Unedited Rush Transcript

Event
Balance: The Economics of Great Powers from Ancient Rome to Modern America

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Fred Bergsten: Let me welcome all of you to the Peterson Institute this afternoon. Adam Posen got deflected, asked me to step in, which I’m happy to do. And welcome all of you. This is a unique opportunity today to hear from Glenn Hubbard on his relatively new book, came out this spring: The Economics of Great Powers from Ancient Rome to Modern America: Balance. It’s a fascinating look at history through the lens of economics. It has some very creative ideas about the evolution of great powers – their rise, their decline – with some lessons for the United States today. And we thought this would be a fascinating topic. Delighted all of you are with us, and we look forward to hearing from Glenn and then his discussions on it.

I’m sure all of you know, or know of, Glenn Hubbard. He’s been Dean of the Columbia Business School since 2004, and was a professor there for a decade prior to that. He was chairman of the Council of Economic Advisors in the Bush 43 period, from its start; 2001 to 2003. He headed an earlier Bush period, served as a Deputy Assistant Secretary of the Treasury Department.

Glenn has written about a hundred books, major articles, to textbooks, corporate finance, investment decisions, banking, public policy and the like. He was a major adviser to Governor Romney, of course, in the last presidential campaign, and so is one of the outstanding economists and political economists in the country. And quite natural, I think, he would turn his talents to a book like this. So we’re delighted that Glenn is with us to make the presentation.

We’re going to have two commentators to lead off; one is Steve Clemons, who’s Washington editor-at-large for the Atlantic, and he’s editor of Atlantic Live. He is a senior fellow and was founder of the American Strategy Program at the New America Foundation, where he was previously Executive Vice President. He writes widely, comments on political, economic, domestic, global issues, and I’m sure you see him quoted all the time. And he will be one of our two discussants.

The other is Charlie Kupchan, who is professor of International Affairs at the School of Foreign Service and government department at Georgetown. He’s also a senior fellow with the Council on Foreign Relations. Charlie was Director for European Affairs at the National Security Council during the first Clinton
Administration. Prior to which, he had also worked on the policy planning staff at the State Department.

He’s written a lot of books, recently entitled No One’s World: The West, The Rising Rest, and the Coming Global Turn, directly relevant to what we’re talking about today. He earlier wrote one about a decade ago, called The End of America Era: US Foreign Policy and the Geopolitics of the 21st Century, and he tells me that he’s currently working on a book on American isolationism, and what the historical record in that respect might imply for the future.

So these folks are expert on the topics of Glenn’s book, but it’s a pleasure, in particular, to ask Glenn to lead off; tell us about Balance, tell us about the history of the various empires that have risen and fallen. Glenn Hubbard, welcome to the podium.

Glenn Hubbard: Thanks so much, Fred, for the kind introduction. I should just say a little bit about what this book, Balance isn’t and is, what it isn’t is one of the economists writes a declinist screen on America book, but what it is is a fantastic Christmas present. So I urge you to buy hundreds of copies for all of your friends, and hopefully I’ll motivate you to do that.

I should say a little bit about why I came to work on a book like this. It is principally, as my remarks will make clear, a book about dangerous currents in American Fiscal policy and their threat to America’s leadership. But it draws a lot of insights from the past, from great powers that came before ourselves, as the great power of the modern period.

I got interested in economics many years ago coming from engineering, because I was interested in the same question I ask Columbia freshmen every time I go in to guest lecture in principles, which is this: “Why isn’t the whole world rich? What is it that makes some countries so much richer than others? Why is that the case?” The answer turns out to be less obvious, perhaps, than you might imagine, but it is important.

Now I say this, because a lot of my own work has focused – like many economists – on growth episodes; what causes growth to start? But in any book about decline, obviously the question is; what causes it to stop? And that turns out to be a harder question for economists, because normally we don’t think about stops, we think about gradual progress, and it may be slightly better some places than others, but progress nonetheless. But in fact, when a great power stumbles, it does just that. What causes that kind of decline and what lessons are there from history for America today?

My thesis is simple. Oftentimes in policy discussions – particularly economic policy in my own area – we tend to treat all discussions as technical. That is, we need to get the smartest people in the room, hash out a solution and carry it out. For example, the financial crisis happened; should we or shouldn’t we have a stimulus package? That’s a technical discussion; arguments can turn on different points of view about its efficacy.
The problem that great powers have faced, and I'll go over the episodes, but mainly talk about the US, is actually not technical challenges at all, but political ones. Namely that the political institutions of the great power have ossified relative to the pace of economic change around them. It wouldn’t surprise you to see an economist, like economics trumping politics, but that indeed is the thesis.

Now, to set this up for you, let’s imagine that instead of having the chance to talk together this afternoon, we talk together a hundred years ago – 1913, and we’re on the verge of the First World War – the average annual income in most of the industrial world at the time was about $3,000 in today’s dollars. You can already see the great progress since then. If you were lucky enough to be an American at that time, the number was $4,000.

Now, turn the clock back from 1913 to the year 1000 in the Common Era, that number that was $3,000 or $4,000 in 1913 was only about $400. Now, turn the clock way back; way back. Let’s turn the clock back to the time of Cesar Augustus’ period of ruling Rome. The interior of Rome in the Augustan period was more prosperous than a thousand years later. What on earth happened?

Now, there is a – you might guess, when stakes are this large, many people have trodden these fields, and of course they have. And probably the most magisterial treatment of these questions comes from a historian. And indeed, I got really interested in thinking about writing a book like this 25 years ago, when I read Paul Kennedy’s book on the rise and decline of great powers, which is a terrific book.

The Kennedy thesis is, in a sense, the opposite of what I’ll talk about today. His thesis is great powers stumble because of military overstretch, and he speaks of Rome – one of the cases I’ll talk about – the British empire, with a clear forecast for America of his time; 1987.

But you know, what caught my attention first about Kennedy’s book was the cover. If you go back and look at the cover of the first edition – because covers subsequently change for reasons that will become apparent – but when you go back to the first edition, there was a globe and there were stairs going up and down the globe. Having fallen all the way down the stairs, his face hitting the floor, was John Bull, the symbol of Britain. Already stumbling, not yet completely collapsed, but clearly on his way down, was our own nation’s symbol Uncle Sam. Who do you suppose is striding up the stairs, eyes heavenward, the center of power in Kennedy’s view of how the world would play. It was Japan, it was Japanese [inaudible 0:08:24].

Now, many economists at the time – I actually wrote an essay on this in the late 1980s – were very skeptical about this, for some of the reasons I talk about in the book Balance, that understanding economic power requires a knowledge of technologies that can move a frontier, not catching up to a frontier. And the Japan of that day, did not strike me or many economists as being that country.

Now, not to blame historians, no less an economist than Paul Samuelson, perhaps the greatest economist of modern times, fell into the same trap. Samuelson used to have an exhibit in his Principles of Economics textbook, which was the
bestselling textbook of its day, showing the year in which the Soviet Union would pass the United States in economic output. With each addition, the year kept moving as a goalpost. And in the early ‘90s, the reference just seemed to disappear from the book. So it’s not just historians, and of course, today China is the boogieman, it’s not Japan, it’s not the Soviet Union, it’s China.

