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IS U.S. PRIMACY FADING? SEARCHING FOR ANSWERS AT HOME AND ABROAD

3:00 – 3:50 P.M.
NO LONGER THE GOLD STANDARD?

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MODERATED BY
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NATHANAEL STICE: All right, good afternoon, everyone, and welcome to our final panel for the day. My name is Nathanael Stice and I am the junior fellow here in the Russia and Eurasia Program.

Our next panel will explore the question of whether the U.S. is still the gold standard in the global economy. And to help us answer this question, we have two very distinguished economists, Dr. Steve Radelet and Dr. Nouriel Roubini.

Dr. Radelet is a senior fellow at the Center for Global Development where he works on issues related to foreign aid, developing country debt, economic growth, and trade between rich and poor countries. He previously was deputy assistant secretary of the U.S. Treasury for Africa, the Middle East, and Asia. He has also served on the faculty of Harvard University as a fellow at Harvard's Institute for International Development, and director of the institute's macroeconomic program. Dr. Radelet received his Ph.D. from Harvard.

Dr. Roubini is a professor of economics at the Stern School of Business at New York University. As a leading economist in the field of international macroeconomics, he has had significant senior-level policy experience as a senior economist on the White House Council of Economic Advisors, and is a senior advisor to the undersecretary for international affairs of the U.S. Treasury. Dr. Roubini also serves as a consultant for a wide range of policy institutions, central banks and senior executives from major financial institutions. Dr. Roubini, like Dr. Radelet, received his Ph.D. from Harvard.

We also have a third economist today as our moderator, Mark Medish, and it must be said, another graduate of Harvard – (laughter) – and another former Treasury employee. Mark is a vice president for studies at the Carnegie Endowment, and his personal research focuses on issues ranging from U.S. Russian relations to emerging markets.

Without further ado, I would like to hand the floor over to Mark.

MARK MEDISH: Stice, thank you very much. Welcome, everybody. I think we have got a really exciting panel here. One thing Stice mentioned was that we were all Treasury colleagues. The key difference was this; that shortly after I joined the Treasury Department, the Asian financial crisis struck, and the world was sent into turmoil. Then these two gentlemen showed up and everything stabilized. (Laughter.) So I'll let you draw the reasonable inferences from that.

No longer the gold standard. We see in today's headlines that Toyota surpassed General Motors in the first quarter of 2007 in terms of car production. This has been featured in all of the economic papers, stories of the day, many suggesting that this is a

metaphor for larger trends. And in a way, the question for our session is what does an event like that mean? Is it really a trend? Does it matter? How should we interpret it?

The conventional wisdom coming out of the 1990s has been that the U.S. economic model, the U.S. economic market culture has won, that it dominates the world like never before. So that seems to be good news. Even Mr. Sarkozy, the leading candidate in France, seems to want to remake the French economy in the U.S. model, which is very flattering.

But there are others who say that there are risks here, and that there are other countertrends that go in a different direction and suggest that while the U.S. has won the battle for cultural dominance, the U.S. as a national economy may be sort of losing the war in terms of competitiveness. And people point to several factors, new factors in the global economy, such as the rise of the BRIC countries, Brazil, Russia, India, China, right; the major emerging markets – point to sustained structural weakness in the U.S. economy reflected in our trade deficits, that the U.S. is the borrower of first resort. And finally people point to the trend – the leveling trends of technology that basically imply that the U.S. may be losing it innovative edge.

So what does the balance sheet really look like, and what are the future prospects? Here are two of the world's leading experts on the subject. We are going to turn first to Dr. Roubini and then to Steve Radelet.

NOURIEL ROUBINI: Maybe I'll stand up at the podium so people can see me. First of all, thanks very much for inviting me. I think that it's a very important topic. And of course, there is this aspect of the debate about the relationship between the geo-economic and geo-strategic power. And the topic of your discussion throughout the day has been the question of U.S. primacy and whether it's fading or not.

And I'm a macroeconomist, so I would like to provide some insights from the point of view of an economist by trying also to link each having to do with economic and geopolitical power. Certainly there seems to be over history some correlation between the two. And as you recollect, Paul Kennedy, when he wrote the book about "The Rise and Fall of the Great Powers," he was writing at time in which the U.S. productivity growth was very low for the period between '73 and 1995 were actually U.S. productivity growth was – productivity growth was about 1.5 percent and total growth for the U.S. economy was between 2, 2.5 percent, so a period of relatively dismal growth with a slow down with all shocks, and whatever not. And his concern was essentially one that this – kind of like the industrialization of the U.S. low productivity would lead to a decline of U.S., the great power or empire or whatnot.

Then suddenly in the mid-'90s, we had this kind of, like, new economy boom. Suddenly we had productivity going from 1.5, tried for the last 20 years to 2.5, three, and then all of these concerns about the U.S. kind of disappeared. Then we got the tech boom and then an economic recovery. But the economic recovery that we have seen in the last few years in many ways, some people worry that it is imbalanced, there is very large U.S.

currency comeback to see if there is a very large U.S. fiscal deficit. There is a very large negative savings of the housing sector. So we are an economy that has major imbalances and we'll discuss how much of these imbalances are a trap to the economy and also political primacy of the United States.

The other point I think is important, is regardless of what that means in absolute terms to the United States, let me show a reality of economic power and the change of it. So for example, while the European Union – the Euro zone is still kind of like a work in progress, EMU and all of the rest, and all of the countries that are joined in the European Union has increased year after year. So as an economic area, at least in terms of the GDP, is larger than the U.S., and economic growth was sluggish for a while. That was the case also in Japan, but now there is a recovery, economic growth in Europe. Some of the structural reforms look like they are leading growth. Actually, last quarter's numbers suggested U.S. growth is actually lower than the Euro zone for the first time in over a decade.

So there is this process of both economic, political, monetary kind of unification in Europe, and some people refer to Europe as being the first example of a post-modern state, and almost going back to the Charlemagne kind of idea of a loose empire of nations that are together, and have joint rules, policies, or regulations, and whatever not. So it's an interesting model of thinking about how you integrate more countries in the global economy. You also make them adopt political institutions and rules and so on.

