

Advancing Enterprise 2005

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Speech by Robert Rubin, Chairman of the Executive Committee and Member of the Office of the Chairman of Citigroup at Advancing Enterprise 2005.

The international economic system.

Thank you, Martin. I've been asked to comment very briefly on a few views with respect to the current economic environment. Let me start by saying that I've been involved in economic issues, market issues, running trading rooms and in government for a long, long time, and the outlook is always uncertain, it's always complex, but I believe that we are at a time of truly extraordinary complexity and extraordinary uncertainty, and that in turn makes for a very difficult decision-making environment for investors, for business people and certainly for policy-makers.

Let me describe in my brief time a few aspects, at least as I see it, of this complicated environment. Number one, it seems to me that the industrial countries are facing a competitive challenge of stark dimensions, and Martin alluded to this, from increasing numbers of well-educated workers in low-wage countries, particularly China and India. We're connected to the industrial countries by real time communication that makes location irrelevant with respect to locating many types of activities. Firstly there's a great many complicated substantive questions. Paul Samuelson wrote a piece recently, as many of you know, with respect to whether globalization still in all circumstances benefits all countries, and in any case the traditional distributional issues around trade with some being hurt while many benefit, have become greatly exacerbated.

Relatedly there are the always extremely difficult politics around trade, and that pressure becomes far greater when the range of goods and services subject to trade pressure becomes greater. The right response, it seems to me, is what President Clinton said when he advocated NAFTA, he stood in the East Room of the White House with living presidents excluding President Reagan who was ill, standing behind him and he said that the right approach forward is trade liberalisation combined with a parallel agenda of domestic programmes such as world-class public education, basic research infrastructure and much else, to help those who are hurt by trade and to promote competitiveness. The problem is that the politics of all of this trade on the one hand and fiscal and budgetary matters on the other is extremely difficult. On the other hand, failure to realise this objective, it seems to me at least, could create enormous pressure toward protectionism and that has got to be the worst path forward.

Relatedly I agree with Martin. I agree with the general view that we are in a period of historic change with respect to the economic positions, geo-political power of the various parts of the world, with China, India and non-Japan Asia generally viewed, I think rightly, as likely to be the most buoyant part of the global economy, and with China likely to become the largest economy in the world and a tough-minded geo-political peer of any other country. Obviously these countries face challenges but it seems to me that the probabilities are high, that those challenges will be met.

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Japan, it seems to me, has still not done much of what needs to be done, and although its history suggests that it will be done, even then with Japan's demographics, growth is likely to be moderate. Continental Europe seems to me likely to grow slowly and to continue to decline. That was Martin's European blip concept, unless the political systems become far more energetic in addressing the issues of structural reform. One caveat that is that there are leaders advocating reform, perhaps they'll prevail. A second caveat is that the pressures of the new entrants to the EU may catalyse reform.

And finally you come to the United States, which for a long time with all that's happening is still going to be the key to the global economy, and in my judgment at least, the United States is at a critical juncture. United States has a dynamic economy, cultural embrace of change, a willingness to take risk, flexible labour markets and sheer size, all of which create tremendous opportunities. On the other hand, the United States also faces enormous challenges that must be met if that potential is going to be realised. These challenges include fiscal and current account imbalances, and I have a fear that these may have a tendency to get worse rather than better. Geo-political threats, public education, health care reform, energy policy, much needed tort reform and much else, these are all very difficult substantively and very difficult politically. The United States imbalances could have, not will have but could have serious bond market effects and also raise very complex questions about our currency.

Let me just say as to exchange rates: the conventional wisdom is that with 6% of GDP current account deficits, very large fiscal deficits, personal savings rate over the last 12 months something under 1%, and the US as a large debtor nation, there is probably a fairly good chance – this is the conventional view, I'm not saying I believe one thing or another – a fairly good chance that the dollar could decline over some period of time. There is a view on one side of that, that the full trade effects of the currency adjustments that have occurred so far have not been fully felt and that as those trade effects are fully felt, the adjustments needed to be made on the dollar will be substantially less than is generally thought. There is a view on the other side, and again I'm not subscribing to any of these views, just describing them, a view on the other side that we could have far more serious and abrupt negative developments.

Two more observations on imbalances: First, the current 10-year fiscal projections to the United States government for almost all independent forecasters, assuming as the administration has advocated that the tax cuts are made permanent and with various realistic assumptions about spending, are that we face a 10-year deficit of somewhere about 5-5½ trillion dollars. The Concord Coalition which is a bi-partisan group that focuses on these things the other day put out a release saying they're projecting 5.8 trillion. These deficits are going to be very difficult both substantively and politically to correct. 80% of our federal budget consists of defence, entitlements and interest, and 20% for everything else, including law enforcement, education and all else. More of these activities are activities the American people want their government to perform, and in my judgment should have their government perform. Tax revenues as a percentage of GDP are

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somewhere around 16% or a touch over that, and that is I believe the low since roughly speaking 1960. This is a very difficult fiscal situation both substantively and politically, and will not be fixed by adjustments around the edges. Secondly, at the end of the 10-year fiscal window, the deficits get worse at a rather rapid rate because of entitlements. The principal problem is the health-care entitlements and there is no serious effort in the political system right now to deal with that. Another problem is social security. The proposal that was leaked the other day by the administration and then augmented by President Bush's comment the other night, would be a variant of something called Model 2 in the President's Commission on Social Security. What it would do is increase the federal deficit by roughly \$1 trillion over its first ten years of operation, by roughly \$3 trillion over its second ten years of operation, and would increase deficits in every year for the next 40 years, and the reason is simply that we're creating a set of private accounts with no mechanism to pay for them except deficits and gradual offsetting savings that equal the cost of those new private accounts beginning in about 40 or 50 years, depending how you measure.

Let me conclude by saying that the United States has been a very resilient society that has met many serious challenges, and it seems to me that that nature of our society is a major positive projecting forward, but there are not guarantees, there is a great deal of work to do and we're going to be enormously affected by the decisions our political system makes. All of this creates an economic reality that is especially complicated and that makes effective decision-making by investors, by business people, and by those involved in the policy-making process most difficult. Thank you all.

Ends.