Now, the balance thesis is about under-stretch, not overstretch. It is that political institutions or such, that a great power under-stretches; it looks inward, it fails to exploit its natural outward advantages, and its politics don’t keep up with economics. And while I won’t go through it much in my remarks, I do put a little bit of economics in the book. I think it is important to understand, particularly for leaders to understand, what are the sources of the wealth of nations?

As an economist, I think of it as being about three s-named economists – Smith, and Solo, and Schumpeter. Smith talked about scale really and division of labor. In today’s economy we would think GDP or something like that would be the consummate Smithian definition. Solo, of course, focused our attention on the future, on investment, as being the indicator of a growing and successful economy. And Schumpeter, of course, focused attention on innovation, where the frontier is.

In the book, my co-author, Tim Kane, and I do suggest a measure of economic power that I won’t talk about much this afternoon, but it is an amalgam of GDP growth and productivity. And in that measure, you can see why the US is considered the preeminent economic power. And for the foreseeable future, at least by our judgment – Tim’s and mine – is likely to be so, but it’s not manna from heaven.

Now in Rome’s case, and this will sound perhaps eerily familiar to today, rather than overstretch, we have building a wall to forestall immigration, we have a fiscal policy that favors the present over the future and currency debasement. I don’t know if any of these sounds familiar in today’s headlines.

The Roman diagnosis which played out over many, many years – the fall was not a single battle or conquest, but followed pretty much that playbook – the Roman episode is not at all unusual of politics problems for great powers. One of the other case studies that Tim and I look at is China, but Ming China, 15th Century China. I’m sure if you’re like me, every school kid of my era learned about the seven great voyages of Cheng Ho and the transliteration of the time I was a boy. And a century before Columbus’ voyages caught our attention, China of course had the commercial envy of its day, in terms of a massively successful fleet, and would have dominated the world had the policies of that time continued. The fleet was not only a source of wealth; it was a source of bringing in new technologies and information to China.

The problem is, just as in Rome, a series of praetorian guards had acted as a rent-seeking elite. Tutors, court eunuchs, around the emperor felt that the rise of the merchant class, which was benefitting handsomely from this trade, was taking away from their own power and influence. Eventually, the ships are ordered to be destroyed, and commerce simply stops. If you look at trade volumes and production data for China during this period, to the extent that such data are
reliable, you see a true cessation of growth; it’s as if somebody had come in and bombed a civilization. Something quite terrible indeed.

Imperial Spain is another case study that Tim and I consider. You know, the expression, “The sun will never set,” is thought of by many as being about Britain, but the line was actually written about Spain. Spain was the empire of its day, and a classic example of not understanding the sources of wealth. Spanish rulers, a series of them, thought that wealth was gold and silver, not institutions, not knowledge, not technology; the series of poor fiscal policies, the failure of politics to engage the contemporary economics of the day and a mercantilist trade policy ultimately bring Spain down.

Now, Britain is a very interesting story in here, because in some sense, Britain should classically fit Kennedy’s thesis. We do know that Britain way overspent in World War I and World War II; that’s undeniable. And Britain left the Second World War exhausted and unable to defend the territory that it had held. Having said that, Tim and I actually go back to, not only our own thesis, but to early work by both Adam Smith and William Pitt, The Elder, to suggest something else in Britain – a failure to be British. That is, while inside Britain, a classic, liberal, free trade, outward looking policy was pursued, the colonies, as we know famously here from 1776 events and onward, were not accorded that same sense of Britishness. It was argued by both Smith and William Pitt, The Elder, that this was a seminal mistake, and might lead to the empire’s downfall.

We also talk about the Ottoman Empire in the book, often identified as the so-called, “Sick man of Europe,” nothing of the case in its early period. The Ottoman Empire was actually an administrative marvel, and it’s a great story in political institutions in capture, because it was a marvel because of the Janissary Corps; an elite group of slaves who rose to administrative positions in the empire, and the head of which was actually the Grand Vizier, typically, to the Sultan. So the chief technocrat of the realm. Eventually though, the Janissary Corps starts to appropriate power for itself, much as the praetorian guards, the court eunuchs, the handlers of the Spanish emperors and so on.

Japan is a case study in the book, seen through the lens of the game of Go, an interesting story, because in Go, which is a very complicated game, of course, the opening moves are much like fresh paint on a canvass because anything is possible. The end we kind of know what’s going to happen. In the middle is where all of the action is. In the book, we talk about the evolution – post war – of state-managed capitalism, the interest groups that it created, and why Japan had such a hard time cracking US levels of income.

A couple of other case studies I’ll just mention in the book, that are chapters 1 is on the Eurozone, where fiscal institutions, as we all know from current news, are not up to snuff. And the final case study before coming to America today, is actually the state of California. Now I’m a New Yorker, so I’m entitled to include California as a foreign country with all of the other countries that I’ve talked about. And what’s interesting about California, it is the only major land mass outside the Mediterranean that shares the wonderful climate of the Mediterranean. It also however shares something else with the Mediterranean – a totally dysfunctional political system.
And what we talk about in the book is how a very rich state, with such wonderful
opportunities has managed to push itself to the edge of a potential growth crisis –
the modern version of the praetorian guards or court eunuchs or teachers’ unions
and public employees’ unions, so perhaps less dramatic than a eunuch or a slave,
but powerful nonetheless.

Now to come to the United States, we have a quote in the book from Yates, from
*The Second Coming*, that things fall apart when the center can’t hold. And an
observation that while in Eisenhower’s period, both the Democratic Party and the
Republican Party saw his favors to be a nominee. Nothing like that figures in
policy discussions today. The real issue facing this empire, this great power, is
fiscal; it’s not an overstretched military issue, it’s fiscal policy. And indeed, we
have very high and rising debt-to-GDP ratios in the United States. We’re on track
in the next decade to achieve our World War II level of debt-to-GDP, but we
didn’t just fight World War II.

This is a problem. You probably saw the kerfuffle over the Reinhart-Rogoff type
calculations of so-called tipping points when debt gets too high. Economists
don’t really know the answer here, but we can do arithmetic; we know that high
and rising debt-to-GDP ratios mean a combination of things; either the taxes have
to rise substantially to defease that debt, meaning slower growth or spending on
much of what folks think government does has to be cut: defense, research,
education, whatever your favorite public good is.

Now, to see where all this is coming from, I want you to imagine with me
something. Imagine a picture – and I’m going to ask you to think of United
States, but I could be asking you on behalf of almost any industrial economy –
let’s look from the time that the American revolution, to about 1970, and plot the
debt-to-GDP ratio. Does anybody have an idea about what that looks like? No
numbers, just shapes – up, down, sideways – any ideas? Revolution 1970. Down,
spikes – the correct answer is spikes.

