

**SCHWARTZ CENTER FOR
ECONOMIC POLICY ANALYSIS
THE NEW SCHOOL**

WILL THE SKY FALL?

**A NATIONAL POLICY FORUM
ON THE FUTURE OF THE AMERICAN
AND GLOBAL ECONOMIES**

Sponsored by Schwartz Center for Economic Policy Analysis at The New School in
cooperation with The New America Foundation/American Strategy Program

**FRIDAY, MAY 11, 2007
10:45 A.M. – 2:00 P.M.**

**902 HART SENATE OFFICE BUILDING
WASHINGTON, D.C.**

*Transcript by:
Federal News Service
Washington, D.C.
(Edited for clarity)*

STEVEN CLEMONS: Ladies and gentlemen, thank you very much for joining us today. My name is Steve Clemons. I direct the foreign policy programs at the New America Foundation, a think tank here in Washington, D.C. And we're very proud to be working with the New School's Schwartz Center for Economic Policy Analysis and helping to support, I think, a truly interesting substantive discussion -- set of conversations -- which we will enjoy this morning. We've worked with a number of people in helping to pull this program together. I'm going to introduce one of the key players, Senator Bob Kerrey. It's great to have Senator Kerrey back in his stomping grounds here in the Senate, but I also want to give special notice, as I think Senator Kerrey will, to Will Milberg. I'm going to point to Will over here who's an economist with the Schwartz Center at the New School who's been a very active partner in this program. And our hope here -- New America Foundation organizes lots of programs but I love the New School programs, and we'd like to see the New School staff, ideas, provocations here in Washington, D.C. as much as possible. So we're very, very grateful to be here.

And I just want to say just in my 30 seconds that what we're trying to do with this question of 'will the economic sky fall' is to struggle with the question of conventional economic wisdom and how we approach and think about various sorts of deficits, fragilities in the economic system, both internationally and domestic, and look at whether or not there are new features of the international economic environment -- the American economic environment -- that are not figuring in to our calculations of how we sculpt policy. And that's what this discussion about -- it's about sculpting policy but it's also about inputs into that decision and whether or not we should alter our course based on some of these questions. I don't want to be overly crude in what we're doing, but to some degree we've brought together just a phenomenal roster of highly talented -- I call them high octane -- public intellectuals, writers, thinkers, and journalists to struggle with these ideas. And to some degree we've brought together the 'doom and gloomers' with some optimists, and we'll see how this comes out.

But please give a round of applause to our partner, Senator Bob Kerrey, president of the New School, who really needs no introduction here in this building. Please welcome Senator Bob Kerrey.

(Applause)

BOB KERREY: Well, I also want to thank Steve and the New America Foundation. I want to thank Bernard Schwartz for coming up with the idea and coming up with the money necessary to not only put this discussion on, but other discussions as well on the question of whether or not conventional wisdom is right. I want to thank Will Milberg, who is a senior economist at the Schwartz Center and at the New School. He has been a terrific partner in putting these conferences on and Will, I very much appreciate the work that you've done to make this possible.

I do kind of remember what it's like to face a political audience, and I don't consider this to be one this morning. But it's hard to stand before an audience without sort of still, after you've been in it for 16 years, not thinking as if you're still trying to get votes. In 1988 when I first ran for the Senate, I

remember very well debating Dave Karnes, who was the incumbent Republican senator at the time, and we were debating on national security as if the Cold War was going to go on forever. We debated the MX missile. We debated what our nuclear posture ought to be to prevent a bolt out of the blue attack. We debated how to defend ourselves against the Soviet Union. We debated what we were going to be doing with Eastern European dictators. The presumption was that it was going to go on for a very, very long time. And I arrived and was sworn into office by George Herbert Walker Bush, and 10 months later we find that the presumptions of that campaign were completely wrong -- devastatingly wrong in many ways. We spent half a dozen years celebrating this great victory and struggling to try to figure out what was going to happen now that that power center had collapsed.

Likewise in 1990s, the dominant metric that you used to judge whether or not you were doing a good job in Congress is whether or not we were making progress on the deficit. Eliminating the deficit was, I would say, broadly seen by Republicans and Democrats as an economic imperative, and there were very few dissenting opinions in the 1990s on that point, and indeed that argument predated the 1990s. Republicans had a balanced budget amendment that they were proposing to the United States Constitution. It was a difficult proposition. I remember very, very well when that amendment failed in the United States Senate by a single vote in 1995 or 1996 -- somewhere in that time period.

So it was accepted wisdom and it still lingers on today. The trade deficit is seen as a parallel problem -- identified constantly as a parallel problem -- and what Bernard and I have come to believe is that it's entirely possible that conventional wisdom is wrong -- that those two metrics all by themselves -- that if we solved that problem instead of making things better, we'd make things worse. And what we hope to do with this and other conferences -- other discussions like this-- is to give the political leadership some opportunity -- some space in which they can consider whether or not conventional wisdom is right or wrong, and where they can devise the right economic strategy coming out of Washington. It is exceptionally difficult to do. Democracy -- I don't have to tell all of you this but believe me -- is more difficult than you think.

Oftentimes you're entirely at the mercy of public opinion, and public opinion can swing back and forth unmercifully. After you've staked out a position that is popular, you find yourself two years later in an unpopular position of having to face public opinion down. So it is exceptionally difficult and very, very important to try to provide an opportunity for debates to go on about things as important as what are the fundamental metrics that we ought to use to guide ourselves in the United States Congress for making decisions about things that need to be done in order to keep the United States of America's economy growing, jobs being created, wealth being generated, income being increased as well as well distributed, and people being relatively satisfied that whatever it is that Washington does to improve the prosperity of the country is being done exceptionally well.

I think, Steve, you're going to introduce the first panel so I'll just pass it back over to you.

MR. CLEMONS: Thank you, sir. Thank you. (Applause.) Senator Kerrey will be back to moderate a fascinating discussion with Senator Bob Bennett, Senator Debbie Stabenow, and Senator

Kent Conrad as well, and to participate in the discussions. There's no one that I can think of better than two other moderators, and I will out them because they happen to be married, but that has nothing to do with them both being here. But the first is Sebastian Mallaby, of course, who's the Paul Volcker senior fellow for international economics at the Council on Foreign Relations, and who has a regular piece of op-ed real estate in The Washington Post where he's become one of the most important economic writers, and framers of policy and discussions on these issues in the country. So on the subject of 'is the economic sky falling,' Sebastian Mallaby will moderate, and then this afternoon we'll have Zanny Minton Beddoes, chief economics writer for The Economist here in Washington, D.C. joining as well. So the floor is now Sebastian Mallaby's. Sebastian?

(Applause.)

SEBASTIAN MALLABY: Okay. So the premise here is that you've been around Washington a while. You've been to lots of these sessions. We've got the coming crisis in health care, the coming crisis in U.S.-China relations, the coming crisis in our education system, and in our retirement system. You name the subject, we can build a crisis scenario around it. The new crisis today is that we are too obsessed with crises -- (laughter) -- and so we're going to reconsider all this stuff.

And we've got a great cast of characters. We've got Daniel Yergin here who, of course, combines being a successful entrepreneur with a Pulitzer Prize winning author. We've got Doug Holtz-Eakin, who is the chief economic advisor on the McCain campaign, formerly head of the Congressional Budget Office and also the Council on Foreign Relations. We've got the Honorable Jim Kolbe, who is now dividing his time between the German Marshall Fund and Kissinger-McLarty Associates. That sounds like intellectual satisfaction and another kind of satisfaction -- (laughter) -- formerly, of course, a prominent member of the House, active on trade and also on aid. We have Mike Mandel, who is the chief economist for Business Week. We have Clyde Prestowitz, who is the president of the Economic Strategy Institute and an expert on East Asian affairs. And we've got James Galbraith from the LBJ School of Public Affairs at the University of Texas at Austin.

Now, my first guinea pig is going to be the most optimistic of all the people on the panel -- the most anti-crisis. That is Mike Mandel, well known in Business Week for saying that the sky will never fall.

MICHAEL MANDEL: Oh, that's not true.

MR. MALLABY: Mike, I just ask you a bit of a general question. I mean, do you think it's right that people exaggerate the possibility of various kinds of bad things happening to the U.S. economy, and in particular, is there a negative consequence from that pessimism?

MR. MANDEL: Well, look. We're here to talk about the budget deficit and the trade deficit so let me just focus on those. People worry about the budget deficit. The main impact of the budget deficit is supposed to be on interest rates, and you don't see that. It's supposed to be on squeezing

down corporate investment, and corporations seem to have plenty of money. The negative effect of worrying about the budget deficit -- and this is always true -- whenever Congress gets into a budget deficit-cutting mood, the first thing that goes is R&D, and education spending. I've gone back and looked at this. You know, in hard times -- in tough times -- what's the most dispensable thing? What's the thing with the least number of constituents? It's R&D -- R&D and education spending. And if you go back to the early Clinton years, you see weakness in R&D spending, and you see it now as well. So what happens is by worrying about the budget deficit what, we end up cutting our seed corn.

The trade deficit, I think, brings up a slightly different set of questions. One set of questions is are we heading for a global financial crisis and, you know, I think that crises do occur but I think if there was a global financial crisis it would be more likely to hit in China than it would be here. If you sort of ask, the global financial system is stressed -- if it's stressed where is it more likely to break? It's more likely to break in the place with the worst financial system, which is China, than it is here. I actually want to correct one misconception here. I don't think that bad things never happen. I just think that the bad things that we expect are not the ones that actually occur so --

MR. MALLABY: There we are -- Mike from Business Week is a perfect example of the way that journalists spend their time, including myself -- sort of, you know, describing other people when they get described. They -- of course, they push back. That's all right.

Clyde Prestowitz, you've written books about Japan, books about China. They, of course, are well known for building growth, particularly in the Japanese case, I guess, on massive public investment, and on direction of private sector investment. Do you think that there's something to this discussion -- that if we lost some of our fear of budget deficits and went in a bigger way for investment we would do better?

CLYDE PRESTOWITZ: Well, I think that the budget deficit question can't be really discussed unless you are discussing national savings. Japan, for example, ran in the 1990s enormous budget deficits, but Japan financed those deficits because it has high savings -- financed them domestically. The U.S. is a low-saving country. So the consequence of budget deficits for us is that we borrow money from abroad to finance our deficit and to finance our consumption, and there's a lot of money abroad. The Chinese and Japanese and the Saudis are swimming in money, and so they lend to us. But this means, of course, that we're accumulating liabilities. And so in answer to the question is the sky falling, I guess I would say the sky's not falling now. It could fall.

In fact, I'm reminded of -- I feel in this discussion kind of like I felt in 1999 or 2000. You remember when Cisco was selling for \$120 a share, and dot com stocks were just a one-way bet, and everybody was talking about the new economy and how everything was different, but it turned out that you could have a crash. Or I remember long-term capital management. They had the smartest guys on Wall Street. They had Nobel Prize winners writing their trading algorithms, and they made the right bet. They made the right bet. It's just their timing was off, and it turned out that hedge funds

could go belly up. So the sky could fall, and I agree with Mike -- it'll happen in a way you haven't thought about. It'll always be something unexpected but, you know, if you talk to Tim Geithner at the Fed in New York, he's kind of worried about derivatives markets. Nobody seems to know where the risk is and nobody seems to know who the counter parties are.

And so that combined with what I see as a stealth move already away from the dollar -- a number of central banks are limiting their dollar holdings, moving to euros -- the sky could fall. But actually the worst thing, in my view, is if the sky doesn't fall and -- because this whole discussion it seems to me is premised on the notion that you don't have to pay for what you consume. In other words, you can run budget deficits -- you don't have to pay -- I mean, I don't know why we have an IRS. If budget deficits don't matter, we don't need taxes. Just print the money. And it's kind of the same thing. So I guess my concern is that we actually go along as we are, accumulating liabilities, which, of course, they have to be financed and so this becomes a long-term tax on future generations.

MR. MALLABY: Right. Okay. So the problem with debt is that ultimately you have to pay it back. Now, I want to go to James Galbraith. The question, I suppose, which people have raised is that we've been borrowing -- we've been running these kinds of current deficits for a very long time. Lately it's gotten even bigger than it was in the 1990s -- doubled as a share of GDP roughly -- and the sky still hasn't fallen. Does this mean it still has to fall one day or could we go on like this for a while? And in particular, just to tie it back to the earlier discussion of public infrastructure investment, could one argue that in the 1980s, East Asian economies financed investment through plentiful cheap savings? Now, these plentiful cheap savings from the Chinese are globalized, hence extremely low interest rates globally, and also from the recycling of oil revenues from the petro states. Given these global capital markets and the willingness of foreigners to hold U.S. instruments, couldn't we take our 90s -- 1980s lenses off and say to ourselves, "Well, there's cheap capital. Before, other people used it. Now we can use it. We can go on an investment spree, and in the long term that will boost our growth rate." Does that make sense or not?

JAMES GALBRAITH: My short answer to that is yes. But I'd arrive at it by a slightly different route. I would say that we will be judged 20 years or a generation from now by our ability to address our material problems -- whether we create jobs, whether we reduce poverty, whether we cope with climate change, whether we deal with social issues, and whether we deal with our infrastructure deficits. That's what the future will judge us by. The question we face is whether we're limited in our ability to address those concerns by financial factors, including the international financial factor that you've just mentioned.

I think the answer to that is that we are not immediately limited in any material way by international or domestic financial factors -- neither by the budget deficit nor by the deficit in international accounts. The Chinese are accumulating U.S. Treasury bonds as reserves for reasons of their own, and there are basically two of those reasons. One is that it helps them -- their export trades help them to manage a process of urbanization, which is the fundamental problem of Chinese development -- the fundamental thrust of Chinese development. And the second is that they have a lot

of money coming in to -- basically to speculate in the Chinese markets, including real estate but also stocks, which they're sterilizing and turning into dollars, and they're holding those dollars. They have no particular use for those dollars, and so it's in some sense a kind of passive process. And the balance in our trade account ultimately is not zero. There's no tendency in the long run for us to have to reduce our trade deficit to any fixed figure. The balance is in the world system between the number -- the value of the bonds that everyone out there wishes to hold and the value that we wish to issue. And there's no telling exactly at any given moment where that balance lies except to say that it hasn't caused us any serious trouble yet, and the way you can gauge that is by looking at the long-term interest rate. The Federal Reserve has raised short-term interest rates repeatedly until it stopped doing so recently, but the long-term interest rate has hardly budged, and that tells you --

MR. MALLABY: So in other words, even if you take the view that there is potentially a risk that one day this current account deficit becomes unsustainable, the point is that that's not a certain problem --

MR. GALBRAITH: Exactly.

MR. MALLABY: -- whereas we have certain problems on the other side of the ledger in terms of a lack of investment in --

MR. GALBRAITH: Exactly, and I would say it's not the current account deficit per se that we should be worried about, but as Clyde just put it, it is the stability of the overall international financial systems. International financial systems do occasionally collapse. They crumble. They have to be rebuilt periodically. We have to worry about that problem but it shouldn't constrain us from doing what we need to do.

MR. MALLABY: I'd like to bring in Jim Kolbe, particularly since I think he might have to leave slightly early. Now, you have more political experience than the rest of us put together --

JIM KOLBE: Not likely.

MR. MALLABY: -- and sometimes people make the argument that the real risk to continued prosperity is not so much something that might go on out there in the private sector. It's that the government -- the political system -- may decide that it can't tolerate something which in fact is crucial to continued growth. It could be that there's a clampdown on cross border movement, both of people and of goods. You've got the CFIUS issue. Concerns over security could get in the way. It could be that the consensus in favor of globalization in trades disintegrates for political reasons driven by growing income inequality. Do you see political risks to the continued success of the system?

MR. KOLBE: Yeah, I think there are political risks. The sky isn't falling but I do see some cracks up there in the sky, and it's long-term. The problem is too many politicians and, frankly, economists and others sometimes cry wolf and people get jaded and they don't believe that. The

political risks -- I'm not as concerned about the political risk of what Congress or politicians or executive branch might do but what they might not do, and when I say that I'm thinking of one thing in particular, and that is I think the long-term risk to the economy is the growth of entitlements and the unwillingness of the Congress, which is reflective of the American people, to really come to grips with what is a massive problem. And it's -- we've really only seen the beginning of this problem because now as the baby boomers start to retire, it's going to become massive. And if we don't focus on that and deal with Social Security, Medicare, Medicaid -- those big things that are gobbling up so much of the deficit -- we're not going to have anything left for that seed corn that was being talked about here earlier. We're not going to have anything left to make the investments in education, in R&D and health and the other kinds of things. We're going to be consumed with our entire budget being a transfer payment to one class of citizens -- to senior citizens.

MR. PRESTOWITZ: Yeah, but Jim, you could just print the money. I mean, deficits don't matter so just borrow it and print it.

MR. KOLBE: Yeah, in theory, yes, you could print it indefinitely, but I think that eventually I think the deficits do matter.

MR. MALLABY: Doug Holtz-Eakin is both the former director of the Budget Office and also now a political advisor. So why don't you come in on this?

DOUGLAS HOLTZ-EAKIN: Well, I am a big Jim Kolbe fan because, number one, he said that the people have become jaded about economists, and that suggests that they once listened to us -- so I find that incredibly heartening. (Laughter.) And because I think he's right about the core problem. If you step back and do the analysis in the boring fashion that is politically unappealing, what we should do is identify the national problems and priorities that we would like. So we'd like to have an economy that continues to grow -- raise standards of living. You then figure out which part is the government's role -- what it can do in the way of regulations, in the way of diplomacy and trade negotiations -- what it can do in the way of government spending programs to foster that goal. And then at the end you figure out how to finance it, and the financing turns out to look like a budget deficit or, in an international context, a current account deficit. That's the tale and a focus -- a discussion that focuses on the tale and whether the tale should be a two or a four is an entirely misplaced discussion.

