society because in a generous society, some people will buy insurance and get care, and other people will buy insurance, and the society will not be willing to not give them care. It simply will not be willing, and that is why each of us in this room pays about an extra thousand dollars a year on our health insurance to cover the cost of those who don’t get insurance, but we’re paying that. Why not create a system in which everyone gets insurance? That is what we now have in this country, and because we now have it, we’re going to be able to do something that we otherwise would not have been able to do. We’re going to be able to seek to control the costs of the healthcare system. Healthcare represented 9% of our incomes in 1980. It represents 18% of our incomes right now. Healthcare is rising by 1% of our income every two years and the pace is accelerating. If 50 million people are without health insurance, and we try to cut down on costs, you know where those costs are going to fall. Only by providing universal health insurance do we have the prospect for expanding our seriousness in containing costs.

Healthcare, financial regulation, responding to recession—these are three examples of what I believe is the challenge of this moment: Strengthening the capacity of a thoughtful government to respond to challenges in its citizens’ lives that cannot be met individualistically. Some see this as a liberal idea or as an idea that is opposed to the objective of maximizing freedom. I see it very differently. Yes, in important ways it is a liberal idea, but in a deeper sense, it is an idea that supports and undergirds freedom. Why is it that we have maintained ourselves as the freest major society in this world? It has a great deal to do with the fact that we have met these challenges in people’s lives before they led to convulsive and catastrophic political change. Why did America in the 1930s not see what so much of Europe and Japan saw during the 1930s? It was because of what Roosevelt was able to do. Why have we maintained the freedoms, the economic liberty, and the scale of government that is relatively small by global standards? It is because we have averted catastrophes. I believe we did that again in 2009 by responding to the recession. I believe that we are seeking to do that by renewing our economy in ways like reforming financial system, healthcare and the other large systems of our country—education and so forth. It is part of the dialectic between the threats that come from the collective and the threats that require collective action that have defined American democracy since the constitutional convention, and as long as we keep having these debates, recognizing sometimes that things need to move in one direction and sometimes they need to move in the other, we will be celebrating the longest, continually functioning republic the world has ever seen for centuries to come. Thank you very much.

George Priest
Well, David thank you very much for the generous introduction. It’s an honor for me to be on the same podium with Glen Hubbard and Larry Summers. My job is to respond to Larry. I have to tell you, he has had so many extraordinary achievements I don’t know how to refer to him. Director Summers, President Summers, Secretary Summers, Professor Summers. Larry’s colleague Henry Kissinger once was faced with that question. He said, “You can just call me Excellency.” But with Larry, you have to use the plural. It’s Excellencies that best characterizes him. I would like to say a few words first about the general theme of this lecture series—Economic Liberties and the American Constitution—and then turn to a response to Larry.

In the history of this country—though it is probably true of all countries—financial crises and peril created difficult times for economic liberties. Politics and the market are our principle mechanisms for organizing societal behavior, and they are often—I think wrongly—viewed as substitutes. As a consequence, when a financial disruption occurs, there is frequently a public belief—and it was reflected really in Larry’s talk this evening—a public belief that the political system must do something to cure or to repair the economic failings. Because the sources of financial crises are generally poorly understood, and especially poorly understood during the crisis itself, the political responses that follow often address the symptoms not the causes and almost always generate harm towards the goal of economic strength because they can strain economic liberties. Of course, the purpose of a constitution is to establish and preserve economic and political liberties, and in many cases, the untoward economic legislation that follows from a crisis is overturned on constitutional grounds. For example, there were frequent periods of financial crisis during the nineteenth century—crashing of bubbles, the increase of debt, foreclosures and the like—and often times both state governments and the federal government responded with debt relief legislation basically abrogating mortgages or other forms of debt contracts. Now this was—these actions as most legislation that responds to a crisis—was counterproductive from the standpoint of economic growth. The principle effect was an increase in the risk of lending, a rise in interest rates. But very commonly during the nineteenth century after some period of litigation, those statues were declared unconstitutional as violating the contracts clause of the Constitution which is one of the most important protections of economic liberties in that document. There have been periods and financial crises, however, of such substantial dimension that the harm that has resulted from the legislation trying to solve the crisis has proven more dangerous to economic liberties and more harmful over economic liberties in the long run because these crises and the response to these crises have affected the Constitution itself. The Great Depression of the 1930s was certainly of this nature.