The correct story for most great powers, and certainly in this period, is war and
peace. So when you fight a war, you borrow a lot of money. After the war, you
stop spending so much. GDP grows and both the numerator and the denominator
are restoring it, that’s how it’s supposed to work. To give you an example, the
debt-to-GDP ratio right after World War II was a little over 100%. That number
was 40% by 1960. That’s how it’s supposed to work.

Our budget institutions are built for that era. The battle we just fought over the
debt ceiling has a little bit of interesting history itself. The debt ceiling laws come
from World War I. Prior to World War I, the Congress had to vote on every bond
issue. And because of the size of the military actions in World War I, the thought
was we would give the Congress more breathing room to carry out the war before
having to reauthorize debt, because we all “know” that after the war, debt falls.
That again, is how it’s supposed to be.

Now, what do you suppose the picture looks like after 1970? I ask for the US, but
I could ask you for a European country, I could ask you for Japan; it’s just rising,
there are bumps along the way. We have periods of sobriety and bingeing, but
basically, we’re marching straight up. And you have to ask yourself what’s different about this world.

Now, the Kennedy thesis, which was clearly written in this period, still argued that it was military spending. Now, there’s no doubt that the United States spends a lot of money on the military, in terms of the aggregate dollars. But again, if you normalize by GDP, if you normalize by the scale of the economy, American military spending has been on a steady march down since the Second World War. And indeed today, most serious debate over defense spending in Washington, is whether it should be maybe three percent of GDP or four percent of GDP if you’re ‘hawk’, these numbers are small relative to what has actually been driving spending, which of course we all know is the change in entitlement programs.

The series of actions in the late 1960s and early 1970s, the founding of Medicare and changes in the structure of the social security program led to a huge march up in spending and debt accumulation in these programs. In 1971, Medicare and Medicaid combined, were only one percent of GDP. It was six times that last year, and we’re on track within the next decade to double again. If we carry the clock forward one generation, the Congressional Budget Office tells us that we’re going to spend about ten percentage points of American GDP more on just social security and Medicare than we do today, if we make no other changes.

Now, there’s a problem with that, because in the public eye, something must give. Herb Stein famously said something to the effect that something that’s growing too fast will stop; that we know. The question is how. The tax increases required to service debt like that would be an absolute growth killer for the economy. And if we tried to cut military spending, education, research, any other spending you want, there’s simply not enough of it left. You know, the public imagines that government spending is about what in Washington is called discretionary spending; defense, education and all those things. Those, as a share of the budget are declining.

Now, if the problem is entitlements, why isn’t it a technical problem? Well, this is not one that economists don’t understand. You could bring before you ten economists, five democrats and five republicans, and they may differ around the edges, but their diagnosis of the problem would be approximately the same. And the only sense in which they might differ is on the remedy; how much of it should be done through revenue increases or spending cut. But the notion of this being a huge problem is an absolute technical consensus; there is no one serious who I think would disagree.

The problem isn’t that; it’s politics. And to see why, I think you need to think about three things. One is the classic economist joke, the second’s the game of basketball, and the third is The Odyssey, the book.

Now, the classic economist joke; now this one pains me, because as you can tell by looking at me, I am the classic economist. And you’ve probably heard it, but in the off chance that you haven’t, I’ll put us all on common ground. So there’s a chemist and a physicist and an economist marooned on a desert island. You’re probably already feeling for the chemist and the physicist. And a can of soup or stew washes up to shore, and the physicist says, “Let’s beat it open and we’ll eat
it.” The chemist says, “No, no, no. That’s too messy. Let’s heat it, it will pop open, and it’ll be warm to boot.” And the economist famously says, “Assume a can opener.”

The problem with the technical arguments that dominate our policy discourse today, is we’re assuming the can opener. We’re assuming we have a good government. We’re assuming that the politics can do this if only the smart guy or gal on a white horse came in to do it. And that’s not true.

Now, here’s where the game of basketball is important. Basketball nearly died as a competitive sport in the 1930s. And it suffered from something written in that day that was called the “tall man problem.” So in that day with the structure of the court, in the absence of a shot clock or a three-point shot, winning the game could be possible simply by having the tallest guys. So if you have the tallest guys and you dominate the lane, you win. Now, that’s great if you happen to have the tallest guys. It’s really not exciting to watch, as it turns out, and there was a great deal of debate among basketball aficionados as to how to fix it.

Well, enter a man named Howard Hobson. Now, Howard Hobson comes to my attention because believe it or not, he writes a PhD dissertation at Columbia. So this is a day when college basketball coaches get PhDs from Ivy League Universities. It’s a different world than the one we currently live in. But Howard Hobson wrote a dissertation, it’s called *Scientific Basketball* if you want to purchase yourself a copy, and came up with the idea of the three-point shot.

Three point shots debuted in 1945, between Columbia and Fordham. Columbia wins, I’m pleased to say. It works its way slowly into college ball, pro ball, makes the career of one Michael Jordan, and makes an important point. Sometimes even something very successful has to change the rules.

Now the book *The Odyssey*, I think gives an idea about how to change the rules. We all know the story of the sirens – it’s one of my favorite stories from *The Odyssey*. It’s a story of temptation, it’s also a story of leadership and solving problems, I suppose, where the men are told to put wax in their ears so they can continue to do the real work of rowing the boat. The sirens’ song and appearance is so tempting, it’s great to pursue them except bad things happen to you, of course, if you go that route.

Now, what does our leader do; Odysseus? He lashes himself to the mast – that’s his famous response – thereby being able to take the opportunity of the sirens’ song, but not lose his life in the process. Now, the question is, what would it mean if we’re off track fiscally and our political institutions were built for a different era? How on earth are we going to change the rules and tie ourselves to the mast?

Well, I would argue that there’s light and heavy rope that we could consider. A light rope would be of the form let’s take the programs that are putting us in this circle, which are social security and Medicare, and take the change and accrue liabilities on those programs and put them on the budget. It’s exactly what a business would do. So if I own a business, and I promise things to all of you, I
have to account for that now, and I don’t get to delay the accounting for it in the future. Just have Congress obey the same rule.

That simple change would force the Congress to go to the American people annually and suggest that they need to raise taxes to pay for that, cut some other spending or change these programs; that is, make a choice. The current system is a kind of what Tim and I talk about in the book, of political prisoners dilemma gaming, where neither side has to make any sacrifices because there’s no choices; one side gets tax cuts, the other side gets spending increases, but our children, of course, get something else entirely.

So a heavier rope would actually be an amendment to the constitution. Now, I never thought that I would suggest this, but balanced budget amendments that have been currently considered have largely been poorly formed. I think most economists, certainly myself included, have been very skeptical about them, because they would exacerbate business cycles. Let’s suppose we ran a deficit in the middle of a significant recession, we don’t want to raise taxes, that’s a bad idea. But it doesn’t mean that we have to throw out the idea of lashing ourselves to the mast.

One kind of rule I talk about in the book, is the spending limitation that says, why don’t we take federal spending and limit it to a moving average of seven years inflation-adjusted revenue? I picked seven, honestly because it was in Pharaoh’s Dream, but if you like six, eight, nine, it doesn’t really matter; the idea is to average across business cycles. Inflation adjustment obviously gets rid of the problem of nominal and real. And differing from conservative brethren, I don’t think we should bias the Congress toward one solution or another; it is perfectly fine with me if the American people decided they want to raise taxes. I don’t happen to agree with it, but that’s a political call and it’s not mine to make.

