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Vernon Jordan: Please welcome Senator Jay Rockefeller from West Virginia and attending as a guest of our member, Sharon Percy Rockefeller. (Applause) Also attending tonight are, Council Member Jack Evans, (Applause) and Chief Financial Officer of the District of Columbia, Natwar Gandhi. (Applause) I didn't see him but I think Chief of Police Ramsey is here. He is not here, Okay. In addition I know that Jim Clark is here today. He is founder and head of Clark Construction, a long time member of the Economic Club of Washington. Clark Construction is celebrating its one hundredth year anniversary from 1906-2006. Jim, we welcome you and we congratulate you. (Applause) For many years the Economic Club has annually awarded two scholarships to promising doctoral students at one of the member institutions of the consortium of universities of the Washington Metropolitan area. At this time I would like to call upon Jerry Hawke, a partner of Arnold and Porter, the Clubs' Vice President for Education to make a special announcement concerning this year's scholarship program.

Jerry Hawke: I am very pleased to announce that the Board of Directors of the Club has approved a third scholarship. This one is to be named the Philip Dearborn Fellowship Award and to be focused on issues relating to the greater Washington Metropolitan Area. The other two scholarships are not so limited. The concept here is to try to stimulate doctoral research on issues relating to the District of Columbia. So, this is being announced tonight and the consortium of universities in the Washington Metropolitan area will announcing the fellowship and encouraging doctoral candidates to apply for it. We hope we get a lot of applications. Thank you very much.

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Vernon Jordan: The last time that I introduced Bob Rubin, I said that Bob Rubin was the best Secretary of the Treasury since Alexander Hamilton. After his speech, Rubin took me aside and asked, “Why is Hamilton first?” (Laughter) So, since I did not know Alexander Hamilton, and given the fact that Bob Rubin accepted my invitation to speak here today, and the fact that he is a very good and dear friend, and given the fact that he is giving me a ride back to New York tonight, I want to say to you that he is the best Secretary of the Treasury ever! (Applause)

The Honorable Robert E. Rubin is Director and Chairman of the Executive Committee, Citi Corps Inc. He began his career in finance at Goldman Sachs and rose through the ranks to become Chairman. In 1993 he accepted President Clinton’s call to join the first Clinton Administration. Bob served as an assistant to the President for economic affairs, where he directed activities of the newly created National Economic Council. Upon the retirement of Secretary Lloyd Benson, Bob Rubin was appointed to serve as our Nation’s Seventieth Secretary of the Treasury. Over the next four and a half years, Bob Rubin was involved in an astounding array of policy issues with great success. He left treasury in July of 1999. Since returning to New York, Bob has volunteered his talent and energies to serve as Chairman of the Local Initiative Support Corporation, the Nation’s leading community developments support organization. As Vice-Chairman of the Council on Foreign Relations, as a member of the Harvard Corporation, and as Founder and

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Chairman of The Hamilton Projects, named after Alexander Hamilton, the Project seeks to advance America's promise of opportunity, prosperity and growth through innovative policy ideas. He is the author of an Uncertain World: Tough Choices from Wall Street to Washington, which was a New York Times best seller. Ladies and Gentlemen of the Economic Club of Washington, it is with great pleasure that I welcome back to the Economic Club of Washington, my friend, a great statesman, Bob Rubin.

Robert Rubin: Thank you Vernon for the kind introduction and its sincerity. I wonder what it would be like if I didn't have an airplane to take him back to New York. One dignitary that has been with us all evening, but Vernon for some reason or another neglected to recognize is that distinguish corporate director, Ann Jordan (Applause). Ann and Vernon and discuss later why Vernon did not include her on the list.(Laughter) I always like to be helpful when I can.(Laughter) Vernon asked me to discuss this evening my framework for thinking about the outlook of the United State's economy whether as an investor or business person or policy maker, which I'll do. While these 3 purposes are different the basic issues at least in my judgment need to be evaluated in the same way they are the same basic issues and they are the basis of making sound decisions from each of these three perspectives. Let me just focus on one for the moment. As an investor, I am an investor and I care enormously investing about what I do with my own funds. I wrestle everyday with what I think may very well be the most complex and uncertain longer term economic environment of my adult lifetime and that obviously makes for a very difficult decision-making environment whether for investors, business people or policy makers. I said a moment ago my discussion is going to focus on the longer term because I believe that's the relevant horizon for investors, policy makers and business people. But let me make couple of brief comments first on the shorter term environment.