The Great Depression was, as we know, a more severe financial dislocation than any crisis the country has faced before or since, and the response of the Hoover Administration was ineffective, constrained by the gold standard, constrained by a restrictionary monetary policy of the Federal Reserve and the reluctance of Democrats to join a Republican rescue. Upon the election of a charismatic and ambitious president in 1932, however, who believed and who convinced the public that political action might provide a solution, a wide range of new legislation was enacted in the first New Deal. Now, it happens empirically that economic recovery had begun from the Great Depression prior to any of Roosevelt’s programs being enacted, but nevertheless, there was a vast enactment of legislation and a change in the face of government entirely. Again this legislation—as is typical in the context of crises—dealt with the symptoms of the crisis and has proved largely counterproductive toward encouraging economic growth
since and during the crisis itself. The best example of this point—though I think the worst example from the standpoint of its affect on the growth—was the enactment of the National Industrial Recovery Act, a centerpiece of the first New Deal. The basic conception of the act was to attempt to achieve recovery by increasing profits for corporations by arranging for them to form industry cartels to raise prices and to raise wages of workers by arranging for the equivalent of union organization even in non-union industries. In the context of the extraordinary drop in aggregate demand of the time, these were the worst policies possible to adopt. The Agricultural Adjustment Act which sought to raise agricultural prices by limiting output was of similar effect. At the outset—again, this legislation was like much crisis legislation, an attempt to deal with the problem but again was subjected to constitutional test—at the outset, the Constitution and the courts as another financial crisis impeded these developments. In 1935, the Supreme Court ruled that the National Industrial Recovery Act was unconstitutional. But that decision and other decisions by the Supreme Court—in invalidating Social Welfare legislation that was counterproductive to growth—led to a political firestorm that caused the court to retreat and radically change its interpretation of the Constitution. It led to a change in the meaning of the Constitution itself that vastly affected economic liberties. Governmental powers over economic affairs were increased dramatically and remain increased today. Although, over the succeeding years, there was some dismantling of specific forms of economic regulation, much of it remains today and is built upon by the financial reform proposals that Larry was talking about. But with this context, let me turn now to our current financial crisis and to the current Administration’s proposed financial regulatory reforms that Larry addressed.

54:58 The current financial crisis is serious, as we all know. It’s not as serious as the Great Depression, but it’s more serious than many others this country has suffered. This crisis, as the others, has generated a feeling, an impression that Larry reflected—I’m not convinced it’s a public demand, but there’s certainly an impression—that the political establishment should do something in the context of this crisis. This was really the theme of Larry’s talk, and it’s led to proposals—the legislation that Larry has defended—that I think is likely to prove—as legislation in other crises—likely to prove counterproductive to economic growth. One of the reasons I think this will be true—as is typical—we really don’t understand what caused our current economic crisis. The cheap money policies of the Federal Reserve? Well, we can’t really change those policies now because of the crisis. We need to stimulate liquidity as much as possible. Excessive incentives to invest in real estate by subprime borrowers? Perhaps. The greater aggregation of risk is a consequence of a securitization of debt instruments? Perhaps, but we really don’t know. The real question I think, with regard to our current crisis—and I think many economists believe this as well—the real question is why were our markets—more sophisticated markets than we’ve ever had before—why were our markets not able to anticipate and prevent the creation of the bubble, or at least to moderate its subsequent collapse? How should we evaluate the current reform legislation in terms of economic liberties and economic growth? I honestly believe—knowing Larry’s work—I honestly believe that Professor Summers and I would not really disagree on the comments I am going to give about this legislation, and that may not be true of Director Summers and I, but I think Professor Summers and I, and as well as Dean and Professor Hubbard would largely agree. Some of the provisions of the current reform proposals are innocuous and may even be modestly beneficial. For example, the regularization of exchanges or clearinghouses for derivatives, more transparency is better than less. Of course the principle question is at what cost? Greater shareholder participation in determining executive compensation may
also be of this nature. Other particulars of the reform, however—other portions of the reform—are likely
to prove counterproductive to economic growth and even to recovery. Larry in other writings, even as
director, has emphasized that when an economy has suffered a substantial contraction in demand, it’s
important to increase liquidity and credit, not to contract it. But many features of the current reform
proposal fail to heed that admonition and create regulatory structures, the effects of which we cannot
predict. For example, the consumer protection provisions, that Larry mentioned, will have—I think