So we would say that it should be symmetric, Congress can do whatever it wants, and in fact, Congress can have exceptions to this as long as it understands that with each passing year, an escalating super majority – three fifths, four sixths, five sevenths – would be required to have that departure from the rule.

Now, why am I optimistic that we can do something radical here? I mean it’s tempting to say, “These are problems we all agree, but there’s nothing we can do about it; we’re all fed up with politics.” But there are a couple of case studies in the very recent period that suggest some hope. Both Sweden and Canada nearly hit the wall. Both countries made very substantial, not just budget technical changes, but process changes to bring their budgets under control, and this is in the modern period.

Another source that I have, which may well be very controversial, has to do with competition for political ideas. I wrote an essay over the summer in Foreign Affairs that got me a fair amount of I would say negative mail, because I advertised my support for the Citizens United court decision. And my argument is that of an economist that, unwittingly perhaps, since the early 1970s, campaign finance laws gave a monopoly in fundraising to the democrat and republican parties.
So it’s not an accident that prior to this period, the bell curves of those parties actually overlapped substantially. After this period they pull apart as if they’re almost drawing balls out of two completely different urns. And any candidate is very dependent on his or her political party for support.

An open system, which is the Citizens United System says I can give money, not just in large amounts to the Republican Party or the Democratic Party, I can give it to whoever I want. You will see nutty ideas as a result, just as some businesses open up that should not, but competition is as valuable in politics surely as it is in business.

Now, I think it’s fair to say that this case study of praetorian guards through history – and they’ve taken on different identities – and each of these great power case studies suggests the importance of adaptive and malleable political institutions. It could be praetorian guards; it could be tutors and eunuchs, janissaries, teachers, or simply the forgetting of the future. And this is something on which we have to focus.

And to conclude, I think of this as being about sort of two pictures to summarize the fork in the road that we are now at. One, was I have a picture of Agatha Christie and here I’ve got a picture of Ben Franklin. Now, I always loved Agatha Christie books as a kid. I mean, what was not to like? I grew up in a small farm town, so to read books of posh castles and wealthy people coming for dinner parties with mystery; that was nice. And one of my favorites was, And Then There Were None. And in the book And Then There Were None, posh dinner party – everybody’s having a good time until someone is murdered. That put a slight damper on the evening as it turned out, but not for long, until someone else was murdered. And the title of the book gives it away, And Then There Were None.

That’s how great powers actually fall, they don’t fall from overstretch and military conquest; they fall much as in And Then There Were None. A political institution does not make the changes even when the murders – in the Agatha Christie sense – tell us it should.

But there is another fork in the road, and that’s a picture of Ben Franklin. One of my favorite Franklin stories was Franklin’s comment at the end of the constitutional convention, that he had been spending his daydreaming time, I suppose, staring at the back of George Washington’s chair and noticing that on the back of the leader’s chair was the sun. And he was trying to ask himself, “Was the sun rising or setting?” and he concluded that it’s rising.

There is every reason to believe that this nation’s assets and liabilities taken together will make it the preeminent economic power. The math behind that’s in our book, you could challenge it if you like. But it isn’t manna from heaven, and getting our political institutions right is an important part of the problems. I’ll stop there, but…

Speaker: [inaudible 0:32:28]

Glenn Hubbard: Sure. Okay.
Fred Bergsten: Glenn, thank you very much; much thought-provoking stuff. We’ll turn it over to our discussants already introduced: Steve Clemons and Charles Kupchan. Steve, lead us off, spend six, eight minutes if you can, and we’ll leave some time for discussion with the group.

Steve Clemons: [inaudible 0:32:54]. Glenn Hubbard is someone that I [inaudible 0:33:05] remember one time with working in the Bush administration – sorry?

Fred Bergsten: Hit your button.

Steve Clemons: I remember when Glenn was working in the Bush administration and gave a talk at the American Enterprise Institute, and I loved his honesty. Because that day, and the Bush administration had announced that they had just appointed, not Glenn, but someone else as the manufacturing czar. I asked Glenn how many jobs would be created by the manufacturing czar – you actually amended that, you said, “One.” And then he said, “No, no. Actually none. No, minus one, because it will take a job out of the private sector.” And it was just a very distinctive opportunity.

So I was looking forward to reading Glenn’s book, and I expected a different book than the one we have here. And with all due respect to Glenn, I expected a dense, tough to read, un-fun book on the economics of powers that would just be tough to get through. This is a highly readable, fun book that deals with the fall of many of the world’s great empires in a couple of hundred pages.

And so it is an interesting take to look at the mechanics, and I think it’s a fairly sophisticated job – even in the limited terrain you have there – of thinking about why empires or great powers or great states come apart. What sorts of characteristics there are in doing that? And there is a, at Cato Institute, a new website that’s just been done called www.humanprogress.org, that largely goes along these same lines and looks at the growth and gains, much that Glenn and Tim Kane go through, looking at the growth and gains in human society in general, and how much progress we’ve made.

But what I like about both that site and Glenn Hubbard’s take is that you can screw up, that states can become too centralized, too much power, that they cannot understand and see the right guardrails that are out; that there’s greater fragility in some of these states that are there.

And so in a way, what was also fun about this was Glenn goes through and sort of fillets alive many of the declinists, while at the same time essentially making an argument that America could be close to decline. I mean, it’s sort of an interesting treatment where on one hand you’re saying if we don’t get policy right, if we don’t fix our democratic experiment, you are in the basket with the declinists. And so it is an interesting struggle with itself internally, because he goes through a very hard to say he’s not of this ilk. I think he describes very well many others that have been there, primarily Kennedy, but the many other tributaries of declinist writing and thinking. My own wasn’t mentioned, but I probably am along some of those lines as well.
But I do think that in the end, you know, particularly at the end of this, you end up, Glenn, in a place where you say, if we don’t get the mechanisms of our democracy and essentially tie our hands in certain ways when it comes to this, that we will go the way of these other great powers; that’s the whole purpose of the book is essentially. That’s why you spend so much time learning about the lost empire of the Ottomans, looking at what happened with Japan. I really, really love the chapter on California, but the problem with the chapter in California is that fundamentally, and I think this – just to go through some of the limits of the book, I think in a friendly way – is that California is not like other great states; it is not a hegemonic force. Most great states essentially set the rules for the gravitational forces of the movement of capital, of investment, of finance, and they typically create a substantial gap between how things work for themselves, versus how things work for others.

So if you were to look at the United States system and the reserve currency status of the dollar, you look at the quid pro quo of the American workers by basically being the institutional builders after World War II, is that we were… the quid pro quo is we defend the world, we make big institutions, and ultimately the American middleclass benefits, not necessarily in ways that others don’t benefit. But the benefits were greater for a long period of time to a certain degree, as others rise in that system. And you have a system where United States is providing a lot of public goods for the rest of the world, but others are reaping those benefits.