Most short term forecasts expect that we're going to have a soft landing that the economy will continue on reasonably good track. My own view is that this may well be the most likely scenario. But that the short term environment has probably got somewhat riskier as for example compared to a year ago. As just one example, as we all know consumption has been based in large measure, or at least the growth consumption, on financing against rising housing prices and now of course housing prices have softened and it seems to me that softness combined with a number of other factors: high oil prices that decline somewhat but are still high compared to where they were, adjustable rate mortgages now having to adjust to a much higher rate environment, higher levels of personal debt very low levels of personal savings, probably create a much higher or substantially higher level of risk with respect to consumption. Beyond this, and very importantly the growth in recent years has been under-gyred by unsound long term fundamentals such as our financial imbalances and I'll get to a discussion of those in just a moment. But for the moment looking at the short term, all of these longer term risks are unlikely to eventuate to materialize in any given short term period. But I do believe that the probability of those longer term risks' materializing in the near term has increased. The only point I'm making is that while the outlook may well be favorable for the shorter term, I do think the odds have shifted somewhat downward and that that outlook, the probability of it being favorable is somewhat lower.

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Let me also point out and this is extremely important not only for policy makers but to investors and business people as well, that despite good growth in recent years, these recent years have been difficult economically for most Americans. Medium real wages as you already know have been roughly stagnant over the last five years and even if you adjust for benefits it is a very complex issue something around real consumption. The reality is that medium reward, the medium reward per hour of work has grown very slowly and the gap between that medium reward for hour of work and productivity growth or the growth of real GDP per capita has been very wide, the consequence being of course a troubling increase in inequality. That was also true for twenty-five of the last thirty years with the only exception being the last five years of the 1990's. And this is not just an issue of values though I think this is very important issue of values, but it is a real threat to future economic growth. Which is why I said a moment ago that this is very important to investors and to business people.

Trade liberalization and even some aspects of a market based economy are only likely to receive broad based public support if the great preponderance of the American people feel that they're going to benefit from those policies and at the present time most Americans feel great anxiety about our economy. There was a Pew Foundation Poll a few months ago; probably most of you saw it, that reported that fifty-five percent of the respondents felt that their children would be worse off economically than they were; thirty-five percent better off; ten percent undecided. That is a striking contrast to the history of American optimism about the future, and reflecting the tendency of most people to disproportionately attribute their economic anxiety to issues around trade.

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A recent CBS New York Times poll reported that sixty-nine percent of those polled felt that trade barriers should be erected where American jobs are threatened. I'll return to this question of trade and to the anxieties with respect to the longer term economy in a few minutes.

But first let me set forth the framework with respect to the longer term outlook. To begin, the United States economy has enormous strength and those strengths are particularly important in this era of great change and rapid change in the global economy. These strengths include: a dynamic society and culture and historic embrace of change, a willingness to take risk, flexible labor and capital markets, a relative openness to immigration, and our shear size. On the other hand we face huge complex and deeply consequential challenges. At the present time the market has put very little weight on these risks, but that doesn't change reality. If you look across asset classes, risk premium are relatively low levels compared to a historic ranges. And even the stock market or that most analysts feel that is pretty fairly priced never less in my judgment presents a real question with respect to whether or not is reflecting risks, adequately reflecting risks. It is always possible that the future will a lot more benign than the past but at least in my opinion it is probably far sounder to expect that the future isn't going to be that dramatically different from the past. In fact, I think that while there are certainly are some factors that have reduce the risks of the environment. For example, the much improved financial position of the emerging market countries of non-Japan Asia. On balance it seems to me the risks are at least as great as they have been and I think probably even a little bit greater. If we meet our challenges, I believe the United States has the potential for a bright future. But, if we don't meet our challenges and in my judgment I'm about to say is receiving far too little focus at the present time. I believe that there is a high likely hood that at some point, some unpredictable point in the future, we are likely to have serious or even severe difficulty. The timing is impossible to predict, as is whether that difficulty will occur gradually or abruptly. Whatever the case may be, it is also in my view that we are not now effectively addressing those challenges on almost any front without regard to the question of how to apportion blame politically. Roughly two years ago, a group of financial people and policy people joined together in what we called as Vernon mentioned, the Hamilton Project which put forth a few months ago an over arching economic strategy and is now developing and putting forth specific policy proposal pursuit there too. To provide a non ideological, pragmatic, and fact based analysis based response to our challenges and there are others that are doing the same thing. I believe that compromise could be found that would represent real progress and most of the issues that we face and would satisfy all but the extremes. However, the politics have to be as good as the policy and in my view at least our most fundamental challenge is how to transformatively improve the effectiveness of our political system. To greatly increase the willingness to reach across party and ideological lines in order to find common ground and the willingness to greatly increase the willingness to make politically tough decisions on substantively critical issues. I know as many of you do the new leaders in both houses at least reasonably well. And I take great comfort from the thought that they are serious people who will address our nation's problems in a serious way and hopefully that can begin movement toward a transformation that I just described.