So that is one trend. The other trend that everybody is now realizing is that suddenly after about – a long period of time in which most of the developing countries were growing very slowly – if anything, actually, until about 20 years ago, people referred that the great divergence, the relative GDPs per capita of the advanced economies are essentially going higher relative to those of the emerging.

There has been now a major process of economic convergence with all of these economies now joining the global economy and growing very fast. People refer of course to the BRICs -- Brazil, Russia, India, and China -- but there is not just the BRICs; it's also many other emerging market economies.

And – (inaudible) – seeing, you know, any kind of like basic kind of even assumption about what is going to be the growth rate of these countries emerging relative to advanced economies suggest that these emerging economies are going to grow much faster and therefore – (inaudible) – level from which they are starting in terms of per capita GDP is smaller than the one of the advanced economies. There is going to be a process of economic convergence in terms of per-capita GDP.

And on top of it, of course for some – and that is why there is attention on the BRICs. The BRICs are counting not only – potentially growing very fast, but they are also having a very large population, and therefore over time, 1-billion-plus Chinese and 1-billion-plus Indians growing very fast means there has been not only convergence of per-capita influence, but also the size in terms of absolute GDP of this country who will

become large. And there are scenarios that Goldman Sachs and others do on how much – how fast – at which point essentially China is going to overtake – you know, first – (inaudible) – then U.K., then Germany, than the EU, then Japan, then the U.S. in terms of absolute size of the GDP. That is a major trend, and I don't think that trend, barring any major collapse or disaster in emerging markets is going to be reversed.

So there is a major shift in relative economic power between the U.S. and emerging markets, and I would say also maybe over time if Europe is getting an act together and growing and becoming larger also, relative to United – relative to Europe.

So I think that one of the many aspects of them – this question is that – and we'll talk about relative changes in geopolitical powers – those outcome of something of a – overtime of a side consequences of that. But the other thing that I think is crucial then is that if people realize that this process requires also neither change in the global economic governance. And by global economic governance now I refer to essentially some of the major institution – you know, the G-7, IMF, and World Bank. Of course there is a bigger debate on how this change in relative power should lead those changes in other international institution – the political ones like the U.N. and so on. That is not my expertise so I'm not going to touch on that one.

And I think that that shift is important for the following reason. First of all, within the G-7 until the '90s, the U.S. are the major leadership essentially. When the three of us were at Treasury, remember, when the Asian crisis occurred – and actually, Mark was very kind about this – the Asian crisis appeared by the time that Steve and I arrived, yes. The Asian crisis was resolved, but in the meanwhile, Russia collapsed and after Russia, Ecuador and Pakistan –

MR. MEDISH: I was there, too. (Laughter.)

MR. ROUBINI: Ukraine, Brazil again, Argentina, Turkey, Ecuador, Dominican Republic, Uruguay.

STEVE RADELET: I think it was after you left, though.

MR. ROUBINI: Exactly. So you know, we were causing some things for everyone, so I don't know; maybe we caused all of these crises. But certainly at that time, whatever were the causes of this mess, the U.S., to put it simply, was really the boss. You know, when Mexico happened, the U.S. went and if you'll read the memoirs of Rubin, told the Europeans what the plan was and said this is the plan and the – (inaudible) – agreed with the managing director of the – (inaudible) – same thing when East Asia kind of collapsed. Those things were kind of almost fait accompli. There was some kind of formal, of course, consultation with the other G-7. But there was really a major primacy.

Or, for example, when after all of these crises were over, the process of international architectural reform, which all of us were very involved in, both crisis

resolution and crisis prevention, there was a taskforce within the U.S. Treasury, worked on it for six months, then it was approved interagency at the U.S. government level and then became effectively official in G-7 policy – were very – (inaudible) – inputs of the other G-7.

Why did that happen? At that time probably you could talk about the relative economic and financial power of the U.S. relative to Europe and Japan, that – (inaudible). There was something of an intellectual power. I would say something ideas, good minds. And the other thing is that the U.S. was able to flex its muscles to – directly, indirectly, kind of over its own allies.

However, things are really changing today, even if the process since then has been different in terms of the dynamics within the G-7. There is more balance of power of discussion and so on, and in part, it's because Europe is becoming bigger, larger, more important, and therefore vis-à-vis the U.S. can always impose its view on the G-7 I think. There is still some degree of leadership, but it's not just a fait accompli that decide what is right for the global economy and so on.

More importantly, I think that the other crucial thing is not just within the G-7 about it changing power, but also is that G-7 by themselves, or even the G-8 are essentially by many standards totally anachronistic because if you think about all of the major kind global economic issues, even things from global imbalances to global climate change to issues regarding all security supply and demand, to just name a few, if you don't have countries at the table discussed, in like, China, and, like, India, like Russia, like Brazil, like some of the other systemically important emerging markets, there is no way you can really have any headway in discussing and agreeing on a set of policies. The result is global economic issues.

So that is certainly crucial. This seven -- G-8 are totally kind of irrelevant by some standards. Now, there is a forum, the G-20 that includes half of the countries advanced – half of the systemically important emerging markets. For now has been mostly something of a talk shop, which lots of things are discussed but it's not likely just having a – (inaudible) – policy decisions that are being made, but there are proposals to think about whether maybe the real core of the decisionmaking on international economic policy should be moved from the G-7, G-8 to the bigger group – G-16 through 20. So that, again, is a question of the relative power of other countries: Asia, China, and the other emerging markets.

The other variant of the same thing is not just G-7 but there is an active debate about the fact that now the governance of the international banking institutions, specifically World Bank – IMF is also kind of out of line – the Asians, but also the Africans and others have said, you know, there is to be a meaningful change both in chairs and shares where chairs has to do with who is essentially in the executive board of this institutions, and the shares is what are the quotas and how you can redistribute them to give them more quota power to counter their becoming more important.