Then it also becomes a way to discipline that system and raise the question of what was the rationale of how you organized it? But I think that the notion of bounded rationality, national identity loss avoidance and trying to kick things down the road in the way they look at all of these various former failed empires and failed key states in the world, was very useful.

What I found confusing is, I found it so useful that I found the discussion of democracy less relevant because you have lots of different kinds of government, and that the notion of then began looking at what the flaws of or benefits were of the US democratic system, I found to be a kind of, you know, that should’ve been Glenn Hubbard and Tim Kane Volume 2; it could be a very, very different sort of subject that came on down the line.

The other just fun comment is, I like this because when you look at the scale of history that Glenn Hubbard took on, you realize what an imprecise and lousy job many of those in economics and economic history have done. It’s such a fuzzy world that we can be looking at these stories, like the fall of Rome, China, what happened with Spain, which he calls, “The most fumbled empire ever,” which I love the distinction, that the empire that basically undid itself without the kinds of pressures that undid others. But in that, it continues to be something that we debate, and it continues to be such an imprecise science because politics does matter so much in all of these cases, and that proves to be the area where you can’t measure.

My final point would be, I liked very much the section, which I assume was the Glenn Hubbard section, on trying to define economic power, and looking at GDP and its functional relationship to productivity and some function of growth and
how you look at momentum, technology; you look at the span of a nation’s wealth in a less static way than we do in most of the GDP comparisons that we have. I thought that was a very, very strong element of it, and I think that it frankly deserves a lot more application than you were able to give it in this book.

And I think that when you look at the empires, though I think it would be hard to come with the same levels of data, it’s important and useful, I think, to come up with methodologies that look at these questions. I thought it was a really well-done chapter that you didn’t use. You gave us a lot of wonderful vignettes, but I thought that was very powerful and could be useful.

And my last – this will be my really last comment – the one element that I found missing in many of the treatments of comparative decline, or comparative economic strength out there or the debates today about the budget deficits, is the avoidance of discussing private sector debt as a key factor in the rise and fall of nations and economic shocks. That the book primarily deals with the public sector dimensions of debt, and not looking at the fact that many of the economic episodes that governments respond to were not just they were functions of private sector catastrophes, or private sector events that occurred that then precipitated the action of using taxpayer money or the coffers of the regime to apply to those problems, thus making it a different kind of public problem. But so there’s sort of an avoidance, perhaps unintended, of discussing the private sector dimensions of this, and how it fits historically.

And while you look at Reinhart and Rogoff – excuse me, Rogowski – I was going to say Rogowski – but Rogoff and Reinhart, when you go back and look – I’ve been looking at some of these data on private sector debt – when you get up to that 140, 150 percent of private sector debt-to-GDP, and you look at the massive buildup and availability of credit over a short period of time, you have something that if you look at European cases, you look at Asian cases, you look at US cases, you go back a hundred, hundred and fifty years, there are new data sets coming online in this area, you see major economic events happen. And that then causes the budget stress in the public dollars that come into this.

So I would just recommend that that would just strengthen this for the next volume of this you would do, but I really did enjoy the book; I do recommend it, and it was a fun, fast, great Glenn Hubbard read.

Fred Bergsten: Thank you Steve. Charles.

Charles Kupchan: Thank you Fred. Let me begin comment [inaudible 00:41:48] Steve said [inaudible 00:41:50] Adam first contacted me…

Fred Bergsten: Hit your button.

Charles Kupchan: When Adam Posen first contacted me to be a discussant this evening, I said, “Yeah, that’s a different venue for me,” I don’t hang out at IIE very often and I knew Professor Hubbard by reputation, so I said yes. And then I thought to myself, “I just committed to reading a book by an economist,” which I thought was going to be a fate worse than death. I probably shouldn’t say that in these hallowed halls, but I’m very pleasantly surprised to say that it was a really good
read. You succeeded in avoiding jargon and using history in such a way that it’s a fun book, and kudos for pulling that off.

Substantively, I really just had two issues that I wanted to raise: One that draws on Steve’s final comment about your power model. And just to – for those of you who may not have read the book yet – Glenn has a kind of aggregate measure of where different countries are in the global pecking order, by merging the concepts of aggregate GDP, growth, and GDP per capita, which is your measure of productivity. And it’s a really nice way of getting around some of the weaknesses associated with any of those measures independently.

The question that I wanted to ask you to say a few things about is the per capita GDP measure, because it’s something that’s always befuddled me in the sense that when you have a conversation, for example, about the rise of China, and you look at projections that suggest Chinese aggregate GDP will surpass that of the United States in, you know, ten to fifteen years give or take – assuming China doesn’t come apart at the seams – but a common rebuttal is; well that doesn’t matter because it’s all about per capita GDP.

And I have to say I don’t fully get that rebuttal, in the sense that the core issue in my mind, is not what China’s per capita GDP, it’s is China a state with sufficient competence and extractive capability to turn its aggregate GDP or some component of its aggregate GDP into geopolitical aspiration? Can it build aircraft carriers? Can it do things that would change the world, despite the fact that measures of per capita GDP, it remains far back in the pack. So if you could just talk a little bit about that, I’d find that particular enlightening.

And then the other issue – and this would be my main reservation about the analysis in the book – is that I found it oddly, that it deals with great powers in isolation and insulation; it’s not interactive. It’s not about the interface between Rome and non-Rome, between the Spanish and the outside world, between the Ottomans and the Europeans, and I think that’s a missing component in the book because yes, one can look at political institutions and say well, they ossify, there’s a praetorian guard, this is why X Empire declined. But if you don’t include the international and geopolitical component, I think you get a 1) perhaps narrow explanation for what’s going on. And let me just give you a few examples of what I’m talking about. And first, I’ll say a few things about the economic side of the equation.

I agree with you completely about Kennedy; I think he’s just wrong. And the historical record suggests that you really need to spend an enormous amount on defense before it starts taking a toll on overall economic performance – double digits, into the 20, 25 percent, and every once in a while, a great power does that – Japan in the Inner War Period, Nazi Germany after they got the war cranked up – but normally, great powers are in the two, three, four percent range, right? We’re now four percent Britain at the apogee of [inaudible 0:46:12] was about two percent. So at those levels, you’re not cutting into economic performance, and you could even argue you’re benefitting it because of spillover effects.

I would say that what’s more important than Kennedy, would be Bob Gilpin or Alexander Gerschenkron, the advantages of backwardness and the tendency for
nodes of innovation and productivity to move from the core to the periphery of the international system over time, in ways that creates this cyclical rise and fall. So if you were to say to me, "What’s going on in America’s position in the world that’s affecting our long-term prospects?" Yes, part of it is political paralysis, but a big part of it is globalization and the effect of globalization on the American economy and its effect abroad, right?