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I would put our economic challenge into five categories: 1) the financial imbalances that I already mentioned 2) deficiencies in the many requisites for promoting economic growth, for promoting broad based participation in growth and for promoting greater economic security that markets by their very nature will not meet therefore must be provided by government 3) exogenous risks 4) threats to the dynamism of our economy and 5) international economic policy. In the limited time I have, I'm going to comment very briefly on each but predominately on the financial imbalances.

With respect to those financial imbalances they are as follows: Our personal savings rate is proximately zero and personal debt is high relative to GDP. Our national savings rate is approximately one percent of GDP. We have large projected fiscal deficits if the '01 and '03 tax cuts are made permanent as proposed. Instead of the surpluses we should have had during this period of growth entitlements begin to increase rapidly as a percentage of GDP in the early part of the next decade and our current account deficit in part caused by our fiscal deficits is an almost unimaginable seven percent of GDP with heavy over weighting of dollar denominated assets in many foreign portfolios including central banks. Any of these conditions could be a problems in itself the combination of all of them is a deep threat to our economy and the entire global economy. So far vast flows of capital come from abroad largely motivated by the desire to support the dollar and thereby to support exports. Some extent from petrol-dollar countries seeking a safe haven in the United States have kept all this going but these vast flows built on top of the imbalances I've just described, seem to me be to be exceedingly unlikely to be indefinitely sustained either because confidence in our interest rate and currency markets diminishes in the face of unsound fundamentals including the increased debt at many levels or because of changed economic circumstances in the countries providing these vast flows of capital or because of exogenous events. The way to address these risks is not complicated. In a conceptual sense, and very complicated with respect to execution, we need to reestablish sound fiscal policies including with respect to entitlements. We need to have a domestic policy agenda that promotes competitiveness and we need to move in the global economy toward market based exchange rates.

On the second challenge, the challenge with respect to the requisites for economic growth, broad based participation in growth and economic security that must be provided by government. That includes education infrastructure, basic research, healthcare policy, energy policy and much else.

Let me make a few observations, brief observations 1) We are substantially deficient in all these areas. Just go to Shanghai or the Shanghai Airport, go to Kennedy Airport and ask yourself which is a first world country which is an emerging market country. It's true, across Manhattan what are the odds that your cell phone isn't going to shut off across Shanghai it's very different or Mumbai. Adequate response involves politically difficult measures. If there are costs must be funded and not met by additional future deficits and very very importantly the imperative for acting is enormously heightened by the new competitive environment.

The third challenge is the exogenous risks we read about in the newspapers everyday: terrorism nuclear proliferation all the rest. My only observation here is that as well as the other risks I am discussing none of these are reflected in markets to any very great extent if at all except in the risk premium for oil.

The fourth challenge and what I am about to say will probably be controversial, at least with some who share the political suasion of Vernon and me. The fourth challenge is the threat to our economy's dynamism. I believe that's getting far too little attention and should be a major focus of public policy. Our society seems to me to have an increasing tendency to want to eliminate or minimize risk. Instead of making cost-benefit judgments on risk in order to achieve optimal balances, the result too often, again in my judgment is regulation, legislation or litigation outcomes whose cost in other areas greatly exceed the benefit of risk reduction. J. Rockefeller had a tort reform proposal, a rather modest one in our administration, we unfortunately never pursued. But I think it was the beginnings of what we need to do with far more energy and effectiveness as we go forward. As I learned in Law School bad facts make bad law and the worst over reactions in terms of cost benefit optimizing often derived from terrible fact situations to lead to a political and media firestorm. In the pharmaceutical area for example, an unexpected increase in mortality from a drug is obviously a great tragedy. The litigation and regulatory reactions may deprive the broad population of a benefit whose value greatly exceeds the gain of eliminating this increasing mortality. Obviously these are very difficult values to balance against each other. But the process should be one of trying to make these weighing and optimizing judgments a lot of (error in tape inaudible) to eliminate or minimize risks. I believe that our over reactions in this area are now having a very substantial negative impact on our economy and our decision making in our economy.