MR. MALLABY: A two or four? What do you mean by that?

MR. HOLTZ-EAKIN: A number -- let's pick a number. Let's make it smaller -- let's make it bigger. It's the wrong focus. The focus should be on our goal. Our goal is to prosper in the future. To do that, we need to set aside sufficient seed corn to educate our young, to finance innovation. We now spend more on innovation and intangibles than we do on physical investment in the United States, but also to build the buildings and factories we need for the future. To do that we need to consume less, and the core issue is the one that Congressman Kolbe has identified, which is we have

enormous government programs whose purpose -- whose stated purpose is to make people consume more now and to not put aside sufficient resources for the future, and they're out of control. So if we want to patch the biggest crack we should take care of the entitlements, and the sky will not fall.

MR. MALLABY: So in other words, to move in a direction of more productive investment, the thing is not to print money as Clyde was suggesting -- possibly facetiously -- but in fact just to rein in consumption, and one way of doing that is to get a handle on entitlements.

MR. HOLTZ-EAKIN: Yeah, it's the single most direct handle that the government has is the self-inflicted problem from these large programs. We should start there. And that doesn't suggest it's the only thing, but should always solve the biggest problem first.

MR. MALLABY: Now, for this side of the room we have a secret weapon who is Dan Yergin, who is hiding behind his lectern. So he's going to move down there now where he will become visible. We will reveal our secret, and as he's working along I'll ask him a question. I think I'll start -- bring you over to the subject for which you're best known, which is, of course, energy and oil. You've written rather persuasively that this concern that oil production would peak, and -- that we've reached the peak and therefore we're moving into a world of declining oil supplies. That this worry comes up repeatedly in history is always proven wrong because of new technology, and so my question is, you know, does this concern about peak oil -- it may be wrong but is it in fact useful in the sense that it persuades people to think about alternative energy, or is it dysfunctional because out of this misguided concerns of peak oil you wind up with dysfunctional policies?

MR. YERGIN: Remove this complicated microphone.

MR. KOLBE: You broke it already.

MR : How many economists does it take to fix a microphone? (Laughter.)

DANIEL YERGIN: Sebastian, as you suggested --

MR : One competent person.

MR. YERGIN: -- I would say that this is not the first time that we've run out of oil. This is the fifth time, and each time technology-new areas have opened it up. I think that it is certainly very motivating. It certainly is a big stimulus to renewables. Part of the risk of it, though, is if you pin your hat on that and then events don't turn out that way, then you lose the momentum that you actually do need to address these broader questions. I think what we're seeing is -- in terms of energy -- is really what -- is a subset of what Bernard Schwartz has pointed to, which is it's really infrastructure. It's bottlenecks that are determining what we're seeing right now, and in time, markets -- expenditures will resolve those.

But I think what's also new -- I think the second thing that the peak oil reflects is this sense that we have this major surge of demand going on in the world, and that -- and this has happened before with China and India -- and that really what we're really seeing in terms of prices now is some disruption but mainly it's a result of success -- it's a result of what we were talking about before -- it's the success of globalization and economic growth that's driving where we are, and I do think markets respond and technology responds. Right now, see what I've sort of dubbed the great bubbling, which is not a reference to champagne, but it's a reference to this kind of technological innovation that you see occurring all along the energy spectrum. And to go back to what Senator Kerrey said, the unexpected will happen and we ought to expect the unexpected. We don't know the timing of it, but I think that three or four years from now things will look different in the energy picture than they do today.

MR. MALLABY: I have another question for you, which is kind of a mixture of a subject which came up earlier in energy, which is this question of financial crises. There can be a crisis, as Mike was reminding me, and one kind of crisis people fear is a financial crisis. And the most recent sort of hiccup we had was in energy trading when Amaranth, the hedge fund, blew up last year and lost \$6 billion rather quickly. In that particular case, the system absorbed it extremely easily. There was almost no collateral damage as far as most people could see. In your knowledge -- and energy markets, obviously in the California case as well threw out another version of a sort of financial malfunction -- do you see, in energy particularly but in other traded markets more broadly, are you worried that something will blow up or we'll wake up with another LTCM -- the Fed will have to intervene?

MR. YERGIN: Yeah. Well, let me say, California, although it remembers the financial crisis it was really, again, an infrastructure crisis. California economy had grown by 29 percent and no new electric power plants had been built, and they basically ran short of electricity. I was thinking as I was listening to discussion in the world of energy you really -- it is dominated by shortages right now -- shortages of engineers, shortages of refining equipment, shortages of commodities with this incredible boom in China and elsewhere in the world. One thing we don't have today is a shortage of money -- a shortage of liquidity -- and thus these low interest rates we've been talking about. One of two things will happen. Either it will go on forever or it won't, and when it won't the economic landscape will change. I don't claim that special knowledge -- probably Tim Geithner has more knowledge -- the concerns about derivatives, but in financial markets and other markets clearly there are vast developments going on that people don't have a grasp over. But I think other people on the panel might have a view but I don't see why there won't be financial crises of one kind or another at some point in the future, and when they happen they will come as a surprise and it will be a name that we -- most of us have never heard of, and afterwards it will be explained why it was all obvious and evitable that it was going to happen.

MR. MALLABY: And I guess the question is, though, how quickly we absorb that crisis. I mean, in the Amaranth case the interesting thing is that it was absorbed extremely quickly.

MR. YERGIN: Yeah, and that does have to do with so much liquidity and so much money and the depths of the markets. But often when you look at crises -- to go back to your abundance of crises -- it's not that one thing happens, but it's that three or four things happen at the same time and come together.

MR. MALLABY: Jim Kolbe, just going back to the earlier discussion and picking up the thread a little bit, I suppose one thing which is emerging is this idea that when it comes to tax cuts, your party -- the Republican party -- has been frequently willing to say, "Look, we want to go for growth here. We're willing to tax -- cut the taxes and getting the growth from the tax cut matters more than fiscal -- the fiscal problem." Why isn't the same -- politically speaking, why hasn't the same argument -- and I'm not saying that that's a generalization about all members of your party -- of course not--

MR. KOLBE: Right.

MR. MALLABY: But at least a wing of the party has been willing to say that. But -- so why is it that there hasn't been this similar argument about infrastructure? "Hey, let's make more infrastructure investment. Let's make more educational investment. We're willing to tolerate some deficit for that." Why is that a less popular kind of --

MR. KOLBE: There should be. There's no question that that's exactly where Republicans -- and Democrats, for that matter -- ought to be talking about that. If we're going to have deficits, that's where we ought to be making the investment. Why don't they do it? I -- the answer to that is simple. We run on two-year terms. Senators run on six-year terms. Governors run on four-year terms. Presidents run on four-year terms. And they're thinking about the next election. And you don't get -- usually get a lot of popularity -- you don't get a lot of votes out of suggesting long-term investments in education -- boring. You don't get a lot of interest among the public by talking about long-term investments in R&D -- ho hum. But if you're going to talk about making a transfer payment -- a new program for veterans -- if you're going to talk about a new program for senior citizens -- a drug prescription program or whatever -- now you're talking about people who are going to be voting for me in the next election. And so it's a matter of the short-term versus the long-term. That's the political dilemma we have today. Our problems are increasingly -- are long-term ones that we're facing out there. Increasingly the horizon for politicians seems to be much more short-term than it ever did before, just because of the nature of the Internet -- of the communications that we have -- things are instantaneous, and people expect instantaneous results and instantaneous things to happen. And so politicians seem to be on a much shorter time leash than they were before, while the problems seem to be out there in the future.

MR. MALLABY: So it's the same reason we don't have entitlement reform, in other words. It's just too long-term --

MR. KOLBE: Yeah. It's -- entitlement reform is, you know, everybody knows it needs to be done. You can't find one politician -- if you took him aside in a corner some here -- place here and talked to him about it, and says, "Yeah, we really need to do something about it but, you know, maybe after the next election we'll think about that one." Well, there's always the next election, and so people just don't think about it. It's always something -- postpone it until there is something of a crisis down the road. And to me that's a puzzling thing because other countries -- now, they don't have the huge -- most of them don't have the huge overlay of entitlement problems that we do in this country. But other countries have dealt with this. They do have a political system that allows them to deal with it. There's -- on any number of countries you can talk about who've -- have reformed their pension system, and to some extent their health care systems -- made major reforms in those things and been willing to do it -- and done it without too much political disaster occurring to people either.

MR. GALBRAITH: Can I offer a comment on this? I think when we discuss entitlements we should always break it into its two major components, and I would argue that Social Security is fundamentally sound and that there is no compelling case for major cuts in Social Security benefits. And in my view, there's no case for any cuts in Social Security benefits. On the other hand -- (inaudible) --

MR. MALLABY: What about on the revenue -- on the --

MR. GALBRAITH: -- on the other hand, Medicare and Medicaid are part of a much larger problem, which is the cost of health care, and that is an important issue but one which needs to be dealt with not as a problem of a government program but as a problem of the health care system as a whole, including the role of private insurance and the fact that we don't have any effective means for managing the costs and the rising costs of that system. But we can't deal with that as a Medicare issue. The worst part about Medicare Part D was not that it extended a drug benefit, but it did so in a way which permitted big pharmaceutical companies to make inordinate profits off of the sale of those prescription medications.

MR. KOLBE: Since I'm probably -- am going to have to leave in just a couple minutes let me just get one thought in. I agree that the health care -- the Medicare and Medicaid -- are much more -- much bigger. They're humongous compared to Social Security, and Jamie's right that it's the -- what's driving it is the uncertainties of health care costs, and we don't know really where we're going with health care. But I do disagree that Social Security is not a problem. Social Security is a problem and to me it's the laboratory. If we don't have the political will to do anything to fix Social Security -- and you've gotten it on both the revenue side and the liabilities over the long term -- there is no question that if you look at Social Security in the next horizon of 30, 40, 50 years as all the baby boomers retire and go to their graves, we're going to be facing a smaller group of people paying into the Social Security system -- a larger group receiving the benefits. There is a problem. It's fixable -- it's very fixable, but there's no political will to do it. That's -- I would just say I think there is a problem.

MR. MALLABY: Well, thank you very much. Mike, you are shaking your head.

MR. MANDEL: Let me actually be the outlier here. You say you can't find anybody who doesn't believe that there's a Medicare -- medical problem. I don't believe that there's a long-term Medicare problem in the same way that other people do. We're talking about 50-year projections and projections of a particular sort. If you hold those paths -- you know, a little bit of extra productivity growth 50 years out ends up turning what looks like an enormous yawning problem to something much more manageable. That's not to say that there -- I've actually had this discussion with Doug before, okay?

MR. HOLTZ-EAKIN: You were wrong the first time. (Laughter.)

MR. MANDEL: I'm not wrong, okay? I may not be right but I'm not wrong. (Laughter.) Two different things. You think about 50-year --

MR. : That's a distinction.

MR. MANDEL: Well, you know, it's about uncertainty and faith versus prudence and so forth. I think that if you think about 50-year projections and if you go back to 1950 and you'd ask what things were going to look like in 2000, I'm not sure you would have gotten very many of the correct guesses at that point. I think the right way to think about health care system is to think they need to be fixed, but that if you have gains in productivity growth it becomes much easier to pay for it.

MR. MALLABY: Doug?

MR. HOLTZ-EAKIN: Well, I'm not sure I agree entirely with Mr. Mandel, however much I might respect him. First, let's remember that this isn't all about the financing and the fact that there's a mismatch between dedicated revenues in these programs and the outlays. The problems are deeper and bigger than that. In Social Security, even if you don't address the fundamental imbalance in the financing -- and that is real -- we have promised 7 percent of our national income in Social Security benefits as far as the eye can see. We have the political will to finance 5 percent of our national income. There's a 2 percentage point gap forever, and so that's not a program that's in good shape.

But even if you ignore that, this is a program that has bad incentives. It actually deters saving in the United States. It doesn't help it -- it makes it worse. It's targeted poorly. We have people who are divorced and ineligible for benefits one day later. Had they remained married for another day they'd get benefits. It is available in ways that make no sense across the income distribution. And so it needs to be fixed regardless of the financing, and it would produce better economic incentives, better social outcomes. Medicare and Medicaid are a reflection of the healthcare system, but the federal government pays 50 percent of the health care bills. So if you want to find the problem just look right around this town, and this town micromanages health care. And we, independent again of the financing, have problems in health. We spend 16 percent of our national income on a health system that does not produce better outcomes than much cheaper systems, and it is financed in a way that puts

people at risk for loss in their financial coverage when they lose their job, leaves them unhappy with their financial outcomes after they are sick. These are all big problems. They need to be addressed and they are fundamentally underfinanced on top of that.

So I don't think you can make the claim they're fine and, in health in particular, the idea we can grow our way out of it is always very enticing, but this one simply gets too big too fast to ever grow our way out of. Health care spending per person is rising 2.5 percentage points faster than income per capita. It would take a productivity boom of unprecedented proportions -- twice anything that anyone could imagine -- for the productivity to make up for the health care growth. We need to come to terms with the problem, not pray for a productivity miracle.

MR. MALLABY: Yes, Dan?

MR. YERGIN: I suppose sitting here on the 9th floor -- at the top floor -- we probably have greater sensitivity than the other floors to the question as to whether the sky is falling. I mean, so we've identified kind of one set of issues that do or do not affect it. I'd like to suggest a second, but it goes back to your point, Sebastian, because you were really asking is there something different in the scale -- in the flexibility of the financial markets now and the overall economy that it can absorb any kind of shock that comes along. Because, you know, if you look at kind of trends you'd say a lot of the economic trends in the world are actually very positive. Imagine, Germany is growing now. Germany's a locomotive of Europe. A year- and-a-half ago one wouldn't have expected it -- a lot of positive trends on economics. But if you look around the world you have to say that there are a number of very negative geopolitical trends, including the reality of anti-Americanism as a political force around the world. And one question maybe is -- do those -- do events that are outside markets -- do they have the ability to really impact markets or do we have such resilience to go through anything?

MR. MALLABY: That's a good question. I mean, it is quite striking that I think one of the most volatile periods in financial markets in the last, say, 10 years was right after the tech bubble crashed. In other words, right before the terrorist attacks of 2001. So at a period of maximum U.S. power -- maximum sort of confidence -- on the geopolitical side, there was maximum nervousness on the financial market side. Then it turned around. We had extreme fear from people who are involved in the security side of our policymaking that there will be another terrorist attack--that Iraq is going badly, Iran is a problem. Almost anywhere you look, you've got a major --

MR. YERGIN: And don't forget Latin America.

MR. MALLABY: Right. And at the same time volatility is incredibly low in stock markets. Yeah -- sure. Mike?

MR. MANDEL: I wanted to step in here -- might make a different -- you know, you can have things going wrong and still not have the sky falling, okay? You can have the period that comes -- you can have booms and busts. You can have real estate busts. You can even have sub prime crises, okay?

And it doesn't mean the sky is falling. It doesn't mean that the system is coming apart, okay? And so what you want to think about here is there anything going -- you know, there's good times and there's bad times, okay? And things may get better, things get worse, things get better. The question is: is there anything going on that could break the system?

MR. YERGIN: Can you answer that?

MR. MANDEL: Right now?

MR. YERGIN: Yeah. I mean, do --

MR. MANDEL: Okay. Right now, from the U.S. side it looks pretty good, and from the Chinese side they're sitting on \$1 trillion in reserves to help soak up whatever financial problems you have. And so I think that you raised a good point about the geopolitical issues as being maybe sort of more suspicious here.

MR. PRESTOWITZ: Well, let me jump in on that because I think there is something that we should be thinking about that may be a breaker, and that is that if you look at the structure of the global economy and there's one major center of net demand, that's of course the United States. Or to broaden it, let's say the Anglo countries -- the Brits, the Americans and the Aussies basically are net buyers. Everybody else is a net seller. We in the U.S. are consuming 6, 7 percent of GDP more than we produce. We're spending more than we earn. So if you argue -- it seems to me if you argue that there's nothing to worry about implicit in that is the assumption that one special set of people, the Americans, can indefinitely consume more than they produce, and somehow not pay for it.

The flip side of this is that very large parts of the world are investing at an enormous rate. I mean, China -- 50 percent of every dollar in China spent is a new factory. Singapore -- a similar kind of thing. It's a small economy but nevertheless very high investment rates, which are predicted upon the notion that you can kind of expand production forever and sell it to the Anglos. Now, in the past we saw economies like Japan's and Korea's pursue a similar track and wind up with enormous excess capacity. They were relatively small countries. You're now talking about some major countries trying to do the same thing, and it seems to me that the assumption that the Americans can consume forever and not pay for it, and that the Chinese can invest at 50 percent forever and not have some kind of a crisis -- I mean, that's I think a fundamental issue to consider.

MR. MALLABY: I'd like to go to questions from the floor in a second but James Galbraith wants to say one thing.

MR. GALBRAITH: I think this raises a very deep question, which is really whether the world needs the United States to perform a role in the world economy and the world security that justifies the financial condition. And we have over the past 50 years largely fulfilled such a role as both the guarantor of stability and as a kind of beacon of democracy and prosperity and other ideals. We have

to face the question whether we are still filling that role, whether we are in the process of squandering or perhaps have already squandered part or all of the moral authority that the world vested in us, and whether we need to take steps to rebuild in some sense a multilateral system in which we can, again, enjoy the kind of respect and the kind of authority that permits us to continue to serve as the financial anchor as well as the security anchor of the world system.