And so if you look at where we were 30 years ago and where we are today, or let’s throw our allies in the mix, right? The west, collectively, was about 75% of global GDP during the Cold War; it peaked at about 75%. We’re down to about 48% now, that’s not principally a story of the ossification of our political institutions; it’s principally a story of Gilpin and the fact that globalization has floated the boats of Chinese and Indonesians and Malaysians and Mexicans, and to some extent it’s come at our expense.

And it seems to me that there’s nothing we can do about that. We could get our institutions cleaned up, we could get our entitlements under control, we could pass a balanced budget resolution, we could do everything you suggest that we need to do, and this broad shift in the global balance of power would still take place, right? Because that’s just the way the world works.

Second way where I thought the interactive component was underplayed, is — I can’t remember which case study this is — but you say something like Rome didn’t fall because there were Barbarians at the gate; that may have been Ottoman, I can’t remember, but in reality, great powers often do fall because there are Barbarians at the gate. And in the case of Rome, the bottom line is, that the western empire after the split into the tetrarchy failed because it was invaded by Visigoths. And the Ottomans, they sputtered — I’m sorry — the Byzantines sputtered on for a while, but then they failed because the Turks conquered Constantinople.

And I think on all the cases that you look at, there was an external component. The Brits, they were doing okay, and then the Germans got uppity and built a high seas fleet and World War I and World War II come along. And in the same respect, as I said, we can clean up our house, we can get our economy going again at three percent growth per annum, we still face a China that is going to pose a serious challenge over the next two, three decades to the United States, in terms of its relative position in the world. So I’m wondering why that sort of interactive side of the house gets little attention in the book.

Fred Bergsten: Okay. Glenn, why don’t you respond to both your commentators, and then we’ll open it up for some floor discussion until about 5:30.

Glenn Hubbard: Okay. Well, first thanks very much both Steve and Charlie for those great comments. On yours, Steve, California is different; it’s not a hegemon, but we included it for a couple of reasons: First, it is very large; it’s one of the world’s largest economies, and we thought it was a good forecast of problems facing the US. Because here, you have a rich American state that’s fundamentally letting its politics bring it to heal. On economic power, the reason that we pick some of the measures we did really is data, that it’s very hard for the historical periods. Madison’s book enables you to go back into the 19th century, and a little bit for
the 1600s and 1700s, but for the early case studies, we’d be basically making it up, so we did not do that. And the private sector debt is a very good point.

Charlie, on yours, with the per capita GDP, I agree with you a hundred percent there, there’s a naiveté that all that matters is just the living standard. Going back the Smith, scale does matter for a lot of things in an economy. In China’s case, I guess Tim and I conclude that it’s still unlikely that China becomes a preeminent overall economic power – at least in our lifetime – because the interaction of those things is not likely to produce it. And in China’s case, I think there’s a huge risk, both to scale and growth from the problems inside the Chinese financial system. So I absolutely agree with you that we need to pay attention to China’s scale.

On the isolation versus integration, as you put it, yeah, we do deliberately take as a story-telling foil the notion that you fall from within and keep to that. I would not though, that if you look at data over long periods of time, it’s very hard for competing countries to catch up to the US level of income. Normally, countries top out, with some exceptions, and they’re, for special reasons, at 80 to 90 percent of US income levels, so there is something special.

It is not inevitable that the United States loses its grip. That’s probably the, maybe the most controversial part of the book; we just don’t think that’s baked in the cake, the notion that the US will be a less relatively important power, we don’t accept, but that is a conclusion that depends on policy. And I absolutely agree with your point on Gerschenkron, the great one.

Fred Bergsten: Okay, good. Just a data point on this relative position of the US; If you look at the last 20 years, the US share of rich country GDP has been growing steadily after the conversions that occurred in the post-war period up until about 1990, where Japan and Europe were closing in on the US, that topped out. And since that time, the US has actually been growing faster and has been reestablishing its lead among the rich countries.

Now meanwhile, the developing countries have been catching up, and that’s the convergence, but the question is how far that goes. The US role is kind of intermediary in between the other main groups, and that adds to kind of the doubts maybe, that there’s any inexorable decline.

Okay. The floor is open, I’ve got several hands. Anders, why don’t you start out and then we’ll come over here. We’ve got travelling mics and a standing mic at the back. Please introduce yourself and fire away.

Anders Aslund: Thank you very much. My name is Anders Aslund. I’m here at the Peterson Institute. Wonderful presentation and it sounds very plausible. Given that the problem is ossification of the politics, are you then advocating that the United States should change the constitution? That would be very refreshing. Thank you.

Glenn Hubbard: The answer’s yes, but there’s both constitutional change and process change; we talk about both in the book. The constitutional change would be the… some sort of spending limitation. And I note in the book, I didn’t say it in my oral remarks, that that’s not as farfetched as it might seem. On multiple occasions, one house of
Congress has passed some form of balanced budget amendment; 32 states have floated it, one needs 34 to get to a threshold. So this is not completely fanciful. The other process measure that I mentioned is competition in the political parties for somewhat dull reasons, math reasons; optimal number of parties in a first pass the post electoral system like we have is two. But it doesn’t have to be these two, so we need some more competition for ideas. That was my Citizens United point.

Fred Bergsten: Okay. We have a question over here.

Participant: Thank you for your excellent presentation. Ben Fairfax, State Department. But you talked mostly about fiscal policy, which I agree is critically important, but what about monetary policy? If the fiscal policy is out of whack the last two years, the monetary policy is even more out of whack. And of course, as you know, it can lead to higher interest rates – the higher inflation, the higher interest rates – which could have a tremendous effect on the US budget and also on US corporations, on your growth and so forth. So it seems like that should be, and it could have a lot of other [inaudible 0:54:40] effects.

The second thing is, what about; how do you convince the population of the US to support the common sense policies that you recommend? I was in Canada in the mid-1970s and the economy there was really out of whack – fiscal policy and so forth – but in subsequent years, they seem to have really got their act together, even to the point that during the financial crisis in 2008, the Canadian populace and all the political parties were very concerned about spending too much money, too much stimulus, because they could overspend and ruin their balance. So maybe that’s a good case study about how they got things right, but how could we do that in the US?

Fred Bergsten: Glenn, let me just add a footnote to the first question on monetary policy. In your presentation, you mentioned as one of the factors in Rome’s demise, currency debasement. You did not mention that elsewhere, but that has frequently been cited historically.

Glenn Hubbard: It has happened elsewhere, too.

Fred Bergsten: Right. But it’s hard to see that in the US now, unless you think the fiscal policy does eventually lead to that. So you might elaborate on that a little bit, which I think is probably the way to turn the monetary policy question into a meaningful possibility.

Glenn Hubbard: On monetary policy, I gave some remarks this morning at a Wall Street Journal event where I was quoted as saying, “The Fed is on a dangerous course,” and I do believe that. But I think it’s a course that has been said as much as anything else by the government’s failure, both the outgoing Bush administration and the incoming Obama administration, to have a fiscal policy that would have reasonably supported the recovery.

The biggest risks to the policy that I think the Federal Reserve is now pursuing are not that I expect some enormous burst of inflation, although that’s possible, but just the massive misallocation of capital that is occurring through this policy. I think the marginal benefits of it are low and the marginal costs are high, but I
don’t think it’s of the order of worry magnitude of fiscal policy, which is on a truly unsustainable trajectory.