And finally the fifth challenge, international economic policy. Then, I am going to return to my earlier discussion of trade. The global economy is undergoing changes of historic dimensions, including technological development, the movement toward market based economics around the globe, continued global integration, the adoption of growth oriented economic policies in China, India, and else where non Japan-Asia. There is a consequence in all this, the emergence of China and India as large potential markets. Which I believe are for us, great opportunity, but more immediately as powerful competitors creating a change in the global competitive environment of historic proportions, probably the most significant change in the global economic order since the emergence of the United States itself or possibly as Larry Summer said in a speech not too long ago since the Industrial Revolution. To take this discussion one step further. The range of goods and services subject to trade has vastly increased due to modern transportation and due to information technology. China and India are changing the global competitive environment that I mentioned a moment ago, due to effective productivity policies, due to an enormous current and potential capacity roughly a third of the world's population in those two countries, and due to large absolute cost advantages now and potentially across virtually all goods and services at current exchange rates and current wage rates. All of this heightens the already difficult situation where the spec to medium real rewards for labor, income inequality, and economic insecurity, beyond that, could create new uncertainties and complexities with respect to GDP growth. There is no question in my mind that trade liberalization is the right path forward and that protectionism will be counterproductive. But the politics of trade, which are always difficult, are likely to be substantially more difficult as we all know in this room. In the greatly changed competitive environment I have just described and that is both for substantive and political reasons. In my judgment, the full range of our economic policy in the face of this new environment needs a great deal of serious and innovative thought. There are some people who may think they may know the answers in the context of this environment, but I believe that if they think they know the answers, they simply don't understand the questions.

Most importantly, trade liberalization needs to be combined with a powerful domestic agenda to promote productivity, promote growth, broad-based participation in growth, and help for those who are dislocated by trade. But the politics of this dual agenda are extremely difficult because those who support trade to often too often do not support the domestic agenda. And those who support the domestic agenda too often do not support trade. Instead, as President Clinton used to say, "There should be a single agenda, a combined growth agenda".

Let me conclude by saying that I have gone through the challenges because they are so critically important to what happens. But, it is always important to remember that the American economy has great strengths and that our society and our economy have historically been highly resilient. Having said that, there is an enormous amount to do in all of these dramatic changes in the global environment greatly increased the imperative for our political system to meet our challenges. We can not afford to complacently assume that we will do well if we do not act. And we must recognize that what needs to be done is substantively difficult and politically difficult. There are no easy answers. For investors and business people, the key is to recognize the complexity and then to make judgments, their own judgments, each of us, as to the probabilities with respect to the relevant variables and possibly future scenarios, and, all that has to include economic analysis and also, very importantly, political analysis as to the likelihood that our political system will meet our challenges. Then, investors and business people, having made those judgments, can position themselves in accordance with their judgments. And beyond that, each of us as citizens can participate in the many ways that are available, in our system, to encourage our elected representatives and our political system to function far more effectively on the challenges that are so central to our future. Thank you very much.

QUESTIONS AND ANSWERS

Vernon Jordan: The first question that I have is, given what happened on Tuesday, what counsel would you give when called by the Majority Leader of the Senate, the new Speaker of the House, the various Chairmen of committees in both the House and the Senate when they ask your counsel on which way from here as they execute their responsibilities? In other words, comment on Tuesday in a way, shape or form you see fit.

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Robert Rubin: Well, what happened on Tuesday or maybe it was Wednesday. I have forgotten which, the Knick's beat Denver. (Laughter) But that's Wednesday, I apologize, I am off by a day, by two points. Jamal Crawford had a three-pointer in the last 3.7 seconds of the game. I tell you, Vernon, I really do think, and I think a lot about this, I live this in a lot of different ways, I think we are in a very complicated period. And I think we are in a critical juncture at lease for the longer term. This could go on for years, the way that it is, with all the imbalances and the borrowing and everything else, and a substandard public education system, and a health care system that does not work. It could go on for years, but it can't go on forever. I think if anyone were to ask me, actually some people have asked me, if people were to ask me, I guess what I would say is that what we all need to do is to think through sensible responses on all of the issues I have just mentioned that are not politically dumb. There is no sense in putting something out there that is politically suicidal because that accomplishes no purpose. But, sensible proposals that commend formative agenda that we can either try to do something about over the next two years, or even in nothing happens, that we can all at least talk about it and debate and hopefully improve the seriousness of purpose for an economic policy debate in our political system. Let me give you one very specific example. This can not go on fiscally. I am not saying it can't go on for another five years, but it can not go on. On the other hand as Pete Peterson likes to say, and I think Pete is right, if you make a serious proposal they are all so hard and tough politically, that if you put up the serious proposal, then all kinds of people are going to take shots at it and a lot of people will then say we need to take it off the table. And they will make it more difficult to go forward, rather than less difficult. So, I think what we need to have, and I think what better time