It seems to me that if we don't do that -- if we don't take that problem seriously -- in other words, if we don't integrate our foreign policy problems -- and here I'll mention the word that hasn't been said yet this morning -- Iraq -- if we don't cope with the kinds of issues that have been raised by the conduct of foreign policy we are running risks of exactly the kind that Dan Yergin raised and other people have raised -- geopolitical risks that are the true potential triggers for instability and crisis in the world financial systems.

MR. MALLABY: So successful foreign policy and a successful economic policy are interlinked. And we have a question right here.

Q: Hi. Martin Huffman and I write a column called The Bear's Lair in which you'd be surprised not at all to realize that my view is that the sky is falling, it just hasn't landed yet. My question in particular is you've got two things I think that are -- have happened but not yet worked them out. One is the housing crisis, which I think is much bigger than people think it being, and you're talking I think \$1 trillion of losses. And the second, this Venezuelan seizure of the Orinoco oil fields, which is 34 percent of world oil reserves -- larger than the Middle East -- and suddenly we've lost our oil security. If there wasn't another obvious buyer it wouldn't matter but there is, of course, it's China, and they can go in there, sort out the Orinoco fields, take the lot off, and make us entirely dependent on the Middle East. And I was just that the loss of security and the financial crash of housing are both bits -- where bits of the sky have come loose and are falling on us but haven't landed.

MR. MALLABY: So Daniel, do you want to do the oil part of that?

MR. YERGIN: Oh, I thought I was going to do the housing. No, I'll do oil. (Laughter.)

MR. MALLABY: No, that's fine -- go right ahead.

MR. YERGIN: Well, I think what you point out what happened -- last week in Venezuela -- was both significant in itself and quite symbolic of the change, and this goes back to Sebastian's question about peak oil. And actually I'm glad you asked that question because I'm trying to finish a chapter on that subject this weekend so your question's very helpful. But I do think that there are plenty of risks above ground -- plenty of risk, and you've pointed to what are the biggest. You know, we've been preoccupied with the Middle East and what's happening there, but the changes in Latin America led by Venezuela -- part of the backlash against globalization -- socialism for the 21st century are really very significant.

Now, needs to be kept in balance. Our -- actually although I think many people think that most of our oil imports -- I mean, you don't -- but most of our oil imports come from the Middle East. Actually, only 19 percent come from the Middle East, and our number one source of oil and energy imports is Canada, which I don't believe is an imminent threat to U.S. national security. There -- if there are any Canadians in the room we can check on that. Mexico -- yes, that's right, a sneaky bunch -- second is Mexico. So there's, you know, there's diversification but nevertheless Venezuela since World War II has been seen as a reliable supplier, and if we look at the world oil market it's not only tight supply because of economic growth. It's also -- there's a kind of aggregate disruption and the declines in Venezuela are part of that, and the political agenda over the economics. So I think that goes -- that set of risks -- that set of geopolitical risks above ground are going to loom larger in the years ahead, at least so far as long as we remain in a high price environment. Housing, I think, somebody else should --

MR. MALLABY: Doug, do you want to take a crack at --

MR. HOLTZ-EAKIN: Oh, I think the sub prime mortgage debacle has, you know, had clear stresses on particular communities and particular households, but it is not broadly a threat to the U.S. economy. It's important to remember the scale of the issue, and this is an issue that affects a very small subset of American households. The vast majority of homeowners don't even have a mortgage -- not the vast majority, but majority -- and it's only in the past couple of years that we've seen the rise in the sub primes as a fraction of mortgage lending. So their problems are real, but they are not typical of the American household, and you have to drive the American household spending substantially south in order to generate large economic problems in the United States, and there's no evidence of that on the books yet.

MR. MALLABY: But if Congress was to worry too much about this potential meltdown, would that have a negative outcome? Would it lead Congress down the wrong policy path?

MR. HOLTZ-EAKIN: Well, I mean, there are two channels by which you can make a problem that's targeted on these households bigger, and one channel is for there to be a financial channel -- a financial crisis of the type that others have mentioned. To do that, you have to get some big lending institutions in problems with their capital base and that's -- there's no evidence of capital impairment out there so they're not going to cut back on loans to businesses and elsewhere, so I don't think we get that. Or bad policy, and bad policy is always a risk, and here the right policy is to put in place standards that would have been appropriate to begin with, that's already taking place, that are broadly -- broad enough to affect all the lenders, and there are new exotic lenders as well as new exotic instruments in this market -- we got to get those. And certainly to prosecute the fraud, and there's some evidence of fraud in this. People should be held accountable and send the message that we're not going to do business this way.

MR. MALLABY: Another question right there. Why don't we take a couple? You had a question too so why don't you go right ahead after this, and we'll take one more here and then we'll have three questions lined up.

Q: Okay. There's been several discussions and talks and views of whether or not the sky is falling or something is going to happen but there's agreement something is going to happen in a way that's -- we've never anticipated. But then hindsight will say, "Oh, we saw all the signs and indicators." Number two, someone brought up Iraq and so was the -- 9/11. You know, it took us by total surprise, but then as we look back there were indicators. So my question to you is to imagine -- to consider what might be the analogy or counterpart to an economic role of terrorism of comparable -- like the World Trade Center? Because we were talking a lot today about governmental actions, but what happened in 9/11 was like free agents, or maybe with government okay. So what might be -- how -- what will we look at for things that are weak that may be vulnerable?

MR. MALLABY: Good. That's a nice simple question -- predict the unpredictable. But we'll go to the next question --

Q: Thanks. Specifically for Mr. Yergin, but for everyone else if you care to comment. In various markets around the world today, you can actually find oil futures priced in euros. And I'm curious what you think would be the impact or the likelihood if other countries around the world followed Iran's lead and started to quote oil in euros or in other currencies as opposed to dollars.

MR. MALLABY: Okay. And did you have a question as well?

Q: Yes, for anyone to take. There was very brief mention here of the derivatives markets, and we all know the Federal Reserve and the other central banks have been occupied with trying to assess what the risks are and whether the banks really understand truly what these risks are. Could any of you comment on whether you think this is really a market that is growing beyond the ability of any one central bank to control and the -- certainly the lack of an international regulatory agency?

MR. MALLABY: Okay. Well, Mike, do you want to go ahead?

MR. MANDEL: I'll take the last one very quickly. The answer is yes, if you have a global economy, ultimately you need a global central bank. If you ask the heads of central banks this question, they say, "Well, we really don't." Okay? But the answer is in the end you do, and when we have the global financial crisis you'll find out.

MR. MALLABY: Dan?

MR. YERGIN: On the euro question I think it will be seen as symbolic. I don't think it matters a great deal so much whether it's priced in oil or euros because it will just arbitrage back and forth. What does matter is what happens to these enormous petrol dollar reserves that have been built

up, and how that money is deployed and where that's deployed. I think that looms larger. I think on that other question, one, you know, you don't want to speculate too much and broadly but I suppose if you're saying where could an unexpected shock come from that would actually hit the system, I would say it would be something that disrupts the global supply chains.

MR. MALLABY: Clyde?

MR. PRESTOWITZ: Yeah, two comments on kind of leading indicators of crises. One, I think Dan's point is very good -- supply chains. One thing that's been happening that nobody's kind of looked at very much is that more and more production is moving to fewer and fewer places. And so, you know, you buy a Dell laptop, you buy an HP laptop, you think you're getting two -- but they come from the same production lines. And so production lines are being concentrated in places frequently that are, you know, higher risk than -- higher risk environments and --

MR. MALLABY: -- is that a new thing? I mean, you know, 30 years ago you bought a car -- be Ford or be a GM. They both came from Detroit. I mean --

MR. PRESTOWITZ: No -- no. I mean, the issue is not if it's new. The question is that it's advanced.

MR. MALLABY: Okay.

MR. PRESTOWITZ: So we're at a point where you have supply chains that are very extended and actually somewhat -- you know, there's not a lot of competition in the supply chain. So if something happens to one piece of the supply chain, there's not redundancy -- say, redundancy in the supply chain. So the risk of something happening in the supply chain is probably higher than people recognize. Second question about what could be leading to a crisis -- I mentioned earlier the stealth move from the dollar. You know, we have to keep in mind that this whole system we've been talking about, and particularly the ability of the United States to do what it does in terms of consumption and so forth, we're the only country who can do this because we print the world's money. Nobody else can do this except us. So this all rests on the rest of the world being happy to hold dollars.

Now, if you go around and talk as I have in the last six months to the world's central bank heads, you find a great deal of nervousness, and you find that banks like Bank of Malaysia and New Zealand, Russia, others, have begun to reduce the proportion of dollars in their reserve holdings, and move to euros or other things. Very interesting movement is OPEC money, which has moved significantly into euros, and there are both economic and political reasons for doing that. And so I think part of the significance of oil futures being quoted in euros is the potential for a movement towards an oil price maybe on a basket of currencies.

China is using its -- it's not sitting on its dollar reserves; it's buying oil fields and it's buying iron ore mines. It's buying commodities. It's buying -- it's buying basic materials, and that suggests

maybe a movement of the world monetary system towards a commodity-based standard, rather than a dollar standard. And if there's not a dollar standard, the U.S. -- the sky will fall.

MR. MALLABY: James Galbraith.

MR. GALBRAITH: Yeah. That is true, but I think the dollar standard is still fairly robust, because it is not in the interest of those who hold dollars to trigger a run on the dollar. You do not want to be the bureaucrat in Beijing who reallocated 10 percent of your portfolio to euro and then caused the other 90 percent to lose half of its value. This would be a very bad career move, I think.

I think this conversation, though, has been very useful because it has focused on the structural risks, the architectural risks in the financial system, and has gotten us away from the kind of argument which says that there is anything material about reducing the trade deficit next year or over three years or reducing the budget deficit that would work on those risks. Those risks are there. They're there as a result of the system we've been in for the last 36 years or so, and they will be dealt with by, one hopes, improving regulation, improving coordination between the central banks, improving our position in the world. And I would say, also, by dealing with the underlying problems of this economy, preventing a slowdown from taking hold in the short run and, in the long run, coming to grips with what everybody sees as our social and infrastructural and environmental problems. And that's where we ought to be putting our energy, recognizing that we need the guardianship, if you like, of the financial regulators and the larger guardians of the financial system, but their job is to make possible the gains that we ought to be making and leaving for the next generation.

MR. MALLABY: Okay. I think we've been given a slight stay of execution. We can take one more question. Someone over there.

Q: Patrick Malloy. When I was with the Senate Banking Committee, we had what we used to call the golden rule, which was "He who has the gold makes the rules." And this fits in with a concern that Warren Buffett has that when we run these massive current account deficits year after year, we're transferring dollars abroad to buy goods. Then the foreigners take these dollars and buy assets in this country. What Warren Buffett said is we're like the rich family living on the hill, transferring portions of our national wealth abroad year after year. So he's voiced major concerns in an article in Fortune Magazine in October 2003, when our current account was only 4 percent; now it's closer to 7 percent. So he said this is a terrible position for the United States to be in. We're losing our power position in the world and it's -- and it's going to undermine our economy in the long run. I just wonder, does anybody share Buffett's concerns about what's going on here?

MR. MALLABY: I think Buffett's phrase was that we're becoming a nation of sharecroppers --

Q: Yeah, he said we're becoming a sharecropper economy. We're working for the other people.

MR. MALLABY: Americans working for companies and -- on land which is increasingly owned by somebody else.

Q: Yes.

MR. MALLABY: That's the idea. Are you worried, Mike?

MR. MANDEL: I'm not worried. (Off mic, laughter.) The land analogy is an interesting one, but incorrect, okay, because you can't make more land. But our national wealth doesn't rest on our land; it rests on our ability to be productive, to come up with new ideas and innovate. And so if you look at the, our -- if you look at the Fed statements of household wealth and you adjusted for inflation and you adjusted for government debt, what you see is that despite our trade deficit, despite the fact that we're selling off pieces of ourselves, that we -- think about a pie, we're selling off pieces of the pie, but the pie keeps getting bigger. And as long as that's happening, we're okay, okay? So that's kind of the better analogy than the land one. Once you go for the land, you've kind of -- you've gone in the wrong direction.

MR. MALLABY: Okay. Well, I think we've reached a sort of consensus, which I would say is that, you know, there are problems. The sky can fall. You've the question of the dollar and the current accounts, you've got the question of supply chain disruption, and you've got the entitlement things looming out there which have to be fixed at some point. But at the same time, one shouldn't let these things blind ourselves to opportunities that we may be foregoing if we only look at the problems, because on the other side there are things that need to be done in terms of investment in infrastructure, investment in education, investment in the social problems that James Galbraith was talking about. And so it's a question of not letting the potentially falling sky obscure the view of what actually needs to be affirmatively done to keep the economy moving forward.

So, I've enjoyed it. I hope some of you did, too. Thank you very much.

(Applause.)

MR. CLEMONS: What we're going to do now -- thank you so much, Sebastian, this was a wonderful panel -- we're now going to have a seamless transition, with no break. We've got a lot of viewers with us from C-SPAN today. Gentlemen, if you might step away from the key stage so we can move, and I'm going to turn the podium over now to Senator Bob Kerrey, who will moderate this next session. So we'll move immediately.

MR. KERREY: We will start this. Senator Conrad is going to be joining us. He's in the middle of a conference call with Congressman Spratt to try to figure out how to get the conference report on the budget up before both the Senate and the House. So he'll be joining us shortly. What I'm going to try to do is to moderate a discussion between Senator Bob Bennett from Utah and Senator

Debbie Stabenow from Michigan about some of the things we were talking about earlier. And the central question that we're trying to analyze is whether or not the economic sky itself is falling, and specifically, are the metrics that we have used for so long -- balancing the budget, trade imbalance, others that you could probably think of as well -- are those metrics still applicable? Do they still work? Are those the things that should guide both the American people as they think about who to elect and what to support in terms of assisting members of Congress to do their work, and what should the members of Congress themselves be focusing on?

Bob, you arrived here in 1993. I arrived four years before that and, as you recall, the conventional wisdom then broadly felt was that fiscal deficits were bad, trade deficits were bad. And it seems to me that those are at least worth questioning today, that there may be larger problems than even those two -- or certainly there needs to be an open and honest debate about what are the key problems that you all are facing and where do you think that our attention should be directed in order to increase the chances that we have sustaining policies that produce economic growth and rising standards of living, all the sorts of things that we know people want.

So Bob, let me start with you, because I know you spent a fair amount of time examining this demographic change that's going to occur over the next 30 years as the baby boomers continue to move both towards and then through retirement age.

SENATOR ROBERT BENNETT (R-UT): All right. Thank you very much. I'm honored to have the opportunity to be here. And how many of you know the poem of the blind man and the elephant? Raise your hand.

MR. KERREY: I thought you were going to ask me if I believed in evolution. (Laughter.)

SEN. BENNETT: No, no, no. Okay, I should have brought it with me, because as written it's far better than the summary I will give it, and I'm a little surprised that more hands didn't go up. In my youth, it was as important and as well known as the story of the emperor with no clothes. But basically, here's the message of the poem. Seven blind men gather around an elephant to try to determine what it's like. And one of them grabs hold of the leg of the elephant and says, "The elephant is like a tree." And somebody else grabs hold of the tail of the elephant and says, "No, the elephant is a rope." And another guy grabs the trunk of the elephant and says, "The elephant is like a hose." Someone touches the tusk of the elephant and says, "The elephant is like a spear." Another man runs into the side of the elephant and says, "The elephant is like a wall." And they all sit there and argue, and the poem ends up saying, "Each one partly in the right, but wholly in the wrong." And I think that's a metaphor for economic analysis.

We grab hold of one economic metric like the tusk of an elephant and say it's like a spear, and then we argue violently among ourselves, saying, "It's like a spear! It's like a spear!" and somebody else is saying, "No, no. It's a rope. It's a rope." We talk about deficits, trade deficits and fiscal deficits and we fall into all kinds of blind-men-and-the-elephant sorts of traps.

If you look at the trade deficit -- or, pardon me, the fiscal deficit -- you can say accurately that the deficit reached historic proportions in early 2000. It was the biggest deficit in American history, if you measure it solely in terms of nominal dollars. If you measure it as a percentage of GDP, it was right smack in the norm for a deficit following a recession. And the reason it was the biggest in American history is that the economy is the biggest in the American history. And if you measure it now as a percentage of GDP, it is very low and, in the immediate term, nothing to worry about. So you can state that slice of the elephant and that group of blind men, they're partly in the right, but are they wholly in the wrong? Same thing is true of trade deficit and all the rest. But one figure that I use, as people get panicked about China and they say, "China is growing in double digits every year, and we are mired down at 2-and-a-half (percent) to 3 percent growth -- China is going to kill us." Well, double digits off of what base?

In the years that George W. Bush has been president -- and we'll take those, because it was a year of recession and then years of growth combined -- the U.S. economy has grown more than the Chinese economy is. Roughly, the numbers of growth addition to GDP from 2001 until now are about \$2.7 trillion we've added to the size of the American economy. The total Chinese GDP is about 2.3 (trillion dollars). Does that help you see a little more of the elephant than just looking at double digit growth, as opposed to 2 (percent) or 3 percent digit growth? And so on, all the way through.

My point is the economy is enormously complex, enormously difficult to understand, but-- to use Alan Greenspan's favorite word -- extraordinarily resilient. Greenspan pointed out to us, he said, you know, we -- we had the bursting of the dot com bubble. NASDAQ fell by, what, two-thirds, when the dot-com bubble burst and all of that came down? You had the Dow down by a third. You had the Enron scandal. You had the dislocation of the IT world as a result of -- of Y2K and all of the purchase changes. You had failing problems abroad, and the American economy just kept on growing. Just kept on going. And Greenspan's point was this is an amazing, extraordinarily -- I have to keep using his favorite word -- extraordinarily resilient economy, and we don't really appreciate it. We don't really understand how good it is.