The paradox is in some sense is today, is that traditionally, those who were running the IMF were, quote, the "creditor countries," they were advance economies with the money and so on. But paradoxically, if you think about it today, the big creditor in the world of the reserves and so on are actually emerging market economies countries like China, Russia, India, some of the other emerging markets, while the biggest net debtor country in the world is actually the United States. So, you know, this leads to vastly larger – (inaudible) – share and veto power within the IMF.

So there is a bit of a kind of a dissonance in terms of changes in economic power and relative financial power in actual – the system in terms of governments having – (inaudible) – a bit obsolete and need changes. So that leads me down to the question of something between the kind of structural and the cyclical of this global balance, is that at this point not anymore a cyclical phenomenon because the U.S. have had this current economic deficit for about since early 1990s not only growing in absolute terms but also as a share of GDP.

And the paradox we're facing today in the world is essentially to simplify. There are a few other countries that have current comeback (?). Essentially the U.S. is the biggest one of all. So the U.S. is both the largest net borrower in the world in terms of running a deficit and to borrow it to finance it, and also terms of the stock, not just the flows; also the largest net debtor in the world with its net kind of foreign debt being something close to $2.5 trillion or about 20 to 25 percent of the U.S. GDP. So as a share of GDP, that counts as a bigger net foreign debt, but in absolute terms, the U.S. is this.

Why this is relevant thinking about – we could have a long discussion about the cause of these global imbalances, whether they are sustainable or not. My view is eventually they are not sustainable. We have a problem when you have a country like the U.S. that essentially is borrowing from the rest of the world every year something close now to $1 trillion because the U.S. current – (inaudible) – deficit is going to be something like 900.

So not only the Chinese and the others are selling us the goods and the services, but they are also providing us also the finance. So they are at a competitive advantage in goods and services while people say the U.S. has a competitive advantage in issuing bonds. Probably bonds and the IOUs – you know, that claim on your future output and – (inaudible) -- at some point that bond is going to come to maturity and you have to pay it back. So you have a net production of services aligned to service that kind of a debt.

So there is this kind of growing imbalance, and it's not becoming smaller; it's becoming larger. And there is a question of its sustainability. In my view, it's going to be problematic over time.

But the twist I want to give is that there is the geopolitical question of it is an interesting point, is the following one. Traditionally, if you think about superpowers or, say, call it empires, because in some sense the U.S. is an empire -- empires traditionally have been always net creditors and net lenders. Right, you know, the last big empire was

the biggest empire; it had the – the pound was the main reserve currency; today it's the U.S. dollar. And the British empire had a current account surplus, right, to the colonies and the rest of the world, and it was a net creditor out to the rest of the world.

Paradoxically, you could ask yourself what was the reason for the decline of the British Empire. There are many reasons that are complex, political, economic, relative growth, whatever. But one of the crucial thing was that essentially around World War II, the United Kingdom become a net borrower because it was running during the war a current income deficit, and was a – it became from a net creditor over time a net-debtor country. And actually it was the U.S., the young economic power that provided a lot of the loans and financed them – the U.K. during that period of war.

So the point I want to make here is that oftentimes, declines of empires, economically, politically, and also in terms of reserve currency are associated with this kind of very large current account deficits or net debt opposition. And the other thing that I think that is interesting – important from this point of view, is not only the U.S. is running the current account deficit – that is to borrow from abroad – we also had an episode like that in the '80s, large deficit and then these appear when the dollar fell by 1990. And then we have had since 1990 another large increase.

The difference between then and today was that the 1980s – the major lenders to the U.S. or the major creditor were its allies, and because our deficit was relative to Germany, Europe, and Japan, so our allies essentially were financing us, while if you ask today where the major net lenders to the United States are countries like China, Russia, Saudi Arabia, to name a few – the largest ones. They are certainly not fully our allies more than I would say – we refer to them as strategic competitors or rivals, or whatever. I don't want to enter the geopolitics of it, but certainly a very different bunch of countries: China, Russia, and Saudi Arabia, from Germany and Japan.

That means that we have in terms in Larry Summers, this kind of balance of financial terror (?) in the global economy. Nobody claims that actively China is actively going to pull the plug on to the U.S. because they are going to shoot themselves in the foot, but at some point, one holding 1 trillion of reserves, three quarters of it in the U.S. Treasury gives you some degree of leverage.

And in this context, the other thing that I think is a crucial trend that is going to create tension politically is that the creditors now until recently were essentially accumulating longer-term Treasury, T-bills or interest rates that were very low. Now then said, enough of having just T-bills at 2 percent, now 5 percent – that is kind of penance – we what the gems of the U.S. economy; we want the real assets. We want FTI; we want to invest and buy your firms to get the higher return given the returns on those that are higher than T-bills.

And that inside had led to a phenomenon. People worry about trade protections. I think the biggest thing to worry about in addition to that is also a phenomenon of asset protection. As you saw it in the CNOOC-Unocal case, which that attempt of acquiring

U.S. firm was thwarted. You saw it in the Dubai ports kind of case or in one case, a Chinese – another one an Arab, Middle Eastern firm, and now there is this process of reform of the – (inaudible) – of the process, which the FDI and the U.S. is being approved.

So we're facing a problem because on one side the U.S. needs the foreign borrowing – until now was cheap borrowing in terms of Treasury, increasing our credit or not – certainly our friends are saying we don't want to lend you just money in the form of TBS – we want real assets and they'll list issues of also economic power. For example, in each one of these major economies now, there are plans to create a system through which an investment fund is going to take the reserves. Instead of investing in a low-yielding treasure, they are going to invest them in equity around the world. China announced one; Russia just announced today one; Japan the other day. In the Middle East many of them are doing. So the question is become then when this government have essentially lots of FDI and is not passive becomes an issue of control of the global economy.

Now, I am kind of running of my time, so I would like just to finish. The other only caveat I would make is that in addition to what is going to happen in the medium term in terms of relative shifts in power – and I would say, if the U.S. fixes its own problems, I'm practically (?) optimistic about the fact that productivity growth and the potential growth of the U.S., while it shrink – (inaudible) – is going to be sustained – the same thing in Europe and so on. So n the medium term you have to be positive about all of these imbalances.

