

THE ECONOMIC CLUB

O F W A S H I N G T O N, D. C.

Excerpts from the Signature Event featuring The Honorable Robert E. Rubin, Director and Chairman, The Executive Committee, Citigroup, INC and Former Secretary of the Treasury

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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.

The short term environment has probably got somewhat riskier as for example compared to a year ago. As we all know [*growth in*] consumption has been based in large measure . . . 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 undermined by unsound long term fundamentals such as our financial imbalances. . . . 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.

. . . 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 per 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.

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.

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 sheer size. On the other hand we face huge complex and deeply consequential challenges.

If we don't meet our challenges . . . I believe that there is a high likelihood that at some point, some unpredictable point in the future, we are likely to have serious or even severe difficulty. . . . It is also 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.

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.

[The] financial imbalances are as follows: Our personal savings rate is approximately 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 that is, 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 problem in itself; the combination of all of them is a deep threat to our economy and the entire global economy.

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. . . . We are substantially deficient in all these areas.

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.

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. . . . There is a consequence in all this, the emergence of China and India as large potential markets. Which I believe are for us, great opportunities, but more immediately as powerful competitors creating a change in the global competitive environment of historic proportions.

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.

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 too often do not support the domestic agenda. And those who support the domestic agenda too often do not support trade.