Now, having said that, if you look ahead in the elephant we've got, we have huge Democratic -- demographic -- challenges facing us. (Laughter.) Freudian slip.

(Laughter, applause.)

MR. KERREY: I couldn't have said it better.

SEN. BENNETT: Yeah. There are some days when I think the demogra -- demo -- Nevermind. (Laughter.) Nevermind.

Starting in 2008, something is going to happen that has never happened in America before.

SEN. STABENOW: That's true.

SEN. BENNETT: The percentage of Americans of retirement age is going to double in a 20-year period, starting in 2008. And that, scary as it is all by itself, is not the only part of the elephant you have to look at. Not only are we getting more Americans once they get to retirement age, they live longer while they're there. If you go back to the time when Social Security was put in place, the percentage of Americans who would enter the workforce at 21 who would still be alive at retirement age was close to 50 percent. You know, they were in a lottery. They were paying their money into the lottery, but there was a 50-50 chance they would never live to get any of it back. So the ones who won the lottery and survived until 65 were living off of the earnings of those who were paying in that were -- were going to get nothing. All right? It's now approaching 80 percent of those who enter the workforce at 25 -- 21 who will still be alive at retirement age. So the lottery dynamics have changed, even as the numbers have gone up, and the life expectancy has gone up. And those things are waiting for us out in the future, and if we just look at the elephant today and say, "Well, the size of the deficit today, measured as GDP, is nothing to worry about. It's acting as recession recovery cycles have acted before in the past, and so we can assume that it will continue to do that," we're kidding ourselves. And so we are facing an enormous series of changes in the shape and size of the elephant, and too many of us are still blind men running around hanging onto the trunk and the leg and the -- and the tail.

With that, I have extended my time beyond --

MR. KERREY: Well, the elephant metaphor offers so many opportunities for cheap and inappropriate responses -- (laughter).

SEN. BENNETT: Oh, go ahead! (Laughter.)

SEN. STABENOW: Bob, I would prefer to talk about a donkey, myself, you know? (Laughs.)

SEN. BENNETT: Yeah. All right, right.

MR. KERREY: Well, Senator Stabenow, let me ask you to respond --

SEN. STABENOW: Yes.

MR. KERREY: -- your own view of the elephant, if you would.

SEN. STABENOW: Absolutely. Thank you.

I do agree with my good friend, Bob Bennett, that it does depend on how you look at what's happening in this country. And I would propose that we fundamentally should be looking at it from the standpoint of Americans -- American quality of life, American businesses. I mean, the economy is not something separate that we celebrate. It's a question of what does that mean? What does that

mean for -- for people who are working hard? What does that mean in terms of opportunities? What does that mean when you invest in businesses? What does that mean for jobs? I mean that, fundamentally, I hope, is how we look at the whole picture.

And you see a very different picture now. In a global economy where your cell phone or Internet could jump any wall -- I mean, there's no point in talking about protectionist versus free trade anymore, because we can talk to people anywhere we want in the world. So the question is how do we have a level playing field, how are we smart in America to make a global economy work for us and for Americans? And this is where I get worried, because I don't think we're doing that right now.

When we look at the numbers -- GDP up, corporate profits up, S&P 500 up, real wages down 20 percent -- we're in a situation now in a global economy where just focusing on the success or the profit of a business does not translate into the profit of the workers or the community. It doesn't. So how do we invest and do things so that in fact we are benefiting from that global economy in America?

Now, I come from a perspective that -- where this is glaring us in the face every day. In Michigan, I mean, we are seeing what has happened by not enforcing our trade laws, quite frankly. We have a \$12 billion counterfeit auto parts industry alone and the top five auto suppliers in the country have declared bankruptcy. Connection? Well, we know we've lost about 250,000 jobs because, even though we have counterfeiting laws on the books, we are not adequately enforcing them.

Now, the administration now, after four years, is coming up now and looking at China and auto parts, which will take another couple of years. But we are not looking in a global economy, or in the economy, and saying how do we make sure when we go into trade deals that they're enforced and that they're fair, and that they create a level playing field? I have authored, with my colleague Lindsey Graham, a bill that would create a U.S. trade prosecutor to be responsible for focusing on those very issues, where currency manipulation, counterfeiting, whatever the issues are -- intellectual property rights -- how do we make sure that this is a level playing field?

I also am very concerned, as we look at where we are now that our trade deficit is higher than the budget deficit, which I believe is too high -- the budget deficit's too high, but the trade deficit is even higher, and what does that mean? Well, first of all, we have seen, because of the fact that we have not had a level playing field, and I think tax laws and innovation investments and other things that focus on American ingenuity and keeping it here, we've lost 3 million manufacturing jobs in the last six years. Three million. And those are good-paying jobs with health care and pensions. Should we worry about that? Should we say, well, we're not going to have manufacturing anymore. We just won't make things in America anymore. Then what happens when we need to make a tank? What happens when we want to make the next generation of technology? I mean, of course we're going to make things. We're going to make things differently. We're going to make -- even in the auto industry, which I'm extremely familiar with -- it's not your father's factory. It's very different; it's very high-tech. But the economy grows if we make things and grow things, and my concern, Bob, is that we're not focusing on the fact that in America, in a global economy where there are wage -- huge wage differences, where

other countries pay for their health care and our businesses pay for our health care, that we're not focusing on the need to make sure we can still make things in this country, as well as grow things.

Our companies today are competing with other countries -- not companies, countries -- with rules that say if you want to do business in China you have to have your plant in China. The Chinese own the business, or co-own the business. And so as we look at all of these things from an economic standpoint, I believe it's incredibly important -- and in fact, you know, we all use the term "middle class," and it becomes rhetoric when politicians say it, but I -- I believe this -- that we are not going to keep the middle class of this country unless we get this right, that the big question in a global economy is how do we compete in a level playing field in smart way and keep the middle class and the way of life that we have known and that is the envy of the world? And that involves worrying about a number of things.

So I would just -- I'm happy -- I will wait for more questions, but Bob, I would simply say that, for me -- there's a lot of ways to look at the numbers. A lot of ways to look at the numbers -- but for me it all comes back to is an American going to be able to get a good-paying job, is a business going to be able to succeed here and have the right kind of tax policies, be able to do their business here and sell it abroad, have a global economy where they can sell their products abroad? Are we going to keep the standard of living that we expect and that we need in this country? And I think it goes to how we structure tax incentives, how we enforce trade laws as well as write new ones, and how we invest in education and innovation for the future in this country.

Thank you.

MR. KERREY: Thank you.

Next, I'm going to ask Senator Conrad, you ran in '86 for the first time; I ran in '88. And Senator Conrad did a remarkable thing. He promised that if the budget wasn't balanced in six years he was going to not run for re-election, and he did. He kept his promise and managed to get back to the Senate and managed now to be chairman of the Budget Committee. But in '86 and in '88, at the time, real interest rates were relatively high and the accepted wisdom earlier, during that era, was that if we balanced the budget, real interest rates would come down, the economy would grow, unemployment rates would drop, that you'd see broad benefits distributed across the country as a result. And there was an effort. I mean, it seems like hundreds of years ago that people were actually talking about amending the Constitution, requiring a balanced budget.

But it seems to have changed, because now we've got real interest rates quite low, the economy is still growing at relatively impressive rates. And so it leads to this question that Bernard Schwartz asked and which caused us to put this conference on with the New America Foundation, and that is: do deficits really matter any longer? Is that conventional wisdom outdated, given what's going on both in the U.S. economy and the world economy?

SENATOR KENT CONRAD (D-ND): Bob, is it all right if I go to the podium --

MR. KERREY: It's all right if you go to the podium. It's wonderful if you go to the podium.

SEN. STABENOW: (Chuckles.)

SEN. CONRAD: You won't be surprised, Bob, but I've got a couple of charts. (Laughter.)

SEN. STABENOW: I forgot mine! I forgot --

SEN. CONRAD: (Off mic.) So do I!

MR. KERREY: You do? You've got charts?

SEN. STABENOW: I've got charts.

SEN. CONRAD: Yeah, deficits do matter. Clearly, they matter. I think all of us would understand if you're spending more money than you're taking in and you're not able to pay your bills and your debt is growing faster than your income, that at some point you have a problem. And it's not immediate, it's not sudden, because markets don't work that way, especially when you're the richest, most powerful nation on Earth. But at some point, these imbalances matter.

Let me just take issue with something Senator Bennett said -- talking about percentage of GDP as a measure of deficit and where we stand in relationship to our history. The problem with the deficit calculation as a percentage of GDP is that it leaves out lots of things. So, for example, last year the deficit went up 248 billion (dollars), but the debt of the country went up by 546 billion (dollars). If you take the 546 billion (dollars) times the size of our economy, you're in the danger zone, what most economists would call the danger zone, in terms of a relationship of deficit to economic size. It's a very different calculation.

And when you look historically, you get a very different conclusion, because if you go back to the '80s and look at deficit as a share of GDP then, you miss a big change. There was virtually no deficit from Social Security -- in fact, in the early years of that decade, there were still surpluses. Now we've turned to massive deficits, and none of that gets captured in the percentage of GDP, deficit as a share of GDP, but all of it has got to be repaid. You know, the debt of the country is going to have to be repaid. It's not the 248 billion-dollar deficit from last year; it's the 546 billion (dollars) that the debt increased. This is why I use this chart with my colleagues -- we're building this wall of debt. At the end of the president's first year, we were at 5.8 trillion dollars of debt; at the end of this year we'll be at 9 trillion dollars of gross debt. If we follow the president's proposal the next five years, we'll be at 12 trillion dollars of debt. That's a doubling of the gross debt of the United States over a 10-year period. Does that create an immediate problem? No. But it creates a long-term problem, because this is before the baby boomers retire, and when the baby boomers retire, we're going to go from 40 million

people eligible for Social Security and Medicare to 80 million, and we're going to do it in a relatively short period of time.

Let's go to the next --

When we rack up this debt, where's the money coming from? Well, increasingly, it is coming from abroad. When we have a bond auction now, about half of it is put up by foreign entities. And I use this chart to make the point about sustainability. It took all the presidents pictured there -- 42 presidents -- 224 years to run up \$1 trillion of debt held abroad, U.S. debt held abroad. This president has more than doubled that amount in six years. Now, we had witness after witness before the Senate Budget Committee who said, "This is not a sustainable course. It is especially not sustainable given the demographic time bomb that's coming at us." And that's not a projection. The baby boomers have been born. They're alive today. They're going to retire, and we have got an utterly unsustainable fiscal situation on our hands. And the faster we deal with it, the better.

Let me just say -- so we're not just talking about challenges and difficulty, my personal view is neither political party is going to handle this on their own. In fact, Senator Bennett and I have had extended discussions on this matter, as we have with Senator Gregg and others. My personal belief is neither party's going to take this challenge on by itself; neither one can sustain the challenges of the choices that have to be made here on their own. This has to be done together.

And so Senator Gregg and I and others have proposed that we put together a group: 16 members -- eight Democrats, eight Republicans, 14 of them members of Congress, two from the administration. Have the administration chair the group, and give them a charge of coming up with a plan. Because frankly, the Social Security shortfall that we hear about fades in comparison to the Medicare shortfall. Medicare's shortfall is at least seven times the shortfall in Social Security. And so our idea is give 16 -- a 16-member group the power to put together a plan, require that it would take 12 of the 16 to report a plan, and then put whatever plan they report on a fast-track basis before the Congress in the fall of this year and take on what is clearly an unsustainable circumstance for our country. There is no way these trend lines can continue. They simply cannot.

The consequences are clear. If you keep on this trend line, the dollar will dramatically drop in value and the United States at some point will have to curtail its standard of living in order to repay these staggering debts that are being run up. Almost any economist, of whatever stripe -- and we had them all before the Budget Committee -- agreed that that's the case. Not this year, not next year, not three years from now, but as the baby boomers retire, if we stay on this current course, if we continue to promise the same benefits to this population, we are going to face a very serious crunch. And the sooner we deal with it, the better.

MR. KERREY: Kent, let me borrow your stump. I do want to give Bob a chance to respond, but I just -- are you developing in your own mind alternative metrics? In other words, just to take one specific that's suggested by the first chart, an ideal percentage that debt should be of GDP? I mean, do

you -- do you go down that course as you're thinking about debt? I mean, debt levels, it seems to me, should be compared against income in some fashion, or otherwise it's very difficult to ascertain whether they're too high or not.

SEN. CONRAD: Yeah. You know, gross debt to GDP now is about 67 (percent), 68 percent. I think the trick is the trend lines. We don't want this debt growing much more rapidly than the size of our economy. That really is the trick here. We want to change this trend line.

But to me, I've got to go back to the fundamental challenge, which is this demographic time bomb. This is something we've not seen before, and it really does require a different response. We've never seen it before; we've never had this same kind of demographic bubble going through the system. And so I think it's very hard for us to adjust. We're not used to it. You know, we typically do this year pretty much what we did last year. That's not going to work. It'll work for a few years, but increasingly this noose is going to tighten.

MR. KERREY: Can you also offer a little bit of detail so that the audience can understand this moment that occurs -- I think it's '12 or somewhere around that time where you get a flipover in Social Security and you have to start redeeming the Treasury bonds to -- to write checks.

SEN. CONRAD: Yeah. About 2017, the trust funds that are now throwing off enormous surpluses -- 185 billion dollars last year, just from the Social Security Trust Fund. 2017, that flips and instead of having these big surpluses, you start -- you go cash negative. And I'll tell you, anybody that doesn't think we're faced with a serious problem just has to put themselves --

You know, a Budget Committee chairman, one thing you learn about is the insatiable demands. I've learned that -- in fact, I was a little late today because we're just negotiating on the budget. I tell you, future generations will curse us if we fail to face up to this. They are going to curse us, because they are going to be faced with truly devilish choices. And this is one area, I think -- Bob and I might disagree on some of these other relatively minor matters; on this larger truth, I think we're very much in agreement.

MR. KERREY: Now I'll need to ask you, since I'm no longer in the Senate, are they going to curse me? (Laughter.)

SEN. CONRAD: Bob, we've been cursing you -- (laughter). Bob used to sit right behind me in the Senate, and Bob -- this is not known about him, but he has an artistic ability. He draws, and he draws the most complex doodles I've ever seen. And there's also a certain nasty wit that's part of this presentation, and I hope that'll be on display today. (Laughter.)

MR. KERREY: Well, I'm going to, speaking of nasty wit, give Bob a chance to respond or to add to what Senator Conrad has just said.

SEN. BENNETT: Well --

MR. KERREY: And I'd say that Senator Stabenow has to catch a plane and leave at 12:45, so she'll be probably getting up maybe in the middle of Bob's response.

SEN. BENNETT: If I'd known you were going to bring charts, I'd have brought my own. Big. (Laughter.)

SEN. STABENOW: That's right.

SEN. BENNETT: I have them, but I just have them small. But I agree absolutely with the size of the problem, but I do not agree as to its inevitability. The inevitable part -- you have two parts of the equation, and we both said that the number of people have already been born, and that's going to happen. The variable size of the equation is the promises of the benefits. And you said, and I wrote it down, if we continue to promise the same benefits, that's the kicker. And if you look at other countries that have aged sooner than we have -- you can go to Europe and get a laboratory of what this problem is, if you look at France and Germany and so on. They have had absolutely no choice but to cut back on the promised benefits.

The things that make Kent's charts accurate -- or, the thing that -- that is essential to make his chart accurate is the assumption that the benefits will stay the same. If we adjust the benefits -- and we do not have to adjust them as drastically as the AARP accuses us of thinking -- if we adjust the benefits, we can bring the line down and make it legitimate.

Kent said that the present debt, including the Social Security and Medicare debt, is about 67 percent, 68 percent of GDP. That is correct. Historically, we have had debt at 150 percent of GDP. That was in 1946 when we were paying off the Second World War. So the issue is to make sure that the trend lines -- and here I'm agreeing with Kent -- make sure that the trend lines don't keep going up. The challenge is to have the political will to change that second part of the equation. The first part is unalterable. The people are all there. But the second part, as one cynic on Wall Street put it to me very directly, he said, "Those are simply political promises. Those are not the same thing as the debt you owe the public. The debt you owe the government is debt based on political promises, and if you change the political promises, you can change the future." That's what he means when he says both parties have to grapple with this.

And when I first came to the Senate, I remember meeting -- and I made the statement, you know, Social Security is basically a Ponzi scheme and we have to do something about it. And a more senior senator stood up and walks to the other side of the room, and he said, "I don't even want to be sitting next to you when you talk like that, because Social Security is the third rail of American politics and you can't discuss it." Well, I've had two subsequent elections in which I've continued to say that, and we are beginning to edge towards the point where both parties are going to start to deal with it.

But we've got to be Butch and Sundance. We've got to both jump off the cliff together, not leaving one of them up there while the other one goes down into the river. (Laughter.) And --

SEN. CONRAD: You jump first. (Laughter.)

SEN. BENNETT: Yeah. Yeah. That's the answer we always get. Every time I bring it up, I'm told, "Bob, we'll deal with this right after the next election." Well, the next election never comes.

So that is the -- the challenge here. We can change Kent's charts if we change the assumptions as to what the level of those benefits is going to be, and that's what we've got to do.

