

LSE alumnus **Robert E Rubin**, former United States secretary of the Treasury from 1995 to 1999, gave a public lecture at the School in February, his topic *Global economy: opportunities and risks*.

No guarantees, real risks

I spent a wonderful year at LSE long ago, in a category officially labelled as 'ostensible student'. That always struck me as a curious label, but it certainly caught the character of my year at LSE. My understanding and views were affected by the internationalism and the different ways of thinking that I encountered at LSE and in London more generally. However, those days of carefree living are long over. This evening I would like to discuss a very serious set of issues that reflect my experience of more recent years.

This great institution was founded over a century ago, when the Industrial Revolution was transforming society – and the people of that time were trying to manage enormous economic changes. Today we are trying to manage our way through another such period of transformation, with new technologies ranging

from advanced computers and the internet to human genome projects, globalisation along many fronts, and the spread of market-based economics to most countries around the globe. LSE was immersed in these debates during the 20th century and is exceedingly well-positioned to provide the same fertile leadership for the equally great challenges of the new century.

Against this backdrop, I would like to share some of my conclusions about the economic future. My comments may seem a bit dour. Perhaps that is the way former secretaries of the Treasury sound, or maybe I've just seen too much over too many years. Actually, I'm something of an optimist, on balance. On balance. That is precisely the point – to recognise both opportunities and risks.

While I do believe that the powerful forces of change just mentioned offer great opportunity for the global econ-

omy in the new century, I also believe there are serious and continuing risks that require clear thinking and action. I will discuss four of these risks: the currently fashionable but counter-productive view that a new economic paradigm will ensure endless and uninterrupted prosperity; the threat to ongoing trade liberalisation and openness to change more generally; the persistence of widespread and vast economic inequality; and the continuation of the underlying conditions related to recent financial disruptions.

To start, there is a paradox that accompanies our prosperity. Our very success seems to diminish our willingness to exercise the discipline and take the actions necessary to prolong that prosperity, among investors, those running businesses, and the public sector. In many ways, our greatest enemy today is the complacency of good times. That complacency is heightened because in

the face of the recent crises, the system has worked. In 1987, the United States stock market fell by 22 per cent in one day but recovered quickly and there was no adverse economic impact. In 1997-1998, for tens of millions of people in Asia, and elsewhere, the financial crisis was a devastating event. But a year and a half later, most western countries have grown without interruption, and most of their markets are well above pre-crisis levels. Moreover, the economies of many of the crisis-affected nations have begun to grow as well, and with this, the commitment to reform in some seems to have flagged. The risk is that, at some point, the excesses may simply become too great, and the inevitable consequences follow.

The economy

It is clear that the economic condition of the US today is dramatically better than it was a decade ago. Some have extrapolated from this to projecting a

robust and untroubled future. The move to an information-based economy may well be as profound a transformation as the move to an industrial economy was for its time. But some see it as more than that. They see a new paradigm that renders irrelevant so many traditional concerns about downturns, risk and sound policy. They fail to see that there are no guarantees, that there are real risks, and that much depends upon whether business and government act to realise the opportunities and deal with the risks.

I profoundly disagree with this view. This view of the economy is contrary to all of human history with respect to markets and economies, and that should be a sobering caution.

Clearly, the new technologies are of profound importance to our economy. But they are not the first new technologies of great economic significance. The telephone, the automobile, the harnessing of electricity, the railroads, the development of mass production, and modern medicine all transformed the age in which they occurred. But none of them, separately or together, produced one-way prosperity.

At the core of how markets and economies work, there is something very fundamental in human nature – a tendency to go to excess by over-emphasising the positive and underweighing risk when times are good – that is unchanging. What has struck me recently is how all aspects of financial life are pervaded with the assumption that 'All will always be well', that any interruptions will be temporary and mild at worst, or solvable, most likely, by the Federal Reserve Board and, in any case, quickly overcome by a renewed focus on the promise of the long term. Before I go on, I want to be clear about one thing: I am not expressing any views with respect to the level of the stock market, but simply that we must act in all financial matters with balance and discipline, and that discipline tends to get lost in good times.

It seems to me that modern capital markets, combined with the tendency of lenders to forego discipline in credit extension during good times and the structural weaknesses of many emerging market financial systems, creates at least the possibility – not the certainty, but the possibility – of further disruptions in the years ahead. And the more we forget that the underlying factors that con-



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tributed to the recent disruptions still exist, the greater the likelihood of future disruptions.

In some ways, these are new or heightened risks, but in another sense these are not new risks, but the oldest risks of all – complacency, loss of discipline, and over-reaching. Back in the days when I was on a trading desk, we called this 'reaching for yield'. It was clearly evident prior to the Asian financial crisis.

Trade and international economics

Future economic conditions will be greatly affected by whether the world presses forward with trade liberalisation. Yet continued expansion of trade faces great difficulty – and even the possibility of reversal and moving backward. Similarly, openness to economic change, and to the advance of technology, could also face a backlash around the world.