than now with a new leadership is for the leadership of both houses and the leadership of both parties and the President of the United States to get together and before you get too caught up in '08 politics recognizing that they have started already, but never the less before you get too caught up, get together and hold hands and start making some very difficult decisions with everything on the table and take the political risk jointly. You might say the probability of that happening isn't high, I would say it is an opportunity for people to make a historic difference.

Vernon Jordan: Is the economy too weak to increase taxes even on the rich? When can tax revenue be increased without slowing the economy?

Robert Rubin: First place, you can not solve the nation's fiscal problems without increase revenues. There is nobody that I know of involved in the political system who has put forth serious specific proposals that would get us anything remotely like toward a sound fiscal position for the long term based solely on expense reduction. So, it is going to have to be some combination of revenues and spending discipline. I think if you were to increase taxes right now you would have probably about zero negative effect on the economy. Because what you would do is you would take some purchasing power out of the economy, but on the other hand, if you stated to see a negative effect, contractive effect, in economic conditions, you could adjust monetary policy. And I think what you would do is begin the process with dealing with our longer term problems. And in terms of the supply side, the supply side argument, that if you increase tax rates, you reduce the willingness to work in all the rest. First place, I think there is very little academic literature to support it. And secondly, I have been on compensation committees of companies for a long, long time and I don't remember anyone ever saying, I am going to work less because my tax rate is higher. I just don't believe there is validity to the thought.

Vernon Jordan: Has Sarbanes-Oxley had a negative or positive impact on your risk reward analysis?

Robert Rubin: Well…let me answer this way. I think that as we look at the regulatory regime in the United States, it is true that the combination of our regulatory environment and litigation environment is having a real impact on where people lose to locate activities and I think in the context in evaluating all that, we ought to evaluate Sarbanes-Oxley. There clear was a need not only for enforcement actions, but for legislative regulatory action in connection with the matters that gave rise to Sarbanes-Oxley. But, I think the question we need to ask ourselves is, has Sarbanes-Oxley created a complexity and cumbersomeness of decision making, to say nothing of the cost, in corporate America that is now detrimental to our best interest and if so should there be an adjustment. And that is something to me that is susceptible to analysis. (Laughter)

Vernon Jordan: As Treasury Secretary, you are much focused on deficit reduction. Some fear that running a two to three percent of GDP deficit is not a problem. Can you please comment on why you feel deficit reduction is so important?

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Robert Rubin: If we continue on the current tract, as I said in my remarks. That if the '01 and '03 tax cuts are made permanent, assuming AMT is adjusted as it would have to be otherwise it just undermines the tax cuts and counting debt service. Debt is a percent of GDP in the United States, public health debt of the Federal Government rather is a percentage of GDP in the United States goes for roughly thirty-six percent today to roughly forty-nine to fifty percent ten years from now. And that is at a time of greatly increasing entitlements and very difficult and troublesome prospects looking forward. I think all of that creates the prospect that at some place out in time the market is going to begin to become very concerned about future fiscal prospects. And if that happened, then the kinds of benign market conditions that we have enjoyed for awhile could very quickly reverse. And the way to get ahead of that and the way to do something about now is to move from the say the 2 ½ or the 2 ¾ percentage of GDP fiscal deficits we have now to get on a tract where if we have the kind growth we have now, the base line is not zero here. We should be back to the surpluses which is what we had at the end of the 1990's where we should be today. And that would make a real difference with respect to the debt ratio I just mentioned and it would obviously increase U.S. savings at a time when our national savings rate is one percent of GDP.

Vernon Jordan: Is there any chance that you would be the Democratic nominee for the President in 1908?

Robert Rubin: In 1908? (Laughter)

Vernon Jordan: In 2008, I am sorry. I apologize. I got you confused with Alexander Hamilton. (Laughter)

Robert Rubin: I don't mind if some people want to consider me retrogressive in my views, but 1908? I don't think that is likely Vernon. No.