Now, before you go, Debbie, very quickly -- I'm sorry -- more Americans are working today than ever in our history, not only in total numbers, but in percentage. Unemployment is at 4.4 percent. I feel for the state of Michigan and I understand what you're saying, but Thad Cochran is now driving a Toyota Pathfinder because it's a local product; Toyota is opening a plant in Mississippi. Lamar Alexander drives a big Nissan, and I said to him, "Do you get any grief driving a Japanese car?" He said, "It's made in Tennessee. It's a home-town product." We picked up George Voinovich to take him, in my wife's Honda Accord. He very delightedly said, "This is an Ohio product. Honda is building these in Ohio. I'm glad to see you supporting hometown business." Before she had an Accord, my wife had a Geo Prizm made in a Toyota plant in California.

MR. KERREY: Bob, can I ask you -- Debbie has to catch a plane.

SEN. STABENOW: Yes.

SEN. CONRAD: Yes.

MR. KERREY: Boy, you've got to let her get her two --

(Laughter.)

SEN. STABENOW: You've got to let me respond. A couple of things.

Well, first of all, we welcome that. My point is we want those made in America. I mean, I welcome --

SEN. BENNETT: They are! They are!

SEN. STABENOW: -- I didn't say they weren't. I'm not saying that. I'm saying the difference between when the Toyota plant is here versus in Japan -- which, by the way, more vehicles were brought in -- 2.2 million vehicles from Japan last year, many more are being brought in than being built here, and I would welcome them being built here. But when you look at the fact that,

indirectly, they are -- there's a currency manipulation going on that has a price differential on a luxury sedan of about \$15,000, when you're bringing those 2.2 million vehicles into the United States -- that's what I'm concerned about, is the currency manipulation or -- or the fact that they're not paying health care so they can put more money into advanced battery technology. And so I want those plants here, and I want us to be addressing a level playing field here.

One more thing, and a comment to Bob's comments. Yes, there are more people working and wages are down. We have more people working in lower-wage situations or multiple lower-wage jobs. When you --

SEN. BENNETT: I'll argue with you about that later. I don't think that's true.

SEN. STABENOW: -- when you're trying to look at standard of living, I mean, I'm happy to talk to anyone about the average standard of living right now and how people feel overall about jobs, health care, pensions, cost of college, cost of gas, everything that's coming, the housing foreclosures. We've got a squeeze going on in the middle class that is another whole discussion, Bob, we should have.

I did want to just add one more thing, though. When we talk about Social Security and putting everything on the table, it's very important that we put everything on the table. And my chart and, as a member of the Budget Committee, you can never compete with Kent. He has more charts than anybody. But one I wish I had brought, because this also important, if we're talking about political will. When you're balancing budgets, it's money coming in and going out, right? So it's always about both revenues and expenditures. And if you look at the gap in Social Security projected over the next 75 years, if you were to simply take the president's overall tax cuts that were done and just cut a third of that, or 30 percent of the projected revenue loss, in 75 years you would pay for the gap in Social Security. So I throw that out there, because it's not right and fair for Americans not to talk about tax policy as well as expenditures, and both of those have to be looked at.

And on that note, Bob, I want to thank you. We would love to have you back in the Senate, by the way.

MR. KERREY: Don't even say it out loud. (Laughs.)

SEN. STABENOW: We would love it. You contributed so much before, we would love to have you back. Thank you to the New School, thank you to everybody that has put this together. It's an important discussion, and I'm sorry that I have to leave to go back to Michigan, but I am very pleased to be a part of this, and I hope you will stay engaged in all of this.

(Applause.)

MR. KERREY: Thanks, Debbie. I'm going to take -- we've got another 15 minutes, and so I'll take a couple questions from the audience.

Yes?

Q: I'm not sure I can go to the microphone.

MR. KERREY: We'll repeat. We'll repeat whatever you've got to ask.

Q: I have a broken leg. It's a recent experience.

MR. KERREY: And it wasn't broken when you came into the room. (Laughter.)

Q: I'm not a baby boomer; my younger sister is. And this is my first experience with Medicare. My concern is not how much the government will spend on the assumptions of paying the kinds of stingy benefits that Medicare pays, but how we are going to drive our world-class medical care system out of business by the kinds of caps that Medicare puts on what they pay the doctors. I had to have emergency surgery. I won't go into all the details, but I will tell you that the Medicare cap paid less than 15 percent of what the hospital and the doctor put on the bill. Some people say that they charge too much. But when they get less than 15 percent, and then my private insurance -- I today am paying twice as much for insurance as I did a year ago, because I'm paying the higher-income Medicare insurance and my private insurance. But my doctors got less than 20 percent of what they might have gotten a year ago, because my private insurance would pay 100 percent of the cost of an accidental injury. That hospital in Colorado got 15 percent, cap set by Medicare, and then the private insurance will only pay the little bit that Medicare doesn't pay. More than half of the doctors in Denver will not take new Medicare patients. The supply will dry up for my younger sister and the people behind her, if we keep the caps the way they are. Forcing everybody over 65 from a private market in medical services is wrong, and I think that's part of the solution.

MR. KERREY: You've confused me badly. Since I have the word "former" in front of my name, I can talk perhaps a little more candidly. Are you asking the Congress to spend more on Medicare?

Q: No. I am saying that we do not have to have every single person who becomes the Medicare-eligible age, which is no longer 65, ever since there's a graduated scale on when you become eligible. But I don't have to be on Medicare. I could go on paying for other insurance. It was when the -- (inaudible) -- the Congress, in those days, said put everybody of a certain age into a government-provided system. A lot of us don't need that, and if we could restore a private market in medical services, we would better address this problem than just talking about a projection and oh, we can't pay the bills, based on these stingy caps.

SEN. BENNETT: That's a subject that would take many, many hours. I will simply tell you that Senator Ron Wyden of Oregon has introduced a bill which I've now co-sponsored as the lead Republican co-sponsor, aimed at restructuring the whole health care system, including Medicare, around sensible solutions. And I agree with you that Medicare is a disaster filled with all kinds of perverse incentives, and needs to be scrapped in favor of the way we practice medicine today.

SEN. CONRAD: Well, let me give an alternative view. I disagree with you entirely --

Q: I thought you would.

SEN. CONRAD: -- and I disagree with Bob entirely about eliminating Medicare. Medicare --

SEN. BENNETT: I didn't say eliminate. I said redo --

Q: Yeah.

SEN. CONRAD: Okay. I think all of us know Medicare has got to be reformed because it's headed for a cliff. But Medicare is one of the most popular programs in the history of the United States. Medicare is a program that has brought tens of millions of elderly out of poverty. Medicare is a program that has given confidence to people that in their senior years they, are going to have medical treatment. Are there problems? There are enormous problems. But the biggest problem with Medicare, according to a study just done by the Congressional Budget Office, is the overall problems of our health care system, that the -- the costs, the extraordinary growth of costs in Medicare are mostly a reflection of the extraordinary costs of our medical system. As a society, we're spending 16 percent of our GDP on health care. The next most expensive country is at 11 percent of their GDP on health care. We have got to have -- and maybe this is, Bob, what you were getting at -- thoroughgoing health care reform.

We've got all kinds of -- I think you talked about perverse incentives.

SEN. BENNETT: Right.

SEN. CONRAD: We incentivize procedures, and when you do that, boy, you get a lot of procedures. And that's exactly what's happening. We have got such disparity around the country between geographic regions. We've just found that in one state they're doing five times as many heart procedures as in other jurisdictions, with no better health care outcomes. We have got massive Medicare fraud, just discovered by the secretary, that he has brought to our attention. There were press interviews this week on massive fraud, cheating. We all know that information technology is not being brought to bear in the way that it could and should be. Rand Corporation tells us we could save \$80 billion a year if we had information technology broadly -- broadly used in health care.

Let me just conclude on this thought. In Medicare, 5 percent of the beneficiaries use half the money; 5 percent use half the money. They're the chronically ill. We do a very poor job of coordinating their care. We've just gotten a study back that showed on 22,000 patients, if you better coordinated their care, you could cut hospitalization in half, with amazing financial savings and better health care outcomes. So we've certainly got a long way to go, but jettisoning Medicare, that would not --

SEN. BENNETT: You're not disagreeing with me. You're reinforcing --

SEN. CONRAD: I'm disagreeing with her.

SEN. BENNETT: All right, fine, but --

Q: I didn't say you should get rid of it, either. I said --

(Cross talk.)

SEN. BENNETT: Yeah.

MR. KERREY: And even I agree with that. I think you're going to have to means-test it, and I've voted to means-test it.

SEN. BENNETT: But if we get those kinds of savings that you're talking about, your chart changes dramatically.

SEN. CONRAD: Well, neither of those charts, because they're based on history.

Q: Senator Conrad, bless you for your charts. And go back and give them hell and tell them that the American people do want the growth in the national debt reduced. And thank you for doing it.

I'm one of the Americans who is losing faith in our political and economic elites to stop the sky from falling, and we've begun to look around to say okay, what can we do with our limited wealth? And I've put some of it into gold and silver, as a store of wealth against decline in the dollar. Do you support the economic right of Americans like me to own gold and silver or, if the sky falls, would you support a government move to make it illegal to buy and sell gold or to confiscate it, as was done in the 1930s?

SEN. CONRAD: No, I think people absolutely have the right to own gold and silver. I can't conceive of a circumstance in which I would support anything other than that. I think people have a right to make their financial judgments on how best to protect themselves. You know, the dollar's

fallen now about 35 percent against the euro. It's very hard to see how the dollar doesn't continue to decline, given our fiscal policy here.

Q: Senator Bennett, do you have an answer on that?

SEN. BENNETT: You can own gold and silver, as far as I'm concerned. I don't intend to join you. I'm not sure I think that's the way to do it, no matter how much I fertilize the gold or warm the silver, it doesn't seem to pay any interest. It doesn't seem to grow anything. It's just depending on somebody else paying me more for it later on than where I am now. So I prefer what little I have -- since I've come to the Senate, my portfolio has shrunk enormously, not because of any economic activity, other than the manager that I put in charge of my trust. (Laughter.) But -- yeah, if it weren't for the Senate ethics rules, I probably would still have a pretty good portfolio.

I fully respect the right and opinions of those who think that holding onto those kinds of commodities is the hedge against the future, but I think investing in a productive entity is better than hanging onto something that you hope that somebody will pay you more for later on.

MR. KERREY: Ben?

Q: As one who is antique enough to remember the birth of the first baby boomers, I would like to assure everybody that this problem is now 60 years old. From the day they were born, people were saying, "My God, how are they going to retire?" or "How are they going to be paid when they do retire?" Just a couple of points.

The Social Security crisis is ameliorated by the fact that the United States, of all the major countries in the world, has the highest total fertility rate and birth rates, so we have a new crop of payers-in. Moreover, we take in somewhat over 1 million immigrants, and that is a great bargain. They are educated on someone else's nickel and then they pay the retirement costs of our people.

The crisis, such as it is, if you think about it, is self-limiting. I don't want to be the person to be the bearer of bad news, but almost all of those baby boomers are going to die. (Laughter.) So the idea that Social Security is a Ponzi game is absolutely correct, and so is life. That is the way the world works. And, you know, when you think about it, there are a lot worse things for the wealthiest nation in the world to do than to spend their money on the health and well-being of their elderly citizens. (Applause.)

SEN. CONRAD: Just a quick response to Ben. First of all, I'm not that worried about Social Security, and I hope I'm not misunderstood here today. The fact is we could right now meet 75 percent of the out-year obligations on Social Security, so we're talking about that final 25 percent of what's been promised.

Number two --

SEN. BENNETT: My -- my plan scores at 100 percent now. I'll give it to you, if you want to co-sponsor.

SEN. CONRAD: Okay. Well, I'm always looking for good ideas, and one thing I've learned about Bob Bennett is he is a man of ideas, and many of them are actually good. (Laughter.)

The second thing I'd say on Social Security is when you look at the projected shortfall, if the economic growth of the United States in the next 20 years is as good as it's been in the last 20 years, 80 percent of the projected shortfall in Social Security disappears. So I think part of the Social Security shortfall is really a result of estimates that are really too conservative in terms of out-year economic growth.

But be that as it may, by far the biggest problem we've got is Medicare, and those shortfalls are much more likely to come true, given medical inflation running ahead of other inflation and given the fact the baby boom generation is here, and they are going to retire. And then you look at things like the Human Genome Project that offers incredible opportunities for health breakthroughs, but at a significant financial cost.

SEN. BENNETT: I agree absolutely that the richest nation in the world can and should spend the money to take care of the health of its senior citizens. My concern is that Medicare is the best Blue Cross/Blue Shield 1960s program, frozen in time like a bad Woody Allen movie. It needs to be updated. It needs to be changed dramatically. The way we practice medicine today has little or no resemblance to the way we practiced medicine at the time those incentives were written into law, and we haven't changed them. And to be very parochial about it, a recent piece by John Goodman in The Wall Street Journal said if every American got his health care, his or her health care, from Intermountain Health Care in Salt Lake City, the quality would be substantially higher than it is in the national norm, and it would cost one-third less.

MR. KERREY: The city would be really crowded if that were to happen. (Laughter.)

Can I get both the last two questions asked serially and then let our senators answer the questions, and we'll wrap this panel up.

Q: Well, I'd like to bring up that multi-ton gorilla in the living room that nobody wants to talk about, and that's illegal immigration, and that is coming to the Senate this next week. It's said that illegal immigration skews the labor market. It brings the wages down. It makes sense that that would be true, and not only in the lower-wage area -- and by the way, all those -- that dime you were talking about that a lot of them are being educated on is the American taxpayer's dime. But it not only skews the economic of the labor market, but if they are legalized, if the 12 million-plus are legalized, plus their families, which is at least two per -- times 12 -- that's a low estimate -- that is really going to skew

social welfare and Medicare payments. So I was wondering what is going to be your stand next week on the illegal immigration issue?

MR. KERREY: I'm going to be standing -- next week. Next -- last question, and we'll --

Q: All right. A quick point to make. In fact, former Senator Kerrey, you brought it up. Everyone makes this classic mistake of comparing our expenditures to gross national or gross domestic product, but that's not how much money we're taking in. That's a calculated measure our economists can argue all day long about what the country's producing. But we really should be comparing it to the tax revenues brought in. You know, that's what the nation's income is, if you want to compare the expenditures against it. And as far as that goes, you know, we all know that we lost track of these entitlement programs when the lock box was broken, however many decades ago, and Congress started dipping in and saying we're going to use this for our operating expenses this year and next year.

What would it take for us to have a referendum where we asked American citizens to tell Congress what they felt about the right of Congress to take away or suspend or in any way, shape, Social Security and Medicare, versus what it really should be compared against, and that's the discretionary spending in the budget of the government each year?

MR. KERREY: I'm going to ask both senators, in the minus two minutes that are remaining, to answer those two questions, and we'll wrap the panel up.

SEN. BENNETT: Quickly, we are moving towards a solution on the immigration issue that I think will have wide bipartisan support. We weren't able to do it in the last Congress. The gaps have been closed with good-faith negotiations on both sides in this Congress, and I feel fairly good about the conversations between Senator Kyl and Senator Cornyn on the Republican side and Senator Kennedy on the Democratic side. A very difficult problem, but I think we have a logical solution that we're moving towards.

What would it take to have a public referendum on these various issues? A constitutional amendment.

MR. KERREY: Do you have any final comments, Senator?

SEN. CONRAD: Well, I agree with Bob entirely on immigration. I think we are moving towards what would be a very strong bipartisan agreement. Obviously, we've got to secure our border. That's one important part of this. If you can't secure your border, you can't secure your future. And we've also got to deal with the 12 million people who are already here. I think the idea that we deport them is totally unrealistic. How we would conceivably go about deporting 11 or 12 million people? I don't think anybody has any serious plan to do that. So we've got to find a way to get them on a path to citizenship, but it's got to be -- they've got to go to the back of the line. Those who have come here by following the rules, playing by the rules, they've got to be respected for having done that, and we've

got to insist that those who are here, if they're going to become citizens, learn the language, that they pay their taxes, that they deal with all of their other outstanding responsibilities. I mean, that is going to be an absolute requirement.

On the question on a national referendum, you know, we've never done that, but with the Web I think we're getting closer to the time where that would be a very interesting approach to addressing a lot of these issues. And give the people of the United States a chance to express themselves in some clear and understandable way. I've found that maybe people aren't too clear on the exact details -- you know, you wouldn't expect them to know the exact numbers of what the budget is or our debt situation, for example, but they've got very good common sense, and they know things don't add up. They know things aren't going in the right direction. You can see it in all the polling. They know full well the country is off track, and I think it would be refreshing to get their input on these questions in a national referendum.

SEN. BENNETT: Yeah, well, you can have an advisory referendum but, again, if you're going to have something binding, you're going to have to amend the Constitution of the United States. We do have a form of referendum now that's laid down in the Constitution. It's called an election.

MR. KERREY: Yeah. I think my final statement would be that elections, I think, is the best route. I think the Founders had this thing figured out pretty well, that we ought to have representative democracy, not pure democracy. I do not consider the Constitution to be a rough draft, so (mild laughter) -- I'll stop at that.

I do want to thank both the senators who are still here as well as Senator Stabenow -- (applause) -- and ask you all to do what you're doing, which is give them a round of applause.

MR. CLEMONS: And I want to thank Bob Kerrey for doing an outstanding job with his colleagues in organizing something that's an extremely rare thing, which is to bring members of both parties, other than when they're on the floor, also in front of C-SPAN, but into a thinking engagement on ideas and issues.