predictably—the effect of reducing the availability of consumer credit especially those with the lowest
incomes and at any rate is a subject that cannot possibly be connected to the source of the crisis. The
constraint on banks from making proprietary investments, especially in derivatives, will impede banks
building reserves and thus increase the riskiness of banks. The requirements of banks to maintain greater
reserves? It’s perhaps a worthy ambition, but again it’s exactly opposite to the policies of the Federal
Reserve which are attempting to increase liquidity not to reduce it, and of course it’s contrary to the
objective of the stimulus that Larry discussed. Similarly increased taxes to create a fund for failing
banks? There’s a symbolic character to this reform—symbolic because the amounts that are discussed
would not have been enough even to bail out even AIG, not to mention the other companies that faced
distress—but it also will have the effect—the increased taxes—of reducing liquidity and reducing credit.
There are other tax proposals in the reform legislation that are simply arbitrary and punitive and that have
no real justification whatsoever. Other forms of regulation are proposed. They are not clearly defined,
and there is no reason to believe that they are not more likely to impair the market than to facilitate it, and
these are only some of the examples.

In evaluating the current financial reform, however, there is one important part and one important point I
think that must be made. Unlike the political impulses and the actions that occurred during the Great
Depression, there is nothing that I see in the current financial regulatory reform that is of constitutional
dimension. There are two meanings to this point. One, there is nothing in the reform that is likely to
change the meaning of the Constitution and the interpretation of the Constitution as happened in the
second New Deal under Franklin Roosevelt. Secondly, however, there is nothing that the Constitution
can stop or impede because of the distance that the country has moved after the legislation of the 1930s.
Perhaps, though, the rather limited nature of the current financial reform proposals which I think could be
in part a good thing—perhaps that’s the work of Director Summers, and if it is, I applaud him and urge
him to continue in that work—but the constrained nature of the proposed regulation I think will surely
impede economic liberties over some range. Not to the extent of the political action of the 1930s, but
economic liberties will be impeded. Why does the legislation not go further? Again that may be because
of sensible advisors like Larry Summers, but I think it also is because the great economic growth in the
United States and in other western nations that has been experienced since the end of World War II has
led to the widespread belief that markets and the preservation of economic liberties are crucial for a
country and that, while markets aren’t perfect, they must not be unduly impaired in order to promote
economic growth and to preserve economic liberties. Thank you.

Glen Hubbard
It seems we have a modest difference of opinion here to try to sort out. Before opening it up to the audience—this is your cue to think of questions— I’d like Larry to ask George a question based on his remarks, and then George you back in turn to Larry. Larry, you first.