And the other final caveat I would make is that my personal view is that there is a large and increasing that actually the imbalances of the U.S. economy from housing to the spillover to others sectors of the economy, the other imbalance might be to a U.S. economic hard-lining and the recession in the next year or so. And that is another club that has important implications for the U.S. economy, for systemic risk or financial markets that we should be worried about if you're thinking about the next 12 months as opposed to the very long term. Thanks.

(Applause.)

MR. MEDISH: Thank you, Nouriel. Steve.

STEVE RADELET: Good afternoon. Thanks, Mark. Thanks for all of your help. Welcome to everybody. Thanks for having me. It's great to be here – fun to see so many people out this afternoon. Although we look like three clones, three old Harvard boy that used to work for the Treasury, we're a little tiny bit different. I can't match the Southern European accent; I'm not even going to try. But from our perspectives as well, Mark actually – his expertise is in Russia and Eastern Europe. Nouriel works, as you can see, on U.S. Europe. To a large extent, he covers the whole globe, but focuses more on that.

I come from the perspective of the poorest countries in the world. I spent a lot of time in Asia and in Africa, Southeast Asia, and these days mostly in Africa. And I think that affects my perspective on the set of issues around globalization, trade, technology, and competition, which is sort of the set of issues that we are talking about here today.

Competition, and is this competition – this new competition from the emerging markets, from China, from India, from other emerging markets a good thing or a bad thing for the U.S. competition. How many people here are economists or how many people here have had a couple of economics classes? Yeah. Okay, put on your economist hat; everybody be an economist. Is competition a good thing or a bad thing? How many think it's a good thing? Okay, how many economists out there think it's a bad thing and you're too embarrassed to raise your – (laughter).

Now, how many people have worked in a textile factory in North Carolina? No. Anybody worked in any kind of manufacturing plant? A couple of people. All right, one person. One or two. Okay, now everybody, this is going to be a little harder to pretend, but pretend you're a textile worker in North Carolina and you have got a family to feed and you're 50 years old, and you have done nothing but working this textile factory for 30 years, and you've got a couple of kid and a mortgage. Now, is competition good or bad? How many of you think competition is a good thing? Just you. One. (Laughter.)

It's an old adage, where you stand depends on where you sit. And a lot of the debate around competition is who is right; who is wrong. And I don't think it frames the question right because they are both right actually. The guy who is the textile worker in North Carolina, he is right. For his perspective and his family perspective, and the fact that he is 48, 50 years old, and knows nothing but textiles, he is right to be worried about it.

But for economists and for others who look at this from a global or from a larger point of view, I think, and I think we would all agree that they are right too, that on the whole competition is a good thing. But thing about competition and the thing about trade, and the thing about globalization is that there are winners and there are losers. Every good economist will tell you that countries gain from trade and I think that is true. Any good economist will tell you that.

That is not the same thing is that anybody gains from trade; it's not the same thing at all. People lose. People who are 50 years old and work in that factory that gets shut down lose. Some of them can be retrained. Some of them can find a new job, but some of them don't; some of them don't, and they go on for the rest of their lives earning less money and being less capable of caring for their family and living out their retirement in a way that they thought it would happen.

And if we can't recognize the fact that there are losers, then you can't really engage usefully I think in the policy discussions. We can't just pretend that everybody is a winner here or that because countries as a whole win, that everybody wins. And I think that is true about competition, globalization. I think it's true about technology. When

new technologies come along, I think we would all say it's a great thing. New technologies are a great thing. Well, it is, except if you happen to manufacture the old technology. All right, if you invested your fortune in typewriters, you are not doing so well these days, for example.

So new technology is a great thing except for people who lose because they have invested in the old technology, and we have to recognize that. Now, the winners outnumber the losers I think in competition and in trade, and in globalization. And the gains globally and for most nations, the gains outweigh the losses.

So, now, we think about China and India. From the perspective of U.S. workers in industries that are open to competition that are trading against them, this competition from China and India and other emerging markets is a threat; it's a bad thing. But we tend to think that those losses are outweighed by the gains. The gains are, well, China is buying a lot of stuff too; they are making stuff, and when they make stuff, that competes with our firms, but they also buy stuff. They are a huge market, a huge market, not only for the United States, but for the world.

Most trade with Southeast Asia – where I used to live and work – I lived in Indonesia for four years – trade from Southeast Asia has been redirected over the last 15 years where their largest export markets used to be Japan and the United States. Their largest export market now is China. It's a market for them that creates jobs for them as it creates jobs here at all of the things that we exported: Boeing at the high-tech centers, at IBM, at Microsoft, places like that, at least for the time being.

So it creates jobs for us. So we think that that is one set of gains. We think there are gains from spurring competition when we all said we like competition. Why. Because that lowers prices; it increases consumer choice; it increases new technologies; it does all kinds of things that we think helps societies as a whole over time. And increased competition from China and India should – and other emerging markets should have that effect; it should spur new technology. And overall that is a good thing, but it does create a threat for those with the old technologies, and many of those are in the United States.

So we think – most economists would say that probably overall this new competition in globalization is good for the world because China provides more markets and more competition, and in the end, that is going to be a good thing. Now, big caveat: We have never seen anything like the emergence of China before. It could rewrite all of the rules because we have never, ever seen a country this size grow this fast for this long and particularly one that is not coming out of nowhere.

This was the world economic leader along with India 500 years ago. This is not some laggard country that all of the sudden is coming out of nowhere; this is countries – the two countries that were before the industrial revolution the world leaders in technology. So this is the comeback. We have never seen anything like this so it could rewrite the rules so we have to be a little bit cautious. But overall, we think that the gains

– we, economists, would think that the gangs would outweigh the losses and that this would be a good thing.