I could sense some of this coming in meetings with foreign officials during the last year or two that I was at the Treasury, when the talk would turn to more general matters and they would express concern about the uneasy political environment in their respective countries around globalisation and change. More recently, I noticed press references to the concerns of some EU officials about the unsettling effects of rapid change – and the suggestion that much of this, revolving around technology and market-based economics, was too 'American'.

The big story in Seattle, in my view, was not the street demonstrations but that each part of the global trading system, gathered together in pursuit of trade liberalisation, was so resistant to reducing barriers in its own most politically sensitive areas; for example, Europe on agriculture and the US on its dumping laws.

Moreover, there is an almost universal unwillingness amongst politicians to explain to their people that the benefits of trade derive not only from exports, but from imports as well. Imports lead to lower consumer prices, greater productivity through increased competition, lower inflation, lower interest rates and higher standards of living, but no politician wants to say this.

But trade, like technology, creates winners and losers, increases dislocation, and prompts anxiety even



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New technology in 1878 – Bell's original telephone apparatus

among those who are doing well.

Throughout his presidency, President Clinton has advocated combining trade liberalisation with an active domestic agenda. The objective of this combined agenda is both to better equip our people to prosper in a rapidly changing global economy and to increase their confidence in their ability to do so. I believe such an approach, combined with far more public education on the benefits of trade, can restore the consensus for trade liberalisation that has existed at many points in many of our nations over the years, and that it will be difficult to move forward without restoring this consensus.

Income inequality

A third threat to our economic well-being is the vast income inequality within developed nations, within many developing nations, and between the developed and developing worlds.

Vast income inequality within nations is a broad-based phenomenon. Even the recent strong economic growth in the United States has still left over 12 per cent of our population under the poverty line. The appropriate response to our inequality is not income redistribution, but investment in our people, including greatly increasing support for equipping the less well off to function

effectively in the mainstream economy.

The other aspect of vast inequality is among nations. According to one study, at the beginning of the 19th century, the ratio of real incomes per capita between the world's richest and poorest countries was three to one. By 2000, it had risen to 60 to one.

During my own time in government, it was clear the affluent make themselves heard; the middle class makes itself heard; the poor are too rarely heard and too little represented. Sometimes, the affluent seem to have a gated community approach, feeling that their wealth is protection against the problems flowing from poverty. I think this is dramatically not so.

Firstly, lifting people out of poverty increases productivity, boosts market demand and reduces social costs, and so contributes to overall economic well-being for all of us. Secondly, poverty – especially in a world of visible affluence – creates understandable alienation and anger. At home, that can lead to crime, drugs and other social ills with economic costs. Internationally, that can lead to political instability, support for extreme nationalism, social strife, and terrorism, all rendered even more dangerous with the spread of weapons of mass destruction and their miniaturisation for delivery anywhere. Similarly, global environmental degradation, the spread of disease, and illegal immigration, can all be greatly exacerbated by the poverty in developing countries.

While there has been real economic progress in many developing nations, due probably more to their own policies than to assistance, vastly more needs to be done, and it is in the economic self-interest of the industrial nations to provide far greater assistance and, perhaps even more importantly, far greater access to our markets. Moreover, there should be greatly increased focus on broad-based sharing of the benefits of growth within developing nations.

The risk of systemic financial crisis

The powerful, largely positive force of international finance poses a fourth threat to our economic well-being. We need a financial architecture as modern as the marketplace. We must try to find ways to induce greater discipline among lenders,

investors, and all others who participate in financial activity, especially during good times. But how to do this is no easy thing. To give just one example, unless the private sector shares the burden of addressing financial crises, we face the very real problem of 'moral hazard' as lenders and investors assume they will be rescued if things go wrong. Yet in practice, the imposition of private sector burden sharing can precipitate the very crisis we are trying to avoid. Similarly, we really don't know what kind of exchange rate regimes make sense for all but the largest countries.

As in many turbulent eras gone by, the great challenge before us is not only moving forward in the intellectual response to complicated substantive issues, but also winning the battle for people's minds in support of good policy. The politics of meeting the challenges of our era is as important as the policy, since if the politics does not work, the policy won't happen.

One of the greatest problems is how to work effectively on transnational issues that can profoundly affect the global economy and each of our economies in a world of sovereign nations. Moreover, in an interdependent world, each of us has an increased stake in what happens within other nations. How to deal with this powerful interest in what happens in each other's countries, in a world of sovereign nations, is another area that needs new thinking.

We face an era of great economic opportunity, that warrants considerable optimism, but there is much to do to realise these opportunities and to minimise the risks. Moreover, these challenges will in many cases require the development of new analytic constructs and new political approaches. Those whose only concern today is bits and bytes and what the Federal Reserve Board might do, need to look back over the 20th century, and really all of human history, to gain a perspective on the full range of issues that are likely to affect our economy and the global economy in the decades ahead. ■