I want to be transparent about one important issue. We do have a secret agenda in this conference, and our secret agenda is, in part, not only to ask the question of will the sky fall, because some people do suspect that it might, but actually to challenge people to think that maybe our calipers and benchmarks of thinking about the economy, the inputs, looking at global capital and their behavior and the fact that a lot of people have been predicting various collapses for a while, and they just haven't come about. That Bernard Schwartz, of course, after whom the Schwartz Center for Economic Policy Analysis at the New School is named, has been trying to be a bit of a -- well, he has been a provocateur, both on the intellectual level, but I think also among -- I guess it's no secret that Bernard is more affiliated with some of the Democratic wing of the establishment -- but try to challenge the doom-and-gloom pessimism that does dominate much of the economics profession, but also certain sets of corridors in the political side.

So I want to let everyone here know, and I'll let the C-SPAN audience know as well, my e-mail is available; you can find it on the Internet. But we will make available to everyone attending a draft version of an article that that will be published -- and it's rare to put something out privately before it's published, but it's a piece written by Bernard Schwartz and Sherle Schwenninger that I think will be an interesting continuation of this provocation.

But to take over now, it's my pleasure to introduce Zanny Minton Beddoes, the chief economics correspondent here in Washington for The Economist magazine. She is going to bring her panel, who should come join us right away -- don't wait for me -- and at the same time, Bernard Schwartz, who has helped provoke this entire intellectual discussion is going to join us at the end of this program to share some of his views and thoughts and reactions to what has happened. So to make the panel more manageable, and the discussion more full, we'll hear from Bernard at the conclusion of this panel.

So Zanny, the floor is yours.

ZANNY BEDDOES: Why don't I start while the panel is seating?

Thanks very much, Steve. I'm delighted to join you here. It's been a very, very interesting discussion this morning. It's also a discussion that's taken the "Chicken Little" metaphor to a whole new level.

You know, we start off by discussing whether the economic sky is falling. Our second panel is going to debate where the sky is and where it will be tomorrow. I can confidently tell you that Drakey Lakey and Henny Penny would be very confused at this point.

I guess what we're trying to do is really answer two questions. What shape is the U.S. economy in? Is all this gloom and doom warranted or not? And is the long-term outlook as dire as some people make it out to be? And if so, what are the big challenges? What are the big problems? What are the big glooms on the horizon that we need to worry about? Are they in fact the ones that we hear about all the time? And it does seem to me, as someone who, I must confess, has been on the gloom and doom side of things for quite a long time, you know, the U.S. economy and the world economy are looking pretty good right now. We're in a period of low inflation, low interest rates. We've had a very long expansion. Globally, we've had the best period of expansion really in half a century. We've got a budget deficit in the U.S. below two percent of GDP. We can argue about what the right metric is, and Senator Conrad is very clear that he does believe the sky is falling in. But by most conventional parameters, right now it's not looking too bad. We have a current account deficit which is big by historic standards, but it's been big for a while. And people like me have been writing that that's problematic for a very long time. And nothing yet has happened. We haven't had the dollar crash that has been predicted.

So all in all, things are really looking pretty good. But yet, we're worried, and I would say with some reason. But I sense that -- and I was not here writing about the U.S. at this point -- but much as in the late 1980s and early 1990s there was a sense that -- well, mid 1980s -- Japan was the big threat, the big problem, the big worry. The U.S. risked being taken over in the global economy. There is a similar sense of concern now I think about China and India -- China particularly. There's a worry that the U.S. is not going to be in the next 25 years where it was in the past 25. There's a worry that politically the consensus for free trade, for globalization is not going to be sustainable unless there are some major changes made. There's a worry, as we've heard very eloquently from the senators, about the fiscal outlook, that with the retiring of the baby boomers, something dramatic has to happen, or the red ink just starts splurging.

There are other worries. There's worries about inequality which has not really played a particularly big part in this country's political discourse for -- until quite recently. There are worries about energy, about geopolitics, about climate change. You know, there's a lot of things people are worrying about. So there's a lot of potential reasons why we might fear the sky is falling.

And what I hope our panel does today is to really think through which of those we should worry about, and why. And to do that -- well, there was already a terrific panel. We had a great panel this morning. We've got another terrific panel now. I'll just introduce them very briefly. I think you have more detail on your tables.

Martin Baily, right here. Martin was chairman of the Council of Economic Advisers under the Clinton administration. To his left -- let me get this right -- to his left, Laurence Meyer, former governor of the Fed, author of an excellent book on the Fed. To his left, Dean Baker, I would say one of the most provocative and interesting commentators in Washington today. And he's a great blogger, by the way. For those of you that don't read his blog, you should. A terrific blogger. To his left, Grant Aldonas, former undersecretary of Commerce for International Trade. Grant, I think, knows more about China than -- I would hesitate to say this -- but probably anybody in this room. A real expert on China. And to his left, Steve Rattner, managing principal of the Quadrangle Group and an adviser to Senator Clinton, which I'm sure most of you knew.

So with that terrific panel, let me start --

MR. : I'm going to do one bit of stage direction, because Gene Sperling has said that he's about to arrive and so --

MS. BEDDOES: Gene Sperling is always about to arrive. (Laughter.)

MR. : -- this chair. (Laughter.)

MS. BEDDOES: Okay.

MR. : Here he comes!

MS. BEDDOES: Last but not least, Gene Sperling. (Laughter.)

Okay, Gene Sperling, another adviser to Senator Clinton and former Bill Clinton administration official.

Well, Gene, I'll let you have some time to catch your breath.

Maybe, Martin, we'll start with you. Let's start with the external situation. The macroeconomic environment where we have this huge trade deficit, financed, in part, as we heard this morning, by large inflows, particularly from foreign central banks, particularly China, low long-term interest rates. Is this status quo sustainable?

MARTIN BAILY: No, I don't think we can go on with rising U.S. current account deficits indefinitely. I don't think China can go on going from 2 to 4 to 6 to 9 percent of GDP as a surplus. China's, obviously, not our only problem. We have deficits with almost everybody. I think one of the concerns is that -- will that cause the sky to fall? And no, I don't think the sky will fall. The U.S. generally tends to muddle through. But I think it is a problem and something that we ought to be addressing and are not really addressing right now.

MS. BEDDOES: How should we address it?

MR. BAILY: How should we address it? Well, we have such a low saving rate in the U.S. We have a low personal saving rate. Corporations right now are very profitable. They are saving. The government is dissaving right at the point still where we have pretty much full employment. If you look at -- that's really the discussion we had earlier that the projected deficits are really high. At this point in the business cycle, we should actually be running a budget surplus. So we have too-low saving.

The other thing is we have a currency exchange system which is out of whack. I think China needs to move towards a more flexible exchange rate. I think I would like to see the yen go up. They are not, at this point, intervening so it's hard to say exactly what to do there. But I think if the Chinese exchange rate were to appreciate, the yen would come up, too, and so would some other Asian currencies.

Right now, globalization's getting a very bad name in the U.S. And there are a couple of reasons for that. One is because we're not doing anything to help the losers, and we're not providing adequate social support. The second reason is because exchange rates are out of whack, and so the U.S. is running this huge deficit. If we can get those things in line, I think the benefits of globalization will be much more visible, and globalization will become, if not popular, a little bit less unpopular.

MS. BEDDOES: You raised a lot of issues there. Let's stick with how sustainable it is.

Larry Meyer, two issues. Martin said, you know, we don't save enough. But as Chairman Bernanke said famously, you know, we have a global savings glut. The Chinese save a huge amount. So for as long as they're prepared to save that, why should we worry about it?

LAURENCE MEYER: Well, I think that certainly puts off problems. It certainly has. There's no sense -- the problem we have now is that we have a situation which is unsustainable over a longer-term period, but there's no crisis pending, and there's no need for doing anything immediate. But inaction will have a very high cost. It's things you have to move with vision and the right direction with. So you put in place sensible policies so that you resolve this over a period of time. And since it's easy to avoid doing anything -- because there is no immediate crisis pending -- and because the actions are often politically difficult and require tough choices, nothing gets done.

And the second thing is it's not just -- we call this global imbalances, okay. We do that for a reason, okay. If our current account deficit is too high, then there are surpluses out there that are too high. And it requires global actions, not enough to point that finger at the Chinese and say 'you do this to solve our problems, okay.' Well, they're global problems. Everybody has to move in the same direction. If we go to the table and we're willing to do something, then we provide leadership in the global community, and we're more likely to get people to move with us in a way that's constructive.

I think we also have a sense -- there's a general consensus about the directions to go, the role of the Europeans, the role of the U.S., the role of the Asian economies but absolutely nobody seems to have any incentive to do anything right now, and we're just letting the things sort of carry on.

I think the biggest issue is really the fiscal side. And the deficit is about average. It's no crisis at all, and yet there's a fiscal train wreck brewing, okay. That's the problem. But it's out there far enough that we can say 'hey, I don't have to worry about it in my eight years as president, okay.' The next president better start to worry.

MS. BEDDOES: Let's wait for a second before we go onto the long-term fiscal train wreck, and let's try and get a sense of how worrying is this short-term? I mean, I hear both of you said we need to do something. We need to do something to unwind these imbalances. But you know, you all believe in markets. You know, the market signals seem to be working. The dollar is gradually depreciating. Why do we have to have huge policy changes? Why can't we expect in this big world of global finance now that this will unwind itself in a way that doesn't mean the sky falls and will happen quite naturally?

Steve, you work in these markets. Why should we worry about it so much? We devote so much attention to worrying about the current account deficit to talking about the need for the Chinese to revalue their exchange rate to talk about the imbalances need sorting out.

MR. RATTNER: Because it is a long-term train wreck. And there are really three issues that I think are interrelated in terms of defining that long-term train wreck. You have the trade deficit which we've talked about. You have our fiscal budget deficit which I think is too high, and I think it's a good bit higher than it appears to be, because the federal government keeps its books in a way that no corporation would keep its books. And if you actually adjusted the federal government's 270 or 280 billion dollar deficit to what a private sector accounting method would look like, it's at least 400 billion dollars higher than what we're looking at. And as one of the earlier speakers said, way too high for this point in the cycle. And lastly, you have the unfunded entitlements. There was some reference in the earlier panel to Social Security and Medicare in a somewhat more positive light than I would put it. The fact is that the GAO has calculated -- and I don't think anyone terribly disputes it -- something like a \$44 trillion, present-value, unfunded set of liabilities, mostly for Medicare, as the previous panel said, but also some for Social Security. And essentially, what's really happening is that we are borrowing 6 (hundred billion dollars) or \$700 billion a year from the rest of the world to finance our lifestyle and not putting anything aside to pay for our own retirements -- my retirement, those of us up on this panel of this age group -- or to pay for our post-retirement health care, all of which is going to have to be paid for and assumed by our children.

So I agree with the idea that at the moment there's a lot of good happening in the economy. Bernard and I have had this discussion many times. And there's a lot of good things to be said about the strength and resiliency and productivity of our economy. But there is this train wreck coming. You can see it coming like almost with a slow-motion camera. And as one of the speakers said a minute ago, if it's not this administration, the next one, someone has to deal with it. So it is something to worry about.

MS. BEDDOES: All right. Let's turn to one aspect of that potential train wreck, which is that the foreigners, particularly the Chinese, may suddenly decide that they no longer want to hold so many U.S. assets. I think it was former Treasury Secretary Larry Summers called it the balance of financial terror. Is that a real risk that one day they wake up in Beijing and say we're just not going to buy anymore of these T-bills any longer?

DEAN BAKER: No. (Laughter.) I mean, the -- two things. First of all, as an economic matter, you know, it's one of those things where if you -- the classic -- you owe the bank \$1 million, the bank owns you. You owe it \$1 trillion, you own the bank. And in this instance, we should remember this is a group of communists. They do want to stay in power. To stay in power, they have to satisfy certain economic expectations as driven by export-led growth. To do that, they have to finance it by buying our bonds. It is a double bind, and that's why I think Laurence was pointing out this is something where there has to be adjustment on both sides. There has to be greater domestic demand in China. Frankly, the most critical thing we could do is actually open up their financial services market so you had companies that were capable of pricing risk accurately. You would start to drive them in a more capital-efficient direction, and you would squeeze out a lot of the excess capacity that becomes trade problems at some point -- the steel capacity gains, things like that. But those are

issues that you take up in a context like the SED and the JCCT. It's not something where you focus on the trade deficit and then manage your economic policy to that end.

MS. BEDDOES: So we're making a mistake focusing too much on the currency.

MR. BAKER: Absolutely.

MS. BEDDOES: Is there anybody on the panel who thinks we're right to focus so much on the currency with China?

MR. BAKER: Yeah, I would take that one. I mean, the currency fundamentally is determining how much we're going to buy from abroad. This is setting the price. It's the same thing if we have a currency that's overvalued by 30 percent, it's just the same thing as if we had a tariff of 30 percent on all our exports and subsidy of 30 percent on all our imports. It's the most fundamental factor determining our trade deficit. So it seems to me that should be front and center in any story you tell about the trade and current account deficit.

MR. MEYER: But it's a matter of balance. You can't go to the Chinese and say 'okay, we have flexible exchange rates, you should have flexible exchange rates.' They'd say 'you're crazy.' I mean, countries have prematurely moved to that kind of a system before they had infrastructures that could handle the risk. Look what happened. We're the only ones who have gotten it right. So gradualism -- you have to stay within the framework of gradualism. You can push. And I think we were doing something in showing more leadership. I don't doubt that we could get something in return, which is gradually move to a somewhat more rapid rate of appreciation, both in China and then with implications for the rest of Asia. But it's got to be balanced. You can't say we want 20 percent appreciation of your currency. We want to go to flexible exchange rates. It's crazy.

MR. BAILY: Let me make a comment on that. We may be overemphasizing China because, as I said, we have a big deficit with everybody, it's not just China. The dollar has adjusted. Maybe it's adjusted enough against the Euro. I think that has changed the competitive balance that we have with Europe. So we have to do the things that make our own economy right. I'd like to see China have more flexibility. I didn't say a floating exchange rate, but they should have more flexibility and revalue a little bit. But we need to do the things that we can do. We've talked about the fiscal one. I think the other one is to make this economy more friendly towards trade and the people who may lose their jobs and provide the right skills, the right investment, that kind of thing. Those are the kinds of policies we need to make trade more productive for the economy.

GRANT ALDONAS: Just to be clear, I didn't say that China should have a flexible exchange rate either. I was just saying a higher one.

MS. BEDDOES: Let's get on to those two things. And I just want to stay a little longer with the big economic questions. And one of the reasons that is often given for why foreigners are very keen

to sending their money to the U.S. is that U.S. productivity growth has accelerated whereas in the rest of the world it hasn't. And that, you know, people like Mike Mandel, who was on the previous panel, is a great optimist about the U.S. economy because of the underlying shift in productivity growth. But productivity growth, as many of you know, has slowed quite a lot recently, at least over the past two years quite, quite dramatically. Is that one of the big clouds on the horizon? I mean, there's a number of very good economists on this panel. Is that something that we should be worrying about more than we do?

Maybe Dean, let's start with you.

MR. BAKER: Yeah, I mean, I would take that very seriously. The last three years -- and I'll fill in for this quarter based on the projections for employment and GDP growth. The last three years we've seen productivity growth of 1.6 percent which is just a hair better than what we had during the '73, '95 slowdown. Is that going to stay? I really have no idea. But the fact is I think if we're all honest here, with the possible exception of Alan Greenspan, none of us saw the upturn coming back in '95. And the fact of the matter is I don't think we would say we have an agreed-upon consensus of why we had the downturn back in '73. So is it going to be the case that we'll continue to see slower productivity growth? I don't really have a good answer to that. But I think you have to take that pretty seriously when you've had three years of slow productivity growth after, you know, this upturn for 10 years. Three is relatively large compared to 10.

MR. BAILY: Well, I would be slightly more optimistic about productivity growth. We had a new trend after 1995. That was when we were running things, and we had an uptick in productivity.

MS. BEDDOES: Was that coincidence?

MR. BAILY: No, no, certainly not coincidence. (Laughter.) But anyway, leaving that aside, we had an upward movement in the rate of productivity growth in the late 1990s. What happened after 2000, there was a great deal of restructuring of the economy, which gave us a temporary boost, so we had even faster growth for two or three years -- 2002, 2003, 2004 -- where it was actually above 3 percent. Now we've gone back to a period of slower growth. Whether this is a sign that we're going back to one and a half or not, I don't think it is. I think it was the end of that restructuring. I would say that if we do go back to slower growth, the economic future's going to look a lot less rosy. So I think we should all be praying that we're going to get a continuation of strong growth.

MS. BEDDOES: Grant.

MR. ALDONAS: Well, I think what you really need to do is draw three threads together, because you can define the perfect storm. The perfect storm is more retirees, fewer workers. That means you have to raise your productivity significantly just to keep your standard of living where it is. Now you're seeing slower productivity growth. At what point do you look at the trade deficit, not as something separate you focus on but as another debt stream that we have to pay off? When do people

start to lose confidence because of the slowing productivity and the demographic equation you're facing and then say we're at the tipping point, right? But we're not there. We're not close to there at this point. The real question is, can we get over the complacency so we start to grapple with those issues and define a better future down the road. Because I think we'd probably all agree the targets ought to be equal opportunity society, rising standard of living across a broad spectrum, relieving the wage compression we're seeing as a result, in part, to globalization. Those ought to be the goals, not the numbers like the deficits.

MS. BEDDOES: So we have two -- if I was just to summarize that -- two risks. One is we've agreed that the status quo can't continue forever. We can't carry on forever having a huge external debt -- a rising one. But it's not going to be a train wreck. The sky's not going to fall immediately, but that leads us to be complacent.