But I want to introduce a different perspective. We have the perspective of the economists, perspective of the factory workers in North Carolina – a political economy perspective in terms of the long-term security of the United States. And think about India in particular in that context. From a security point of view, from the United States, is it better to have an India with very few jobs, most people very poor, with prospects that are not very great watching China get rich, watching the United States and Europe be rich for a long time.

Is that good for the United States in the long term, or would we rather see a thriving India with a lot of jobs, a growing economy, hope for people that they can get a better job, that if they educate their kids, if there is economic prospects available for them, and that they can take care of their families. Which is better in the long run for the United States, particularly given the geopolitical – the geographical position of India on the subcontinent. We have got several people that it looks to me like historically may be their families are from the subcontinent, and it's a rough neighborhood obviously.

So which is in the better interest of the United States? A thriving, growing, middle-class India and neighboring countries, Sri Lanka, Pakistan, Afghanistan, or one where there is no jobs and no prospects? I think it's a slam-dunk. I think it's a slam-dunk. And it drives me a little crazy when people talk about the threat from these service centers, these call centers in India that this is a threat to the United States. I think it's great for the United States that there are jobs in India and that there I hope and that we have got chance for the second-largest country in the world, soon to be the largest country in the world to be a relatively open liberal democracies with an emerging middle class and job prospects in a system that works. I think anything else is really bad for the United States.

So I think that competition is a good thing for us from that perspective as well. Now, China may be a little bit different. China people worry about more of a military threat. I don't know anything about the military side of that, but I would remiss to at least not mention that, again, China may be a different – a little bit different story, but I think by and large, it is the same story.

Okay, so overall, I think this is good for the United States, good for the world, but we have to remember that there are losers in this process. So will the U.S. be able to maintain absolute superiority? I don't think so, but I don't think that is necessarily a bad thing for the world; I don't think that is necessarily a bad thing for the world at all. I think it could be a bad thing depending on how it plays out, but it could be a very good thing for the U.S. to not quite have the superiority that it does today. It depends on how it is going to play out and depends on how we manage it, we being the world economy.

So how do we manage it? We could have a long conversation about that, but let me just say three things about – given that these trends are happening, that overall I

believe that they are good for the world and good for the United States, but that managing the process is really going to be important. Three key things: one is leadership within the United States and other parts of the world.

We need leaders that are going to frame this debate and frame this discourse in a reasonable way, and not frame it in terms of scares and threats and those kinds of things, but frame it in a much more constructive way – lay out the issues and the tradeoffs, and the fact that there are losers and winners, and lay those issues out much more clearly and honestly without invoking fear.

Part of that leadership is not only in framing the discourse but in framing our economic policies so that they will work. I'm not – I'm talking a little bit here about the global imbalances issues, but more of a longer term. If we are going to be able to manage this process, we need all of our economic tools. We are in great danger of losing one of them which is fiscal policy because our budget deficit is so far out of whack. And when we are operating from a situation where we cannot use expenditures to manage this process – and I'll talk about in a second one way we can do that, we are taking tools out of our basket because of short-term political means.

So part of the leadership question is making sure that we have got a robust set of economic tools in the basket, in the tool chest if you will, for policymakers to use, and we don't have that at the moment. So leadership is number one: studying the situation and making sure we have the tools.

Two, just obvious I think is training. If the United States is going to deal from a position of strength in this emerging global competitive marketplace and compete in a good way that can keep the technological gains that we have and be ready for what comes up in the next few decades in a good and positive way, we need training and education programs much better than we have now. The U.S. public education system is frankly pathetic. But that is not part of he discourse really around this – these issues around competition – global competition, globalization, and the U.S. position in the world.

If we react to China's emerging technology and India's emerging technology by trying to shut them off, we are going to lose. If we react to that the way that economists would say competition, if you react to it, you improve your training programs, you improve your education systems, you react to the competition by doing better, not by shutting it off, but we haven't done that yet. And there is a huge disconnect between the talk about globalization and trade and about training and education programs. And that brings me back to this budget situation; we can't improve our budget and training education systems without budget.

Third, global institutions. Nouriel mentioned the global institutions. If we want to manage this process of the emerging powers of India and China and other emerging powers, we have got to integrate them into the global system that operates reasonably well at the moment, and particularly into the global economic institutions and political institutions, the U.N., the World Bank, the IMF, which are now constructed based on

post-World War II power structures rather than the structures today. And they are losing their legitimacy because these emerging countries don't have the voice and the power that they deserve. So we are going to need to reshape those and get China and India invested into those institutions in a way that they work so that we can manage things going forward.

The first – there is some positive hints around that. It's a little noticed point, but China pushed hard for Margaret Chan to become the new head of the World Health Organization. Now, why would the do that? It has nothing to do with China grabbing primary product exports from Africa or dominating competition or anything else; it has o do with China investing in an important global institutions, the United Nations, and particularly the World Health Organization. To me, it was a step that they want to invest in these institutions. And that is something in the long-run good of the world, I think we want to support.

So we need to make these institutions more legitimate and give voice to these. The U.S. may not be able to dominate these systems anymore, but I think we want to make sure that we maintain these systems that have worked reasonably well.

This session is about – it was titled, "The U.S. No Longer the Gold Standard." Gold standard was a fix and ridged system. When it was faced by pressures in a changing world, it collapsed. I hope we're not on the gold system; I hope we're not on the gold standard because if we are and we're in a fixed rigid system that doesn't adapt to a changing world, it's going to collapse. I hope instead that we have got a much more flexible attitude, and can adapt and manage the changes that are happening – not try to resist them, but try to manage them in a constructive kind of way. And if we can do this in a much more flexible way, I think that we have a chance of managing this in a good way rather than watching it collapse. Thank you very much.

(Applause.)

MR. MEDISH: Well, thank you both. Those were great presentations. You echoed in your own styles many of the same themes. The dominant one I heard was this thesis or hypothesis that the era of U.S. absolute economic superiority is probably a thing of the past. Nouriel put it in different terms highlighting the megatrend toward major powershifts in the world economy, the multi-polarity. And both speakers sketched or hinted at several different areas where the U.S. has to focus on to adapt, adjust, compete, and lead in order to manage a kind of soft landing and transition given these trends.