How do we get the public engaged? I think it’s two things: One is awareness, and the other is forcing choices. Canada’s reforms in the ’90s were a great example of a public being aware that changes had to be made, and a series of rule changes forced choices to be made. Sweden also went through such an episode.

Right now, the American people don’t believe they have to make choices. If you look at polling data, people will opine that they do think, “Government is too big,” or, “Spending should be cut.” But when they’re asked about specific programs, they generally specifically say that social security and Medicare shouldn’t be touched. Well, we can’t get there if that’s the answer.

So I think part of this is education. Neither side of the aisle has done a good job in reaching out to voters on this; I mentioned the political prisoners’ dilemma game – that’s indeed what’s happened. You know, I’ll take my tax cuts and you can have your spending increases, and we just won’t talk with the public about the consequences. And unfortunately, that’s what’s happening.

Fred Bergsten: Glenn, if I might just pick up and extend that discussion of current policy, since you’re an expert on that. As you well know, much of the current debate just recently has said that the threat to the republic is not what you’re talking about, but the opposite; secular stagnation. So we need more stimulus. How do you respond?

Glenn Hubbard: No. But I’ll give a longer…

Fred Bergsten: How about analytically about the risk of secular stagnation?

Glenn Hubbard: [inaudible 0:57:57] give a longer answer to that, because that’s just… This is an example of a technical debate. So after the financial crisis, policymakers, I think, misunderstood the nature of the shock. So their policy responses made sense if this were a temporary aggregate demand shock, much as you would imagine in a typical recession. That is not at all what happens when you have financial meltdowns; you’re really getting at the plumbing of the economic system, so it’s really much more like a structural shock.

So for example, Larry Summers’ comments of targeted, timely, temporary; wrong. In that kind of system, what you would want is a long-term response, and the more clarity you have about the long-term, the easier it is to make the decisions you need in the short-term. That same advice goes in Europe as well, where near-term hair shirt policy is being pursued, when the real problem is the longer term policy that’s being left unchecked.

So I don’t think we need more stimulus. Having said that, I am very worried about the sluggish incomes, I’m very worried about the decline in the employment-population ratio in the non-American territory. And the number of prime-age men who have essentially left the workforce. These are all very unhealthy signs for the economy. The remedy for them though I don’t think is
classic stimulus as much as it is more of a jolt pro-growth policy. But that’s not on order.

Fred Bergsten: But you’re saying you basically believe Reinhart-Rogoff, that this was a huge financial crisis requiring a deleveraging period inevitably, and it made things worse…

Glenn Hubbard: Yes, but policy could have… if you… The thing about Reinhart-Rogoff, they almost say, well you know, when you have a financial crisis, you’re just stuck. I don’t think that’s true. Policy can take strong actions. So let’s go back to the financial crisis we went through. There were tools that were useful. The Fed did something very useful in intervening in the mortgage backed securities market to correct a market imperfection and the spread between mortgage rates and treasury rates.

We could have allowed a mass refinancing of home mortgages, which would have been a potent stimulus. We could have mimicked the negative interest rate that the economy needed by having massive investment incentives. But each of those steps required a diagnosis that said we are in a long-term problem, not a short-term problem. Go back and look at Federal Reserve forecasts around the time of the crisis. In fact, to this very day, you see, much like my discussion of the Samuelson textbook, a series of hockey sticks – growth will be three and a half or four percent tomorrow; tomorrow keeps sliding out. And I think we still are not treating this cycle the way we should.

Fred Bergsten: Steve, if you want to get in there then we’ll go a couple…

Steve Clemons: If I may, I just want to kind of pose a question, because the only chapter I really want to address with you and I wanted to try and understand more is the last, in which it seemed it was the most faith-based chapter in the sense you’d come up with all of these case studies of decline and of the characteristics of whether it’s ossification or just rigidity – the inability of a system to adapt. It’s also clear that you do believe that we’ve past that Rogoff-Reinhart tipping point, and you’re fairly bleak, which is what makes it interesting.

And then you end up in this chapter saying you’re not a declinist and you fundamentally believe in the system. And I’m trying to understand where that comes from, and how you’re not committing some of the same mistakes of some of the pundits you criticized, like Jim Fallows on Japan. One of the fun things about it, you’re very, very polite in it, but you take on a whole lot of people in how they’ve gotten their analyses at the time wrong, but I’m sort of looking at what are the intellectual dimensions of your belief in the system today, when you do such a good job showing why it’s not working?

Glenn Hubbard: Well, there is another book called Why Nations Fail. Some of you may have seen this outstanding book by Daron Acemoglu and Jim Robinson. And its thesis is about inclusive and extractive political institutions. In contrast, and this gets to the answer to your question, what we stress is how adaptive political institutions are. So the United States is at the top of the inclusive mark in the Acemoglu-Robinson, yet we’re the great power that’s in trouble. We are a democracy, we
are inclusive, we’re all those things and we’re struggling, and because it’s about adaptability.

In the past, America has shown an ability to adapt to major budget and economic challenges. And the economic power measures we show suggest that if we even stay on normal growth trajectories, we could still be the preeminent economic power. So it’s not faith that the US would have Chinese growth rates to pull this off, only that it returned to a period of normalcy, and I still think that’s possible.

Fred Bergsten: Question at the far back. Go on up to the mic.

Participant: [inaudible 1:02:54] Institute. I have two connected questions: One is I will try to follow the path that Fred suggested, just talking about, not only about the position of the United States within the rich countries, but also within several groups of rich countries. Some of them are increasing their share in the dollar-rich countries, some of them declining. And the relative position of the United States versus to the group of countries.

If I’m not mistaken, in the first group would be such countries like Hong Kong, Singapore – which we would not consider completely democratic – and probably Luxembourg and Normandy that are monarchies. So from these point of view, should we consider about the political changes, so changes in political institutions, again, this ossification – moving versus those kind of political systems that are demonstrated by those countries or by some other countries. If yes, which are?

And the second question concerning California. Assuming everything has been said about California, that is not a full country, full state and so on. Nevertheless, if California is not such a good example to follow for the United States as a whole, which alternative within the United States, which another state would you suggest as an alternative to California?

Fred Bergsten: Good questions. And Charlie, you should come in on that first question too.

Glenn Hubbard: Two great questions. One of the… We actually do have some tables in the book that get at your first comparison, and to Fred’s point that the US relative position remains very strong. As I mentioned, outside of some of the smaller, city state examples you mentioned, it’s very hard for economies to hit US income levels. In part, because the institutions that support productivity growth and technology are less strong, frankly, in much of the rest of the world, than they are in the United States. And that’s part of why this book is so optimistic about the states.

On the state of California, indeed we think California is the example. So California is a wonderful microcosm of America; it is a technological marvel. It is probably among the most diverse states, in terms of economic base. Then the question is; how can a state so rich allow its politics to put it at the forefront of virtual budget default?