The second risk which you've all alluded to, and I want to ask Gene about now, is the political sustainability, even in the short term of the current situation. We heard some from Senator Stabenow this morning -- we have a lot of concern about China as unfair trader. We have a lot of -- you look at polls. People have become more skeptical about globalization. How sustainable is the status quo politically? And what do you need to do to make it more sustainable, Gene?

MR. SPERLING: Well, I think going back to, you know, putting aside who was president when -- no, seriously -- you do have a period -- a decade or longer -- where you've had a significant jump in productivity growth. And you've actually seen a tale of two cities as to what that means for typical workers. It was in the late '90s a bit more of a Goldilocks situation. There was a significant increase in globalization, competition, innovation. But the story seemed to work out as we'd like to. There was simply more volatility. People may have been losing jobs, but they seemed to be finding better jobs. And you saw really one of the best five- or six-year periods of the last several decades in terms of rising wage growth. And that, I think, led to more of the story that a lot of people wanted to say now, which is that you simply just have to have better adjustment assistance, because this is all working to raise wages. Now I think you have a much deeper problem, and it's not as easily solved simply by having wage insurance -- as important as I think those adjustment issues are -- which is that you've had the occasion of rising productivity, rising corporate profits with significantly stagnant wage growth, and the suspicion of many that some of this is downward pressure on the middle is coming from an increase in global labor market competition. And I think that is the thing that is the most worrisome. And I think those of us who are policy people, you know, need to think harder. Because I do think if one does not take this issue seriously, you could easily have a type of people losing faith in the current open market system. You could have a backlash that could be harmful for future productivity. But the answer's not simply just to make fun or to denigrate the people who are worried about these. I think it's figuring out how we start addressing some of this stuff in the medium term.

And I will say that I think one of the challenges for many people who are progressives, like myself, and like to think of themselves as pro-globalization is that we tend to talk, one, about adjustment assistance which to a lot of people means just, you know, burial insurance. I always say it's

the pre-empt of public policy -- what we're going to do for you after something bad happens in your life. Most people want to know how they're going to save their job or save their marriage, not the counseling you're going to give them after something bad happens. And secondly, many of us, you know, growing out of the Clinton and tradition -- public investment which I think is also very sound. But go to people feeling anxiety and tell them that you're going to double NIH funding or increase Head Start, it doesn't address that as much. And so I think what really is the difficult issue and the difficult challenge is do we have something to say about middle-class job creation, higher-wage job creation in the near term that is economically sound, that's not industrial policy or big public work programs. And I think that more of us have to think about that.

And I think when Kerry -- President Kerry -- President, I wish -- Senator Kerry talked about the tax incentives -- and Grant and I debated this during the campaign on deferral -- whether you're for that proposal or not, the notion of starting to think more seriously about what affects where the jobs are located, whether it's tax policy, health care, R&D, I think this should be very much center stage. And I think we spend all our time debating particular trade agreements or capital gains taxes. And I think we're spending way too little time at figuring out sound policy, things that have something to say about where the optimism that Bernard talks about should come from the typical family wondering where the new middle-class jobs are.

MS. BEDDOES: Grant, you were nodding at that. What's your take on what -- what would the ingredients be of the Sperling package?

MR. ALDONAS: No, actually, I mean, Gene and I, I think, agree on a lot of the nature of the underlying problem, the things that public policy should address. If there's a difference, it might be how we think about the relative efficiency of the government as a financial intermediary. Because in effect, it's taken an awful lot of income from savers, it's providing a lot of goods, it's not making investments that are very productive in the long term in terms of whether it's infrastructure or whether it's education, things of that nature. So I think where Gene and I would find a way to find common ground is, how does the government start to focus on those things that are in fact investments for the future rather than what we're doing right now? You have a tax code that encourages leverage rather than equity. You have a tax code that encourages consumption rather than savings. There's a variety of things that we ought to be focusing on. But those are the right questions to be asking right now rather than being complacent about what we're faced with.

MS. BEDDOES: Dean, where would you say -- what do we need to do to build up this middle-class consensus?

MR. BAKER: Well, I think we have to do kind of a flip on trade. I mean, it always gets me that we're supposed to be so worried about protectionism. Well, we have an awful lot of protections, and that tends to be more for the people around this table than for autoworkers and textile workers who we want to compete with people in China and other developing countries. So what I actually say -- and people don't think I'm serious; I am dead serious -- we could design trade agreements that make

it very easy for smart kids in India, Mexico, China -- pick your country -- to come and compete, come and work here as doctors, lawyers, and we could actually -- we're smart enough as economists to work out redistributions to ensure that they share in the gains. And that would both be a big increase in efficiency. We're concerned about protectionists and we don't want to be evil protectionists, so that wouldn't be protectionist. And it would also be equalizing trade rather than de-equalizing trade. So you know, I've thrown it on the table a lot of different places, and people insist that I'm not serious. I am serious.

MS. BEDDOES: You have a lot of people nodding on this panel actually.

MR. BAILY: Well, I'm not -- I don't necessarily agree with that. I think trade and globalization are probably getting too much blame for what's happening. I think there are serious concerns, and Gene has alluded to the wage distribution and a lot of people in our economy that are not doing that well in the current economy, even though macro measures suggest we're at full employment and we have economic growth. So the question is, do you blame that on trade? And although evidence says I'm not a protectionist, if you start to blame it on trade then you're probably going to end up down a protectionist road which was not the road we went down in the 1990s when wages were rising. So I think we need to do more to make sure that there are good opportunities for people and that we do things like providing some alternatives on health care. Our current health care system, as we know, is sort of collapsing. Those are the things that make America a good place to produce. I don't think we want to go down a protectionist road.

MR. RATTNER: I think even those of us -- and I agree with you certainly. I personally would not want to go down the protectionist route. But I think even those of us who are believers in open, free trade have to acknowledge that there has been this unbelievable widening of income and equality, not just in this country but around the world. And there are a whole series of reasons for it, which we can talk about. But I think it's very hard to intellectually deny that what's happening to wage compression, not just at the middle but even more so at the bottom, is a phenomenon to some degree -- we can't say exactly what percent but some very meaningful degree -- a phenomenon of the fact that labor markets are now heavily global for many, many products and not just goods but also for services, and that it has had a downward effect on wages for certain Americans.

And I don't think that necessarily leads you, Martin, to say 'well then, we should be protectionists,' because I think that's a losing game ultimately. But I think it does lead you to say that we have to find a way to get people both comfortable psychologically and get people comfortable in reality about their financial situation, i.e., improve it for those who are affected by this, or else we will end up in protectionism. And so I think you end up back in some of the kinds of ideas that Gene was talking about.

And while I do agree that government does a lot of things that are not productive and not helpful, I don't think we can solve this problem without government, because I don't think this is a

problem the market is going to solve left to its own devices. I think government has to play a role, hopefully a constructive, thoughtful role, but it has to play a role.

MR. MEYER: I think there are two issues associated with globalization. One is like technological change. It's a time of very rapid change in the economy, and it creates winners and losers. And I would say the private sector is enormously good at squeezing out the increases in productivity from technical changes and globalization opportunities, and the public sector is very bad at dealing with the losers and mitigating the pain. So that's one aspect. And the second aspect is the big increase in globalization, the increase in lower skilled workers in the global economy that are part of the global market. And that has a tendency to depress the wages of low-skilled workers.

Now, we shouldn't be competing with low-skilled workers. We're the, you know, most affluent country in the world. We should have high-skilled workers. But we are very well endowed in low-skilled workers. So what are you going to do? We know what to do with the future. Of course, we're not doing it, okay -- improve our education, reduce our abundant supply of unskilled workers. But we have to find something to do in the intermediate term. But for the longer term, boy, we have to do a better job there.

MR. SPERLING: I do think it's important -- you know, we all like to come with the exact answers. But I do think it's important to recognize where the problems are tough and where we may have to be thinking a bit harder. I think one of the reasons that there has been an increase in anxiety is because people have seen evidence that what they were told about simply getting an education has not necessarily panned out, as many of us would like to suggest. Now, you know, so for example I think that when there are stories about radiologists, software engineers and, if Dean Baker had his way, a lot more professional people seeing their wages compressed or losing their jobs, it's very easy for people to say well, it's really only this 20,000 dollars here or 20,000 dollars there. But I think it's important to note what that does to the psyche of a lot of Americans. A lot of Americans base their whole life around the notion that if they work hard and save hard and can send their child to go to a good, public college that they're going to have a degree of economic security. And so when they see the examples of that not working out, it's a, I guess, kind of a personal paradigm shift, or it makes people wonder about their own assumptions. And I think that is behind a lot of the anxiety.

Now, the trick is -- and this is the difficult part -- I still think everything that Larry Meyer and others and the work that Larry Katz and Claudia Gold and others have done is very powerful in suggesting that education is still the best bet. But it leads to the following paradox. We're at a particular period where education may mean less for economic security than ever before and still be your best bet for economic security. And that's a tough message for people to deliver. But I think that's the world we live in. It's less of a guarantee than ever before and more important than ever before.

MR. BAILY: I agree with Gene. Let me just make a quick comment, though, on this globalization thing. When we were in the administration in the 1990s, Kodak was having a big dispute

with Fuji. And there was a lot of talk about we had to protect American jobs, and we had to do this, we had to do that. You know what Kodak should have done? They should have sold the whole film business right out there, because it was technology -- it's technology that's affecting those jobs, it's not the battle over trade. And so I think we misfocus a lot of times when we look at this as just a globalization. It's a combination of globalization and technology. And we don't want to become Luddites -- and nobody would say we should. That means we have to deal with the things like education and improving the social safety net and making the market work more effectively for everybody.

MR. ALDONAS: So why are we protectionists for high-end workers? (Laughter.)

MS. BEDDOES: Can I just pull these things together, because I think we've touched on several things which actually come together in one big question. Which is, what should our fiscal priorities be? Because we've talked about the winners and losers here, whether it's from technology, whether it's from trade. Frankly, it doesn't really matter. We've got a situation where, you know, there are losers, and it's important to do something about them. We've talked about the priorities -- investment priorities. We heard from an earlier discussion today about the deficit and whether deficit reduction should be a priority. You know, when you put all these together, the biggest component, the biggest thing that government, that people in this town, in this building can do is figure out fiscal priorities -- appropriate tax rates, appropriate budget deficits and whether you should spend the money on entitlements or whether you should spend it on investment.

So for all of you, I want you to answer two questions. First of all, have we got our fiscal priorities right? Are we focusing on the right thing right now? And if not, where should the shift be?

And I want to start with you, Steve.

MR. RATTNER: Well, I think there are two aspects to your question. First, in terms of the overall fiscal balance, I think I made my views known, which are that we are completely on the wrong path and an unsustainable path, and there is a piper that is going to have to be paid, and we might as well get on with it and deal with the basic fiscal imbalance when you mark everything to market. I think within the question that we've all been sort of touching on or how the government can play a role here doesn't -- I think I would agree with an earlier comment that I think the government is uniquely poor at evaluating the benefits from its spending. You know, whether it be on tax expenditures or actual expenditures. There's really no -- and this gets to I think things Bernard cares about -- there's really no methodology that exists, or certainly that is paid any attention to, to evaluate what is the rate of return on a government program or on spending for a certain purpose. And it's clear that much of what government spends its money on earns no return. And there are other things, some of which we've alluded to on this panel, where one hopes there would be a return.

You know, unfortunately, the government is not a business, and so it has to conduct its operations differently. You can't, for example, take the entire Defense budget which does absolutely

nothing for productivity and ultimate growth of our workers and turn it into education and training and other things we like it to, because the government does have these other priorities, like keeping our borders safe. But there really needs to be a better method, or a method at all for that matter, of evaluating government's role in these matters and coming up with more cost-effective or more higher-returning ways of using government's money, along the lines of what we've talked about.

MS. BEDDOES: So the first step is to have a better sense of where the returns are and where they're not and then an improvement in accounting.

MR. RATTNER: Yeah. We don't have an accounting system that, as I said, bears any resemblance to how the private sector accounts. Nor do we have any method to evaluate what the returns are from any particular government program or any particular government effort.

MR. ALDONAS: I agree with what Steve's saying completely. And just two examples that I think help. One is we build nuclear submarines in New London, Connecticut as an adjustment policy.

MS. BEDDOES: As a trade adjustment policy?

MR. ALDONAS: As an adjustment policy, not a trade adjustment policy. But we don't need another nuclear submarine given the threats that we have in the world. And yet, we're still manufacturing them. Better to take the \$1.8 billion that it takes to build a submarine and put it into education and end the lottery system that we have by virtue of where you're born in terms of how we fund public education in this country. That would be a wise fiscal policy choice. (Applause.)

The second thing on the tax side is, you know -- this perplexes me, because the most regressive tax we have in the system, apart from tariffs, is FICA. If you really want to help someone at the low end of the circumstance, you try and introduce things in the tax code that allows them to save, number one. And number two, what you do is you integrate FICA into the progressive tax code, and you give people on the low end back the 14 percent you're taking off their income. But the opposition to that is oh no, we have to have this universal funding mechanism, otherwise we'll lose all support for a social safety net. I simply disagree with that. I don't think that's where Americans are. But if you really want to help people on the low end, there's a way to do it through priorities in the tax code.

MS. BEDDOES: I'm actually going to switch to Gene, because I think he may have a response right to that.

And then after you, Dean.

MR. SPERLING: Well, maybe not directly, but what I wanted to do was first link the globalization and the fiscal issue for one second. And then I'm going to give you five very precise things I would do.

To me, what we've been talking about is that whether it's globalization, technology -- and I think it's probably less trade and more the combination of just the globalization and information technology generally -- is compressing middle-income wages. It is also I think creating more of a winner-take-all, loser-lose-all economy. I think people at the very top we know are doing much better. And I think there's a lot of evidence that people who are losing middle-class jobs may be taking deeper falls.

Now, in that scenario, one of the most important things is, therefore, to have a progressive taxation system. Because you might not be able to get in the way and interfere, but you can at least say that if that's the way the economy is working, that a few people are capturing an enormous amount of the productivity gains in their income, that you at least want to be able to recycle some of that back to help more people become part of the global economy. So the idea that we have, during this particular period, had such a significant tax relief on those who are reaping the greatest gains is not just inequitable, I think it's just unwise in terms of shared growth.

So what would I do? Five things -- one, if there's one thing I think we should know how to do, it's health insurance. And I think it's good in reducing the anxiety of people in between jobs -- most important adjustment thing. I think it's just a moral imperative. It's a national disgrace we don't have it. But three, I just think this idea that you're going to fix Medicare entitlement alone without dealing with the overall health care costs is just not real. So if we were spending more money that could have gone to deficit reduction but we're doing it to get a health care system that not only covers everyone but puts some downward pressure on prices, that would be extremely important.

Second, private savings for the middle class. I'm a long supporter of USA accounts which I now call in my own forum universal 401(k)s. But I think that actually leverages more savings. It actually helps net national savings and spreads wealth creation. So as opposed to spreading the wealth, it at least spreads the wealth creation. Three, I do think these adjustment policies, even if they are seen as burial insurance, are important. I think -- fourth -- I think a more massive investment in kind of the innovation and energy and research -- the fact that we're flatlining NIH at a time we're competing like crazy for R&D jobs. And then finally, a stronger amount percentage of our population going forward is going to be minority youth, minority families -- a stronger percentage of our work force. So for me, I would be spending far more on not just particular programs but creating a line of hope and aspiration for children from the poorest families, particularly minority families. And I would do it for no other reason than just moral value reasons. But I do think the economic argument for our work force should mean that even if one doesn't think we should do it for those reasons, just for common sense, I think we should have a much more massive investment in the future opportunities of our poorest minority children.

MS. BEDDOES: Dean, do we have our fiscal priorities right?

MR. BAKER: Well, I don't think the budget is hugely out of whack. I mean, I would like to see a smaller deficit. I'm thinking in the order of 100 to 150 billion dollars, which basically you get by

ending the war in Iraq. So it's not huge lifting. (Applause.) I would like to see -- I'm glad to see some support for that -- some of the tax cuts certainly taken back. And there are priorities -- education, obviously, a good one. I'd like to see things like universal broadband -- a real commitment towards that. We're getting there, but we could do it much more quickly. Gene mentioned NIH. If we spent another 30 or 40 billion dollars on biomedical research, we could replace what the pharmaceutical industry's doing and get rid of patent protection. Again, I'm a free trader. Let's get rid of patent protection for prescription drugs. We'd save about \$200 billion a year. It's a very good deal in my book.

The last point I just want to make is that I really -- you know, the long-term deficit stories -- and you know, I've been around with David Walker and everyone else, and I get the trillions -- I think it's up to 70 trillion dollars now. The story is health care, you know. And if we don't fix health care, we're going to have these really big numbers. And just real quickly, in terms of, you know, one way you could do it -- I know about, you know, the politics behind or defeating health care reform. Let's go to trade. One of the things I came up with -- Medicare Choice Plus -- why don't we give every beneficiary a voucher that allows them to buy into the health care system of every country that has a longer life expectancy of the United States, and we split the savings? So that way, you know, David Walker's trillions come way, way down. People get money in their pocket. It's a win-win.

MS. BEDDOES: Okay, very briefly, Larry, what's your wish list?

And then we'll go to a couple of questions.

Oh, and Martin -- I'm sorry, Martin.

MR. MEYER: Okay, so the issue isn't, you know, the fiscal issue today and what the budget deficit's going to be tomorrow. It's making decisions today that put the budget on a sustainable path going forward. And those are contentious issues. They're very difficult issues. They're cuts in benefits. You've got to think about taxes. As you're doing that, taxes are part of it. You've got to think more broadly about tax reform.