So let me open it up. I'm sure there are many questions and observations out there. Use the microphones; identify yourselves; you know the rules. Thanks. Go ahead.

Q: Adam Shroyer, Senate Foreign Relations Committee. This to Steve. What changes do you think the U.S. needs to make in its education system and in its social welfare policy. What you were talking about in regards to education kind of reminds me

of what Clinton was saying when h was talking about globalization, but I guess it didn't really happen – No Child Left Behind. Let's hear an economist's point of view of real changes that you want to make and changes that can realistically be made in America's political system in the next couple of decades.

MR. RADELET: That one or we take –

MR. MEDISH: Do you want to take a few?

MR. RADELET: Yeah.

MR. MEDISH: Let's take a few.

Q: Toric (sp) from SAIS.

My question is should we worry about the losers in this game, and if so, what can we do to assist them?

MR. RADELET: Yeah, good question.

MR. MEDISH: Let me take one more – right –

Q: Mike Cho with the U.S. Department of Commerce. I'm a little ashamed to ask this but I guess could you educate me in terms of trade deficits because I understand that, yes, in terms of our budget deficits and in terms of borrowing of U.S. government debt, that is being done a major scale by foreign nations. But I have always viewed trade deficits not so much as something we need to equalize or a balance, but it's just a matter of specialties – economies buying certain things from other economies that those economies are good at – comparative advantage. And also from my experience at commerce, it's also a matter of market access, whereas our markets are open, other markets are not, therefore that is a major factor of trade imbalances. So if there is – do we really need to balance trade imbalances?

MR. RADELET: Why don't we start with these. Do you want to start with this one, Nouriel, or –

MR. ROUBINI: Either way, you know. Maybe I'll touch on some of them, and –

MR. RADELET: I'm not an education – an expert on education systems, so – but that doesn't stop me from having opinions. (Laughter.) You know, the U.S. universities are the best in the world. The U.S. public schools aren't. So that is one part of it. I have a couple of kids in the public schools. Well, one graduated through – and they are just not – and good public schools, some of the best supposedly in the country around the suburban Washington, D.C., area, but they are not very good.

I think we at a public school level, it's going to cost money, but I think we need smaller schools. I think we need kids in school longer with – instead of letting them out of school at 2:00 in the afternoon. If we send our kids to school starting at 7:30 in the morning and by 2:30 they are home, and they sit around and play videogames from 2:30 until 6:00. It doesn't make any sense from anybody's – besides competition, it doesn't make a lot of sense for a lot of reasons to have your teenage kids hanging around at home all afternoon.

But I think we need smaller schools, better programmatic stuff, much more focused on the world and perspectives from a much more international perspective in the schools, and a lot better science and technology training starting from a very, very early age; not starting from high school biology and chemistry classes, but to start at a much earlier level. Those are the things we do in our top graduate schools. They are smaller; they are much more targeted in what we do, and we need to do that at a younger level.

Whether that is feasible or not, I don't know. It's not feasible the way the discourse is framed, and that is where the leadership comes in, is that these kinds of issues have to be framed in a much more constructive way and facing budget issues, people have to be willing to pay for it. And to be willing to pay for it, they have to realize they are going to get value out of it. And the public discussion is not around that; it's just we hate taxes and therefore we can't do this, which is just – doesn't get us anywhere in the long run.

Losers – should we worry about the losers? If so, what do we do? I think we have to worry about the losers, because I think if we have seen anything in the world in the last 10 years, is that the small number of disgruntled people can really screw things up. So when there are losers for whatever reason – economic, political, if they perceive that there is an unjust system and that they are not being heard, I think that that creates problems even if there are many winners. I think if you have losers, it's a lot easier for people to lose it if they at least think the system is legitimate and fair.

And perhaps the best example of that is court cases. You go to court, you may lose. Or in democracies, you have a candidate and the candidate may lose. It's a lot easier to accept that if you think the system is fair, all right, if you have got a candidate that you support and you're disappointed they lose, if you think the system was fair and they lost, you can accept it. The same thing in a court case. If you think the system is not fair, then you're not going to accept it and you're going to cause all kinds of – so I do think we do need to recognize the losers, and I think we do need to take steps to try to minimize the losses.

From the big picture, you can kind of separate the losers into two categories at an individual level. One is, those that can go on to do something else can be retrained. Typically, younger people at an earlier stage in their career and they might be able to be retrained and move on to a new career. That leads to issues around training, adult education, that sort of thing.

There are others that are older; they are in their mid-'50s, and they are not going to – realistically we're not going to retrain them. Or younger people as well. That means social safety nets. If you think about this from a generational perspective, it may be great that the next generation moves on to other things, but that – the first generation that loses out, I think we need some social safety net protection for people that do lose their jobs and try to recognize that. Shaping those in a good constructive way is hard, but I think we need to do it.

My grandfather was a lumberman, and there were a lot of lumber people in those days, and I'm awfully glad that is not what I do. But when the pressure came on, boy, he held onto that job as long as he could because for him that was the best thing. Great – you know, I didn't have to suffer through it. So the transition in the long run was a good thing, but for the people who lose out, it's a tough thing.

So I think we do need to recognize them and we do need to have the training programs in place. Let me leave there and turn to Nouriel for the trade issues and these other questions.

MR. ROUBINI: Yeah, before I get to the issue of the trade deficit, I would like to say something on the issue of the losers, certainly points that Steve has made I think are very valid. I think that the problem we are facing now with some of the backlash against globalization is that as people hinted out, there are losers, but these losers in some sense occurs across different countries and within countries. For example, in the U.S. and Europe and Japan, it used to be that workers in labor-intensive industry would be phased out because of competition and emergence of China.

But today, we see all of this malaise coming from the middle class – worries about real wages not growing as much in productivity, income inequality rising, worries about offshore outsourcing. So it used to be the case that blue-collar work is – (inaudible) – being displaced by trade. Right now there is also white-collar workers. Of course in an economy in which factors are just, you get other jobs, and trade is all good and beneficial, there is this question of transitional costs and some of the losers.