George, maybe I’ll ask you a couple of questions. It’s a bracing world you present. First question would be: The Supreme Court for some years in the early midpart of the 30s essentially took the position that if two individuals contracted with each other or company contracted with an individual or company contracted with another that it was an inappropriate abrogation on freedom—I’m sure I’m not using the right legal words—to make such contracts unenforceable or to interfere and regulate those contracts. I couldn’t tell—when you seemed to favor what the Supreme Court had done with respect to the NRA but seemed to remark that it was unlikely that the Supreme Court would do this, would interfere with President Obama’s financial reform bill because of “the distance the country had moved”—whether you approved of those moves or not. If 1935 Supreme Court prevailed, would that have been better for America to this point would be my first question. And if you’ll permit me a second question, Glen, here’s an example that sort of poses some of these issues and ironically in the example I’m going to give, Franklin Roosevelt was not on the side that you would expect. There is an issue of deposit insurance. The way that deposit insurance works—and I’m obviously oversimplifying—is that banks are charged a small tax. The money goes into a fund, and if a bank fails and is unable to pay its depositors back, the fund is used to pay the depositors back. Because we have deposit insurance, on the one hand, people can put their money in banks and rest at ease. Banks don’t have runs in the way they did before because people don’t have to worry because the government is guaranteeing their deposits, and those are seen as positive things. On the other hand, it is a subsidy from strong banks to weak banks, since strong banks don’t need the insurance and weak banks rely on the insurance. They’re able to get money because they have it, and banks sometimes borrow money, relying on the insurance, and then they invest it and waste it or lend it to the bank owner’s brother-in-law, and that certainly has happened. On balance, I think we as a country are much better off for having deposit insurance, though there are a whole range of issues that come in with respect to its management and its implications for the regulation of banks. But those in the tradition that you were arguing from strongly opposed deposit insurance at the time it was instituted, and indeed rather surprisingly to a modern view of things, Franklin Roosevelt opposed deposit insurance or is said to have opposed deposit insurance for that reason. So just as a kind of window into how you see your kind of rather fundamentalist view of economic liberty and modern institutions, I would just be curious, do you believe we’re better off for having deposit insurance? I would confess that I do think we are better off for having deposit insurance.

George Priest
Those are fair questions, Larry. I’m not an anarchist. You call me an economic fundamentalist, I’m not quite sure that--?

**Lawrence Summers**

It’s like being a Baptist.

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**George Priest**

Oh, like a Baptist? I thought he was meaning a terrorist, so— I wasn’t quite sure what the meaning of that was. Your first question about the 1935 Court—or the Court before in 1935 changed its approach toward government shortly thereafter—it’s a difficult question. The effect of the political pressure that President Roosevelt put on the Court through the Court Backing Plan, the great public animist that was generated by the president and others in Congress against the Court caused the Court—and this is not my conclusion alone, this is a well accepted point—caused the Court basically to interpret—as I have mentioned—interpret the Constitution differently and to relax the interpretation of the Constitution that had placed limits on governmental power, in particular limits on federal governmental power versus state governmental power.

**Lawrence Summers**

Right.

**George Priest**

So the world is changed, the world changed in 1935—

**Lawrence Summers**

But I was asking, was that a good or bad thing?

**George Priest**

1:08:04 You know, it’s a counterfactual that is hard to answer. I think that it is unfortunate that it occurred in the context of a crisis which—as I tried to suggest in my remarks—often warps judgement and leads to actions that wouldn’t have been adapted earlier, but again, I’m not Richard Epstein and suggesting we should go back to 1932 or 1890 or, for that matter, 1840. I understand the world we live
in. It has meant, however, that efforts to constrain the role of government or the control of government over economic affairs and societal affairs has been transformed from Constitutional issues into essentially management issues or political issues, and those efforts are important, and they remain important. Now with regard to deposit insurance— to call deposit insurance “insurance” is something of a misnomer because, as you point out, it’s really a tax it’s not really insurance—deposit insurance could be converted and has been converted over the years especially after the deposit insurance system failed in the context of Savings and Loan crisis. There are more insurance-like aspects that have been added to it—greater risk related premiums and the like, reducing the subsidy from the stable banks to the unstable banks—more could be done with regard to that system. I think we all see, and we all are aware of the concern of a cascade of bank failures from the experience of the 30s and to some extent from the experience we see within the last two years, and I think we’re all grateful that there are some mechanisms to arrest those cascades. The market, though, has become much more sophisticated over those years as well. But I support deposit insurance, although I think it can be reformed.