And you've got to remember, during this period where we're cutting back on benefits and there's going to be pressure on all kinds of discretionary government spending. So the efficiency with which we spend money -- and leveraging off the private sector and incentives and partnering with the private sector -- those are going to be the things that are important.

But we're going to need new ideas. In terms of health care and dealing with the medical side of the entitlement program, tinkering out the edges is not going to do. We're going to have to sit back and really have some vision and we may need to do something much more radical.

MS. BEDDOES: Martin, very briefly.

MR. BAILY: I was very encouraged hearing about the need to have a more progressive and fair tax system on both sides of the table. So I heartily agree with that. I think we take advantage of the productivity growth. We take advantage of what we can get from globalization and then we have a more fair tax system.

If I would change one priority on spending, we currently spend quite a bit of money -- and I'm not against it -- on finding new medical technologies. As everyone has said, health care is the huge issue. We spend hardly any money on figuring out which health care technologies work and which don't work, and how we would create treatment protocols that would be cost effective and then figure out how to get incentives that those protocols are actually used by medical providers.

MS. BEDDOES: Thank you all.

We have time, I think, for just a couple of questions. And I think, James Galbraith, you had a first question.

MR. GALBRAITH: Thank you very much.

As Dean said, and I think the panel largely agrees, the problem is health care. That is the financial issue that we do face. So I want to pose the following question: Suppose we move to a system in which all of those who are presently uninsured during their working lives got insurance, and therefore, got care that they presently forgo for the chronic conditions that they developed during their working lives -- hypertension, diabetes and the like -- which under our present system dumps them into Medicare sicker than they ought to be at that age. In that case, wouldn't we have a healthier, older population that would work longer and cost less to treat under Medicare, while at the same time contributing for a longer period of time into Social Security? And would this not be one of the single most effective things we could do, not only for the broader health of the population, but also for the financial balance in these two programs. Dean?

MS. BEDDOES: So -- Grant.

MR. ALDONAS: No. Moral hazard -- it's like the Massachusetts and California schemes. They won't do anything about the price of care. What they will induce people to do is make broader use of it. On top of that, the penalty in terms of a tax rate -- at the low end no one's paying taxes so there's no penalty not to get the insurance. So it --

MR. GALBRAITH: My point is that if health status improves --

MR. ALDONAS: Bear with me -- bear with me.

MR. GALBRAITH: -- won't care diminish?

MR. ALDONAS: So the point would be, what could you do to effect cost? And here I think Dean is absolutely right. What we've seen is a manufacturing sector which has been opened first to globalization and they've faced the harshest adjustment. We see the highest productivity gains there. We see low productivity gains in services. What's the answer? They should share in the burden, really, of this adjustment along with the process, which is Dean's point, which is you could provide medical care through public clinics at a very low cost if what you did was allow more nurse practitioners to do basic medicine. They could be in every Wal-Mart in the country and you could back that into an Indian supply chain that drives the cost down to about 10 percent of what it is right now. That would have an impact on cost and make health care broadly available to people who are currently underserved in a way that no insurance program would.

MR. BAILY: Yeah -- let me just quick comment, though.

MS. BEDDOES: Very quickly.

MR. BAILY: A recent study by the McKenzie Institute of Health Status found that only a very small fraction of our higher health care costs are associated with the U.S. being sick or having higher disease incidence. So I don't think the primary problem is that we're sicker than other countries.

MS. BEDDOES: Will, last question.

Q Just a quick question, which is it seems to me that the issue of the sustainability of the current count deficit is different from its desirability -- and some of the unequalizing effects that have already been mentioned. And I guess I would like to ask the panel to elaborate a bit. My fear is, of course, we wave our hand at the issue of compensating losers and we repeatedly fail to come up with a serious plan to do that. And I'd love to hear some serious ideas both about levels of funding, new programs beyond trade adjustment assistance and wage insurance, which have so far really not added up to much.

Thank you.

MS. BEDDOES: That is a very good question. Everyone talks about the need to compensate the losers. Trade adjustment system, I think, is what -- \$100 million a year? It's a very, very small program compared --

MR. ALDONAS: Billion.

MS. BEDDOES: -- billion dollars, yeah -- compared to the gains that are --

MR. ALDONAS: (Off mic.)

MS. BEDDOES: A hundred million -- it's a tiny program anyway.

MR. SPERLING: It's nothing.

MS. BEDDOES: Yeah, it's very, very small. So how much should be spent?

MR. SPERLING: I think this is right. And I think part of the problem was that when people were doing agreements and these things there was the fiscal concern. So it was just simply to say you would expand it. If you're really serious about affecting the anxiety level, things have to be universal.

I mean, I do think more middle-class parents send their kids to school, because in some way they do understand that there is a student loan program and they have sense of where to go. And truthfully, you can go anywhere in the United States. And most people also know where to go in any city to order a pizza or rent a video, but my guess is -- and I'd bet on this -- I bet there's not 5,000 people in the entire United States who on the day they lost their job completely understood the difference between dislocated worker assistance, TAA, the wage insurance program, the old NAFTA adjustment program that's down.

So if you're going to do this, I agree, it's got to be -- it cannot be, number one, contingent on how you lost your job. That makes no sense and it's going to be difficult to distinguish. I think the wage insurance could be effective if it's broader and more universal. I think you have to go to one place to do this. And the last thing I just want to say is just that, you know, I agree on the anti-industrial policy point that we can never pick winners.

It is not the case that we can never figure out what communities may get hurt in the near future or the next five, 10 years. We should -- every policy we have is adjustment assistance. It's once you've lost a job, once a community has started the downward spiral. We've got to figure out a little bit how to help a community before the downward spiral. And I think that's one of the real vacuums in public policy now.

MS. BEDDOES: Thank you all. We could have this discussion for a very long time, but I'm under terrific time pressure here from Steve. As you see, he's pushing me off the podium.

That was a great panel. Thank you very much. (Applause.)

MR. CLEMONS: Zanny is a fabulous, fabulous moderator and I would like to ask all of the panelists here for just the next few minutes, if we can all remain assembled, I'd like to -- I was serious about this fact when we opened the forum today we were going to have a discussion between those people who saw clouds or the doom-and-gloom crowd and those people who said that we've got a lot to be optimistic about and maybe we need to take a new look and think about our calipers for this.

And the driver of this -- Will Milberg was the last person to ask a question from the Schwartz Center for Economic Analysis at the New School. And Bernard Schwartz, after whom the Center has

been named, is also a provocateur -- an ideas guy. He happens to be a businessman, but he's also an ideas guy and for 24 years served as chairman of Loral Corporation. He retired as chairman of the board and CEO of Loral Space and Communications and is now chairman and CEO of BLS Investments. And it is his paper, along with Sherle Schwenninger, that I'd be happy to distribute, which will be published shortly.

But let me invite Bernard to come up and offer a final provocation and his own thoughts and reaction to this panel. And we will conclude with that. So Bernard. (Applause.)

MR. SCHWARTZ: Thank you.

We're running over time. I'm not going to keep you long, but I've just made some observations as the discussion proceeded.

First, let me give a heartfelt thanks to Steve and to New American Foundation whose organizational skills, discipline, and driving force made this an exciting morning. But a very, very special recognition of the part played in this whole development of an idea and bringing it into the public discussion by The New School University up in New York, and particularly by the vision and the energy displayed by Bob Kerrey. And I think in large measure what we're doing here today is because they have put together joint forces to make this happen.

I personally want to pay a little attention to Sherle Schwenninger, who helped me co-author the paper that will be presented to you. It's not the Bible by any means, but it does recognize the fact that there are things going on in the world that we should pay attention to.

Let me give you a little bit about the genesis of this discussion. We're talking about subtle analysis of the economic business environment in which we are developing. My view has been a much longer one. I've looked at the 200 years of development and maybe 2,000 years of human development. I think we are at the very peak of -- I shouldn't say peak, because that indicates that it's ending -- I think we're in the middle of one of the grandest, broadest, strongest, most robust periods of progress development on a much more diverse basis -- more people having the opportunity to enjoy this development -- than the world has ever known. And we should not misunderstand that a year or two or some difficulties of adjustment are nothing more than adjustment in the flow of a very strong development that is continuing, and started a long time ago.

Even the title of this meeting that we're having here -- it first started out by saying, "Is the sky falling?" It was after an editorial, I think, in The Wall Street Journal or somewhere, that we began thinking about this problem: Is the sky falling? You'll notice that the title on this meeting today is, "Will the Sky Fall?" That's a very interesting, subtle difference. What we're doing is taking what was then a present, catastrophic event that was about to fall on all of us, to now a somewhat far distant future undefined. And that's been the problem with the discussion over a long period of time. It was only a few years ago that the great disaster looking over our heads in the United States was the Social

Security problem. The Social Security problem -- that's all you could hear about. What Social Security problem? Suddenly today it's become a very small problem. Maybe not even a problem if you adjust Social Security taxes.

So the point I'm making is that we have a tendency to underestimate some of the strengths that are driving our economy, and have the sense that it really can't be this good, something bad must be going to happen. I don't think it's necessarily that the conventional wisdom is wrong. It may be that the economic performance has been so strong and so consistent for such a long period of time, has shown so much resilience, that we are all surprised at this. This is not the way the economy is supposed to act. We should have had now double-digit inflation, double-digit interest, a lack of investment capital around the world, there should have been recessions, unemployment. What the hell's wrong with the economy? Why doesn't it behave? And I think that's got a lot of people disoriented.

The discussion here has been an important one, because this discussion has to do with policy. And unfortunately, we have bound ourselves into a straitjacket politically, because we are depending on definitions of economic data comparisons that are no longer relevant. And unless we get that straightened out, we're going to continue to have that policy. So that policy is very important to us and it's very important for us to have good policy, because things won't be good forever unless we do things that are right. That's very important.

Just a couple of comments about what we heard today. There's nothing sacrosanct about some of the things we think are so important like savings, that we hear about negative savings in the United States. That's strictly a definitional problem, because this country spends an extraordinary amount of money on education, for example. And it doesn't count to wealth, it doesn't count to gross domestic product and it doesn't count to savings. Now, we can argue that in an economic sense, but I prefer not to do that. And I prefer not to do it, because I'd rather look at the performance of the economy. After all, Japan had the highest savings rate in the industrial world and had a 14-year recession. So it's not just cause and effect. And I think we have to put those things into some kind of a better context.

What I think is around in the world that we've never seen before is the undervalued element of the wealth factor. We have seen over a long period of time since the Second World War, an accumulation of wealth at a scale that the world has never seen. Over the last 15 years that wealth accumulation has been extraordinary. And it is an economic palpable driver. And I think just like they could not measure in the 1990s the effect -- the economic effect of productivity and the economists and the policymakers had it wrong all during that decade, we have it wrong today -- because we can't measure it -- what the effect of wealth is, and it's not going to disappear.

When you talk about wealth creation, I'm talking about something as little as giving a micro-loan to some family in Africa and South America of \$450, which allows them to go out and buy a sewing machine and they're suddenly capitalists. That is a translation of economic power that has never been measured before -- can't be measured, perhaps -- but it's still an economic factor.

Also, I think we have a tendency as a society to underestimate -- I shouldn't say society. We have a tendency in Washington to underestimate technology and innovation and entrepreneurialism. It was interesting -- Dan Yergin here said this morning that this is not the first time -- referring to the recent oil crisis -- this is not the first time we've had an oil shortage. It's the fifth time we've had an oil shortage. And what has happened each time is that technology has brought to bear new techniques that kept the price of oil down and abundant.

I think we can all agree there's a consensus that bad things happen. But the history of the last 50 years, over a long period of time, is that global economic development -- technology, innovation, wealth accumulation, et cetera, et cetera, you know the litany -- have minimized the periods of adjustment that we have to go through. But it also minimizes the resiliency of our economy to be able to restore itself and get on its feet and continue a forward progression.

Is it possible for the future to avoid these so-called catastrophic events? Well, if history is any reading at all, the answer's yes. We do manage the temporary adjustments that occur. And look what's happened over the last 10 years. You've had financial failures of important financial institutions. You've had two wars. We've had \$75 oil. We have had all kinds of innumerable pitfalls. And yet, the economy hasn't even paused long enough to take notice of those things. So we do have a robustness here that I think the policy people in Washington do not acknowledge.

Now, it's something -- I think it was Mike Mandel today who said it -- that appeals to me a lot and I'd like to pose this about myself. I may be not very right, but I'm not wrong. And I have to tell you, that's only to give a concession to the smarter and wiser people who are economists and politicians and educators in this room, that as a businessman, I can't know everything, but I do take notice of the environment and what happens. And of course, we produce winners and losers. That's what happens. But we can produce -- as a matter of fact, over the long pull we've really produced winners and winners. And good policy can eliminate to a very great extent, or soften, the temporary losers to make us all a society of winners and winners.

A quick word about globalization: We've had offshore manufacturing shifts and globalization since 1776 in this nation -- and probably before that too. We used to make ships and locomotives and shoes and textiles and steels and autos and so on. It goes on forever. I suggest to you that this is not the Armageddon of our society. It'll continue as long as we exist. But America's innovation skills, our industry, our imagination and the investment in public policy and public investment has been able to keep us at the leading edge of that.

And a word about China -- just an offshoot of this: We're worried about the competition of China. China has a water problem that will probably be its main concern going forward, other than its political problem. The water table in China is diminishing very, very fast. I think you brought that out the last time we were on a podium together. If you look at China, China in 10 years will be importing 70 percent of their energy. They have a labor shortage today. So as a comparative

competitive situation, I don't think 'doom and gloom' for the United States is necessarily where it should be.

If we had in this country, for example, an operating budget like every business has in the world -- if you had an operating and a capital budget -- we would not be running deficits. We would not be talking about deficits. We'd be talking about operating deficits so that it would be in balance. And you'd be talking about, how do we best invest in capital, even if it takes some borrowing to do so?

So in conclusion, let me just say that almost all of the consensus is that we need public investment. And we all have our list of those things that have to be done, whether it's water resources in the United States, bridges, new control of investments that go into national security. The issue is unfortunately not what we need, it's whether we can afford to have it now. And those of us who say in our political environment that we have to postpone investments in infrastructure, including education and all the good things that we want to have, if we postpone that until we balance the budget, we will have lost a generation's opportunity to bring our people the promise that they should expect from our leaders, and it's not necessary. The fiscal deficit, as so many of our people have spoke to today, is not the most critical issue that we have.

As long as the pie grows -- and this has been America's style forever -- we're not going to redistribute the wealth in this country. I'm not sure we're going to be able to rollback taxes -- some of the tax decreases that you think might have been inappropriate. Politically, that's not going to happen. But as long as the pie grows, we'll be able to have a better distribution and a continuing growing distribution.

I'd like to point out one other thing that is important to me. When we talk about 'you can't spend forever more than you earn' -- you've heard that here today -- and debt has to be repaid, well, that's just not true. For example, historically, it's incorrect. We never paid the debt that was incurred in the purchase of Louisiana. We never paid for the debt that was incurred in the GI Bill. We never paid for the overall electrification in this country, nor is debt related to the GDP the only statistic we should be thinking about. We should be thinking about spending money or GDP -- whatever the deficits we incur -- against wealth, as well as income. And that's where I think we're making a big mistake by that omission.

So finally, let me say one last thing. I'd like to point out one thing about myself. I may be the only person in this room who has ever made things. My whole career has been involved with making things in America, getting it into the mercantile stream, having it sold, employing employees, using technology and innovation and the sweat and energy of the people involved in those tasks. And it has produced, I think -- the cumulous of other likes that is what makes our optimism valid in this country.

I'm optimistic only because I have seen the physical translation of what America is doing today -- not the theoretical woes that might befall us if some unknown thing occurs. So I'm hoping that you will join me in looking at history as a long-term history rather than the last five years of history, but

look around you. I mean, if you think that we're in some kind of circumstances that are really difficult, if you think gloom and doom is about to strike, look around you. Look at your people. Look at your neighbor. Do you think we're about to slide on the banana peel and disappear forever? I think not. And I hope you will, however, applaud the panelists who have been extraordinary in the debate today. I think we've been well served.

(Applause.)

Thank you.

MR. CLEMONS: Thank you.

I want to just quickly, besides thanking Bernard, I very specifically want to thank Steve Rattner -- very particularly since he's a member of our board at the New America Foundation; Martin Baily; Larry Meyer -- it's a great privilege to have Larry with us today; Grant Aldonas; Dean Baker and Gene Sperling. It's been an extraordinary day. You know, we've had 21 personalities up here in about three hours.

And just in conclusion, behind these 21 personalities not only do I want to say what a privilege it was to work with Senator Bob Kerrey and The New School, but I want to thank a lot of people who are behind this: at The New School, Kathy Trainor and Will Milberg. Part of Bernard Schwartz's staff, Jeanette Clonan. I want to thank Sherle Schwenninger and Michael Lind, who've been part of this process. And Bob's chief of staff, Sherry Brabham.

The New America Foundation, you know, I get the credit, but the real workers are Jerry Irvine, Sarah Brennan, Liz Wu, Adam Lebovitz, Jeff Meyer, Hannah Graff, Leela Seroj, Ellie Arnoff, Guthrie Lobe. You know, you never get this kind of service, not on United Airlines, where your sandwiches come quietly and silently during the middle so then there's never a break.

I want to thank Harry Reid and my former boss here, Senator Jeff Bingaman, because we would not have been in this room had they not pulled some strings for us. I want to thank the Senate catering staff; the C-SPAN crew who's here; and Ben Wattenberg and his PBS show "Think Tank" for taping all this.

So thank all of you. Thank everyone else, thank Bob Kerrey, and we'll go from there. Thank you!
(Applause.)

(END)