The losers, however, are also within kind of other economies. If you take China overall – China, you know, inequality has fallen and many are going to urban – (inaudible) – center doing well. But recent suggest that actually the very poor rural workers are doing worse than otherwise. There are also countries that are middle-income countries that feel sort of threatened by the rise of China and other emerging markets. Countries likes, for example, Mexico, South Africa that have to change their relative competitive advantage as a way to being able now to compete and produce things that are not produced cheaper by China and other countries in Asia.

So I think that when you look at across, you see a wide variety of losers. What to do about it – what Steve suggested is correct. You know, for some people, training and education is crucial. In the U.S. there was a lot of talk about trade adjustment assistant, returning people for other jobs. There was job – the unions used to say for a long time

that it was not a trade-adjustment system; it was trade barrier assistance because essentially nobody was getting essentially new jobs. They were all phased out. That has been a problem.

The trade adjustment system program has been reform interaction of maybe something more positive. But also there are creative ideas that we should think about things like whether unemployment and benefits should be much more widespread, whether we should give wage insurance in terms of subsidizing workers that have lower wages because of being displaced by trade.

There is also a broader debate, and people have argued – that is controversial, but an interesting thing to put on the table, where the tax policy should be changed. In world in which trends and technology and trade, or whatever – (inaudible) – skill to skilled workers versus unskilled leads to great inequality of income or capitals versus labor than some people say. Maybe the tax system should become more progressive as a way then to redistribute the resource and financing those that hired the losers.

So I think there is a whole span of things to do. And I think that the crucial thing in some sense is the following point that I think is very important. Traditionally we say we want a world in which people are much more flexible. Economies are more flexible, labor markets are more flexible, countries are more flexible because it used to be the case, the old model, you model, you get the job of a lifetime and you have a change of company in Japan but also in Europe, less so in the U.S.

But in the new economy, all of you might be changing jobs, you know, five, 10 times, partly because of change in technology skills – also trade. All of those things are happening, so workers have to be flexible. But paradoxically I think my kind of inference is that because exactly you want markets to work better, that means that actually in some sense governments should have greater role in terms of social insurance.

So if you want people to be flexible to lose jobs, move to another one, then you have to have a tax policy, transfers, benefits, retraining, and other tool so that there is a parachute. In bad times, you are essentially kind of helping people to adjust, otherwise this backlash is going to become severe. So paradoxically in its own form of insurance, insurance will be a social insurance provided by governments. I don't think it's going to be provided by the private sector.

There is, again, the point that is debated in Europe about essentially protecting workers rather than jobs. If you protect jobs, then of course you have high hiring and firing costs that is a rigid liberal market and that is not efficient because you have an – (inaudible) – location. But if you want to have more flexibility, then you have to protect workers if you aren't protecting the specific jobs.

So I think that the set of questions; it is a very open one. And the other set of a very open question is that in countries like the rich ones, there aren't enough maybe fiscal sources in spite of the constraints to maybe help some of the losers. The question is what

do you do in countries like – (inaudible) – or South Africa, where the fiscal resources might be more limited given the – (inaudible) – system and other things. So I think it is a big question.

The final point on the trade deficit, you know, there are many reasons, and all economists know that actually running current income deficit and trade deficit may be optimal shocks to savings, investment, changes, in active productivity and whatever not. So nobody says that all countries should have a balanced trade forever, but we also know that over time, a country that runs very large and persistent trade and current income deficit is going to have an accumulation of its net – (inaudible) – either in the form of debt or equity. And at some point, that accumulation of liability become unsustainable.

Now, in the case of emerging market economies, each one of those we cited before in work during the year at Treasury, current income deficits become unsustainable because it led to a large accumulation of foreign liabilities, led to currency and financial – currency, banking, corporate, sometimes sovereign (?) debt default depending on the country. Some – all of it – some of it.

In the case of the U.S. of course, the U.S. – (inaudible) – emerging market economy – (inaudible) – twin deficit, fiscal and current account would have already gone belly-up a long time ago; that is clear. Of course the U.S. is not an emerging market economy in many characteristics. We bought in our own currency and other foreign currency. We have the major reserve currency; we never defaulted in our public debt, and we have also this idea that over time, given pressure, there is enough policy adjustment to correct imbalances that are in the economy. That is why we can keep on borrowing for longer and sustain these imbalances for longer.

But at some point, you know, some consensus (?) is going to be hit. At some point accumulating net foreign liabilities at the rate we do is not sustainable; therefore, changes do have to occur within the U.S. and also in the rest of the world in order to make sure that the rebalancing of this global imbalance is going to be orderly rather than disorderly. If these things continue forever, eventually, even for the U.S. that today looks like the biggest emerging market of all, there will be a hard landing. We have to worry about it. So trade deficit persist and over time actually do matter.

MR. MEDISH: We have got one right there.

Q: Hi, Timothy Ryan from the American Enterprise Institute.

As China and the U.S. and India become more economically interdependent, my instinct at least is to become hopeful for a lasting piece between all of them. It seems to me war that war is fundamentally bad for business. Do you agree with that assessment?

MR. MEDISH: Is war bad for business? And let me add a dimension to it that occurred to me as I listened to both of you responding earlier, and that is, you know, the famous brick study that Goldman Sachs put out in 2003 I guess it was – it was framed in

a very interesting way. This wasn't sort of an abstract economic research; it was directed at Goldman's client base, global corporations. And it was basically a message to that client base to wake up and look at the way markets are restructuring. You can't afford to stay domestic; you have got to go global basically if you want to be able to maintain scale and competitiveness.

Could you two comment on whether there is a growing mismatch between the interests of global corporations and the national economic challenges that countries and societies face, and if there is a mismatch, how does one bridge that gap? Does it automatically happen because of the market or is there some deeper contradiction? And there is the trigger question, is war bad for business.