Glen Hubbard

How about a quick question to Larry?

George Priest

Well, maybe you can’t talk about this as an insider, but I want to—and as a person that’s involved in the design of the financial regulation itself—but I’d just like to ask you your conception of it because the complimentary things I said, mostly about you not about your talk, were seriously meant.

Lawrence Summers

Love the sinner, hate the sin.

George Priest

1:10:39 I do respect your work immensely, but what I’m wondering is how is—and you don’t have to speak for the Administration now—how is it being considered or what mechanisms are being considered in the context of the design of these financial regulatory institutions? No so much the individual statutory provisions, but when you’re designing regulatory institutions—for example you’ve said trillions of dollars of derivatives ought to be regulated, all of this consumer credit ought to be regulated—how are you thinking about the design of this regulation in a way that one will constrain the regulation from drowning out, or strangling out, the most valuable economic activity associated with it? But secondly, also, how
Lawrence Summers

Let me just make three points if I could. First—and it’s difficult without getting into detail I guess to explain—it will be designed, we hope and trust, with a lot of sincerity, carefully and thoughtfully with an awareness of the dangers that you describe. Notice that it’s unlikely to fail simultaneously on both your tests. That is, one could imagine—to take a simple example—that a consumer regulator could be overly punitive in setting a ceiling on lending rates that was too low and therefore denied a lot of people credit, and one could imagine that a consumer regulator would prove to be overly responsive to the interests of banks and therefore not regulate severely enough, but at least it’s hard to imagine both at the same time and to some extent—

George Priest

Yeah, but I was trying to ask you about how you balance it.

Lawrence Summers

To some extent those pressures offset. My reading of history of the last two and a half decades, perhaps longer, is that we as a society have made many more errors on the side of accepting substantial instability and on the side of not regulating potential major sources of risk than we have made of stifling innovation or limiting of flows of credit. So, I’m much more worried over the longer term starting from where we are now, about allowing major instability than I am about limiting innovation. But there’s obviously a risk that has to be considered there, and it goes to thoughtful approaches by those who the president chooses to appoint. I think if one looks at the approaches that the Administration has taken with respect to the financial crisis, they have on some spectrum of opinion—you know probably, depending on where you sit, you see different spectrums of opinion—but the approaches have not been what people would, despite some of the rhetoric, regard as radical. Suggestions by many for nationalization of banks were firmly rejected. Suggestions for various kinds of Draconian restrictions on activities were rejected. So, I think that the approaches that have been followed in the past were suggestions that took off on the kind of example you referenced historically—for foreclosure moratoria—were rejected. So I think the evidence is in what has happened, and I tried to stress in my remarks—and you know there would be some who would have my general orientation who probably would think differently—that the country profits from a kind of cyclical dialectic where sometimes we’re responding to the larger problems coming from people’s exposure to an unchecked market, and sometimes we’re responding to people’s response to an unchecked government. My perspective is that this is one of the former times. I think probably—I flatter myself—
that we might do better if more people saw things that way rather than seeing things in a more polarized way where they always believe what is called for is more government or what they always believe is less government.

Just one very quick point George. You said something two or three times that we really are very mindful of—and it would be a completely fair point if we weren’t mindful of it, but we really are—which is everybody understands that it is the irony of financial crisis that the very things that should have been done to prevent it run the risk of making it worse once it happens. Therefore everyone is very sensitive to the fact that, as new capital standards are phased in and the like, it needs to be done in a very careful way that reflects the fact that, as the problem 2 years ago, 3 years ago, 4 years ago was excessive risk taking

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and excessive lending, the problem that’s the essence of the crisis is probably insufficient risk taking and insufficient lending and that the avoidance—to use the technical term—of procyclicality has to be an essential part of the design of the strategy, and I think I can give you, even if you don’t agree with them—some of the things I say—that there’s a lot of protections in the way this will be implemented.