A state like Illinois is truly a fiscal basket case; I hope none of you is an Illinois tax payer if I make that remark. California is not; it’s simply a political ossification. California has zero problem servicing the debt that it has; it’s simply
has institutions that don’t work. So we picked it precisely because we do think it’s a good example for the US. It is a great state that just needs to get its act together.

Fred Bergsten: Charlie, [inaudible 1:05:30] the international comparisons?

Charles Kupchan: Yeah, just two quick points. One is that I agree with what you said, Fred, about where the US is in this game. I mean, we’ve been holding relatively steady at somewhere between 23 and 25% of GDP. I guess I don’t find it particularly optimistic news that our key allies are the ones who are sinking. Because when I think about American power, when I think about Pax Americana, we could not have done it alone; we needed strong allies in Asia, and we needed strong allies in Europe. And if in fact, for demographic reasons, for reasons of ossification, the EU and the Japanese are in an irreversible sink, that’s not good news for us.

And then the second point would be on this question of adaptation. In the book, you say that there’s an over-centralization that takes place. And I just throw this out as a hypothesis. Aren’t there times in which adaptation occurs because there is a level of centralization? So for example, some economic historians feel that British decline was in part a function of a Laissez-faire political system in which there was not an ability to counter Germany’s kind of centralized cartels that allocated investment in a much more targeted way. And the British were sort of sitting around and had a very adaptive system, but so adaptive that they didn’t get with the program.

Or another example might be the Chinese today. They have a very centralized system. They’ve made some reasonably good choices economically, that allowed them to weather the financial crisis better than we have. So I wonder if adaptation isn’t sometimes better fulfilled by countries that have more centralized government.

Glenn Hubbard: [inaudible 1:07:25] something about that that. I think that is obviously the case that there’s sometimes centralized decisions can be better than decentralized. The Chinese stimulus package was much better than the American stimulus package. In part, because it actually diagnosed what happened in a way US policymakers didn’t seem to do.

But having said that, over the long sweep of years – you know, history is not usually kind to the notion that centralized decisions get it right – but the reason that I was gently teasing Kennedy’s cover about Japan inevitably eating the United States’ lunch, that was just so extraordinarily not likely to happen, nor is it likely to happen that China will, for the same reason. That China’s state-directed capitalism/socialism is doing very well at directing credit to an overinvestment economy, but China says it wants to pivot to a consumer-directed economy.

That means market or in institutions, but political figures get all their power from the allocation of credit. So I see this as a set of contradictions that just makes it unlikely for me. So I remain a Laissez-faire fan.

Fred Bergsten: Okay. Mike and then Barry, and we’ll have to close it at that.
Mike: Thanks. I want to pick up on a theme that has been played with, but I don’t think enough, and that is the way great powers respond to crises. You could take your analysis and look out and say it’s not just a question of how we deal with wars, but how do we deal with the stock market crash in ’29, the Second World War, the breaking of the link with the gold standard – you had a series of big crises, some of them military, but most of them economic. And the way the US responded was to create institutions; was to do reforms that actually created a basis for global growth that lifted all boats and our boat with it.

So I wonder whether part of the problem is, the last crisis we were sort of in the notion of Fukiyama, that we were beyond crises; that rational markets and the way the world was constructed, we didn’t have to worry. Maybe localized, regional crises; Asia, Russia, Mexico, but those would all be managed by the committee to rule the world. And along came this crisis – the financial crisis – that surprised everybody, and we weren’t ready for it; sort of like New Orleans before the dykes first collapsed.

And since no one – well, I don’t know that there… it seems to be that there is no real consensus that what we have done in response to the crisis has really fixed the dykes, so that we never have to worry again about another crisis, but rather the fault lines are still there, and a lot of concern that people aren’t really investing for the long-term, the way they did after the Second World War, under the Bretton Woods system; they made long-term bets before it was secure enough.

So my question is, shouldn’t we be thinking about the next crisis, even if we don’t know exactly where it will come from – because that’s what makes it a crisis – shouldn’t we be preparing the engineering plans for how to respond? Because what you’ve said is, the reason we don’t do all these things is there’s not enough political will. And what happened in the last crisis is that the dilemma of how do you recover if your reforms will actually complicate recovery, meant that we didn’t do all the things that we could’ve done to deal with the underlying problem.

So my question is, is there something to the notion that we ought to be preparing now with the agenda of reforms, that when the next crisis comes, that’ll give us the political will to make the reforms, we’ll be ready with the engineering plans for redoing the dykes once and for all.

Glenn Hubbard: I think the shortest answer to your question is absolutely. I mean, most good policy economists work on things all the time because you never know when a political situation will happen and the leader will tap you on the shoulder and say do you have an idea about this or that? Unlike military and foreign policy planning, where scenario analysis happens all the time, there’s way too little of it in economic policy, and we have become incredibly complacent.

I mean, the comments that were coming out of the Fed before the crisis sounded eerily like Arthur Burns’ presidential address to the American Economic Association in the 1960s, where he argued the business cycle was dead. It was the same sort of thing that, you know, there may be idiosyncratic problems with
the washout; there really isn’t any aggregate risk. That of course wasn’t true. And I think, what we need to do is sharpen the Fed’s attention on financial instability – really focus it as part of what they need to be doing.

So I think that we could make a process change there that would make it more like the scenario planning we do in foreign policy and the military, because once again, we’ve become complacent. Dodd Frank wasn’t that related to the crisis we actually went through. That doesn’t mean it’s all bad, there’s actually some very good stuff in it, but it really didn’t fix the issues that were there before. So there’s no reason to believe it couldn’t happen again.

Fred Bergsten: Last question, Barry.

Barry Wood: Barry Wood, RTHK in Hong Kong. Glenn, what do you think are the likely events or triggers that might get the United States into this needed debate on fiscal policy? Is it going to be, do you think, high inflation, high interest rates, continued sluggish growth?

Glenn Hubbard: Well, one hopes it happens gradually while there’s the chance to adjust policy in a way that’s not harmful to many people. But I fear that just when I described the Canadian and Swedish situations, those didn’t happen because of a gentile discussion over many years, they happened because of crisis. And if you asked me to map out what might happen in the US, if we just return to a normal term structure of interest rates – not an interest rate spike, just say, pre-crisis term structure of interest rates – and ask what that does to the budget of the Federal government, I think it will be a shocking experience to many on Wall Street who’ve just ruled out that as a possibility.

The government’s been effectively borrowing at 0%. That would change in that world and I think highlight the attention. And the continuing problems we’re facing in discretionary spending, I think, are forcing many politicians to think about, “Well, what are the limits to this? We know we can’t keep raising taxes, but nor can we stop education, stop defense. How are we going to fix this?” I have to hope that that will call the question.

Fred Bergsten: Steve or Charles, any last words of wisdom? I will add to the recommendation to buy Glenn’s book at the same time of course, that you buy several new Institute books for your Christmas reading list in general.

Congratulations to Glenn on the book. Thanks very much for joining us. Thanks to Steve, to Charlie, for rounding out the discussion. Thanks to all of you. Meeting adjourned.