MR. RADELET: Yeah, is war bad for business. It was an easy question followed by a much harder question. (Laughter.) Well, the easy answer, delivered by Shakespeare and Bertolt Brecht was that war was very good for business, actually. But I'm sure you have a different answer. (Laughter.) You know, I think you framed it in a way where the question answers itself, but there is a big but, and I think the but is that these countries need to integrate together with each other in a way that each of them sees the pie growing, if you will, the overall economic benefits to each of them growing.

If instead it's a rigid system where, with increasing rules and blockages to trade and integration, then if you're fighting for a share in a stagnant pie, then war becomes much more palatable, and that is actually what 500 years ago, before the global economy was growing so fast, 300 years ago, that is what a lot of wars were about, were about grabbing a larger share of an existing pool of resources.

So if we get ourselves caught in a system that is too rigid, you can't adjust to these change, then I think conflict is much more likely. If instead we adapt and adjust the system so that everyone sees it as legitimate and everyone can gain from this, then I think your optimistic point of view makes more sense.

The second question, I don't know whether there is or not in terms of mismatch between global corporations and national interests. I think – 10 years ago I would have been more likely to say yes. But I guess I'm less convinced these day of sort of a small cartel with global corporations that have that kind of power simply because they are more globalized in that their interests are I think in many ways more consistent with national interests, that they are in fact the force for greater integration and greater globalization because that is what they are doing.

If you look at the – you know, Toyota just overcame General Motors, as you just mentioned. And what kind of a reaction is that getting? Actually, not much. If that had happened 20 years ago, there would be protests up on Capitol Hill today with people with sledgehammers beating on a Toyota, which they were – you know, Japan-bashing. Now we are talking about China bashing. Twenty years ago it was Japan bashing and people were scared. It's not happening this week. Why? Because there is a lot of Toyota factories in the United States, that is why. Toyota is not so much a Japanese firm

anymore. General Motors is not so much an American – they still are at their core, but their production systems, even if their ownership is not, their production systems and the parts, they are making all over the world. These are globalized corporations. So I think their interests are much more consistent with a globalized world. That is my immediate reaction.

MR. ROUBINI: Yeah, I'll add a couple of maybe additional observation to the very good point that Steve has made. Certainly on the first question, I think that the more there is economic interdependence across countries, the more there are benefits from trade, the more per-capita incomes rise, the more you have middle classes. The less middle classes – (inaudible) – war, right. So it's not very interesting, so therefore usually countries that are economically developed tend to less have war, and of course if they are also democracies, usually they don't tend to have war with each other.

So one of the important byproducts of the fact that China is becoming integrated in the global economy is that while some people express concern about the kind of geopolitical power tat China is flexing around Asia or even in Africa is that paradoxically, things in the past would have more likely led to political and military tensions like, say – (inaudible) – between China and Taiwan now become less of a problem.

Of course as an unresolved question, this particular one, but, say, the fact that China has a huge amount to lose from having a situation for which there is a war that destabilizes them – international relations, trade and so on, is one reason why eventually, slowly, slowly, these two countries are going to get their act together and find something that is kind of valuable for both. So I think that is certainly one of the trends that is happening.

The only caveat that I would make to this one is that – so, this globalized economy with things – integrate in spite of the tension and loser whatever not, should be a force for piece rather than war. But the only caveat I would make is that in the previous era of globalization, we know that previous area of globalization where there was so much integration of trade, financial flows, and whatever not, collapsed in 1914 and collapsed because of World War I.

And that was a situation, and historians have looked at this evidence and said why World War I happened, and economically, politically, it was a totally avoidable war, and it was a war that actually ended up a disaster and set back the global economy, and the global war for almost 90 years because then we had the Great Depression, we had the Bolshevik Revolution, we had the communist regime, we had the fascists and the Nazis, and we got the Cold War, and it took literally until about 15 years – (inaudible) – side effects of World War I were not actually resolved, and yet an integration then of the Iron Curtain, of China in the global economy.

So this was something that really came in sense out of nowhere, and my lesson of it is that essentially you have to be very careful with wars. You know, you go to war and

things then escalate. We have seen in this country what happens. I mean, we went to Iraq – not only is a mess. There is a risk of the conflict becoming actually regional, or whatever not. So when you start some things that is a military conflict, the consequence actually could lead to something much more ugly. I think that is a lesson of World War I. we should keep in mind today.

On the issue about the global corporation, the mismatch with national interest, I agree on the substance on what you say, but I think that what is happening actually is there is this amount of – there was a period of time where FDI – everybody said it was a great FDI both for emerging markets and advanced technologies, whatever not. Today, we have seen a bit of a backlash.

The backlash you have seen the United States – (inaudible) – the divide force, but you also say it in Europe. Even within Europe when a firm from – (inaudible) – wants to buy one in France or one in Germany, wants to buy an energy company in Spain or one – the German banks want to buy an Italian, there is resistance I think in part because many of these firms that are now state owned, then, there is a risk for the workers that that the foreign firm is going to restructure them and therefore the safety of having public ownerships is that the reason why there is a worry about cross-border ownership.

And the same kind of backlash, you see it a little bit also in Asia today. You see, for example, with now Tylenol, the country being worried about – (inaudible) – kind of company in Singapore having – (inaudible) – power throughout East Asia. With even China until was now was in favor of FDI – now they are in second thoughts about it. So I think that there is issue of an element of a beginning of a backlash that expresses at least the perception, but the national interest might be different from the one of the – with the national population to do FDI. I think that is a misperception from a strict economic point of view, but we should recognize that from a political point of view actually there is this rising tension. That is something we should admit and figure out what we can do about it.

Certainly, if the US starts having a backlash against FDI, it cannot go around the world and tell other countries. It should open up to FDI where we don't let foreign firms to get into the United States.

MR. MEDISH: Great. Thank you, both. That was a very rich session. Thank you. Thank you.

(Applause.)

MR. STICE: I would like to echo those thanks, and also thank you, Mark, for your excellent moderation of the panel.

(END)