Glen Hubbard

1:17:58 Let me jump in here because I do want to get to a couple of audience questions, but I did—listening to both of you—just wanted to make one observation—and maybe we can come back to it after taking a couple of audience questions—that I hear the philosophical differences between the two of you in talking about the crises every three years and the recent period or depression, but it strikes me there’s some practical issues too about the role of government. The 1930s were a period in where major policy mistakes, both brought on and enhanced the Depression from trade policy to monetary policy to wage policy. In the current period, it was highly regulated institutions that got into trouble. It was Fanny Mae and Freddy Mac that were virtual wards of the state. How confident are the two of you about this practical ability? I’ll let that hang for a minute and come back to it. I think we have probably time for a couple of questions from the audience. Sir? Right there—please wait and go to a microphone or—Because it’s being recorded.

Male Audience Member

What do you gentlemen think: In 2008, Congressman Ron Paul of Texas ran for the Republican nomination for president, and one of his ideas was to abolish the Federal Reserve system and go back on the gold standard. What do you gentlemen think of that idea?

Glen Hubbard

I don’t buy it, but I’ll let Larry and George speak for themselves.
George Priest

I think it’s totally impractical.

Male Audience Member

Why?

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George Priest

Well, there are lots of rigidities in the gold standard, and the economy has become so complex that allowing monetary policy to be determined by the volume of gold reserves is simply not going to allow the flexibility that a central bank like the Federal Reserve needs to deal with the economic issues that it faces. But I’m not even an economist, I’m just a lawyer. I’ll let Larry answer the question.

Glen Hubbard

I’m going to remind Larry not really to comment on monetary policy too much, so I’ll spare him that—given his current role—but I think we probably have time for another question. Sir?

Male Audience Member

Why is it that for many poor and working class and even middle class folks that when we talk about less regulation and more economic liberty that often seems to translate into the rich getting richer and the poor getting poorer?

Lawrence Summers

1:20:27 I think that was directed to me. Well, it shouldn’t result in the rich getting richer and the poor getting poorer. If the economy is operating well, and if there is sensible tax policy and sensible regulatory policy, the rich may be getting richer, but we want the poor to get richer too. That is, in a properly functioning economy, a rising tide lifts all boats and lifts the lowest boat first, to use the metaphor. There are, however, in our economy—as in many economies around the world—many rigidities and limitations and labor markets for lower income and lower skilled individuals that sometimes impair that effect. But I don’t think it’s simply—It’s not a function of more governmental regulation, it’s a function of the structure of the economy.
Glen Hubbard

1:21:23 Because I’m getting a slight “hi” sign from our organizers, here, I did want to ask one question that came from the Daily Finance audience, and the question is for you, Larry, from a Daily Finance reader who asked: Do you feel you were mistaken in supporting deregulation on Wall Street in the past?

Lawrence Summers

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Lawrence Summers

It’s really great to be here. Keynes famously said, “When circumstances change, I change my views. And you?” Clearly, we’re in a different world than we were in the 1990s. Clearly, we’ve seen a great deal, and I’ve laid out the kinds of approaches that we in the Administration favor. I think the record with respect to the 1990s, and my previous service in government and all of us who served at that time is rather more complex that the question suggests. In general, I think it’s always best not to focus on more regulation or less—George would probably agree with this, actually—not to focus on more regulation or less regulation, but on what regulation. Some of the important issues in the 90s where we favored—and I think look right today for having favored—stronger regulation include predatory lending, include paying more attention to issues of systemic risk, include concerns about the health of the GICs. So, I would rather be judged and try to frame my views on the basis of specific issues, and I think it will usually be the case, that in some areas where we need more regulation and then in other areas we need less, rather than to frame the question in terms of overall direction.

Glen Hubbard

1:24:08 Keynes also said, “Of course in the long run, we’re all dead.” We’re not going to run that long tonight. We’re going to do a wrap, but please join me in thanking Larry Summers, George Priest.

[Audience applause]
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