The Economic Club of New York

311th Meeting
79th Year

E. Gerald Corrigan
President, Federal Reserve Bank of New York

and

Edwin Meese
U.S. Attorney General

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Questioners: James C. Goodale
Attorney at Law, Debevoise and Plimpton and
Formerly General Counsel and Vice Chairman
of the New York Times Company

Ralph F. Peters
Chairman and Chief Executive Officer
of the Discount Corporation of New York

Introduction

Dwayne O. Andreas, Chairman

Mr. Corrigan, ladies and gentlemen, welcome to this 311th dinner in the 79th year of the Economic Club of New York. In a moment I will introduce the first of tonight's two speakers. But first, a little Economic Club family business. It is a special pleasure to welcome back to the head table as an honorary member of this Club, our former President, Ed Locke. Ed retired from the Club presidency last summer to become President of a newly formed savings bank here in New York. For eight years Ed served the Club with great distinction and dedication. He made many warm friends among its members. I aspire to be one of them. We owe him an enormous debt of gratitude for the fine work he did and the shape the Club is in. Ed will you please show yourself. (Applause) I would also like to welcome our new President, Ray Price. Ray has spent most of his life in the public policy arena. Twenty years ago he ran the editorial page of the *New York Herald Tribune*. More recently, he served in the White House as a special consultant and chief speech writer for President Nixon. He is an author, an editor, a syndicated columnist. He comes to us from the staff of CBS founder William Paley. We are delighted that he is now going to look after the affairs of the Economic Club. Ray, welcome aboard. (Applause)

Each of our two speakers tonight heads a major public institution. They are also both exceptionally close to their respective bosses. If President Reagan has an alter ego, it is probably Ed Meese. If Paul Volcker has an alter ego, it is probably Gerry Corrigan. So we have a pair of

speakers tonight who represent the Executive Branch and the Federal Reserve System with extraordinary authority. We will be hearing first from the President of the Federal Reserve Bank of New York, E. Gerald Corrigan. In the Federal Reserve System, the President of the New York Fed is widely considered second in importance, only to the systems Chairman. As you know, the Fed of New York executes the system's monetary policy by buying and selling government securities. It intervenes in foreign exchange markets on behalf of the Feds and on behalf of the Treasury. The heads of the other regional banks rotate on the policy making open market committee, but the New York President is the committee's permanent Vice Chairman. When there is a crisis to deal with, Chairman Volcker often reaches out for his old friend Gerry Corrigan. He did that in the collapse of the Drysdale Government Securities and he did it again with the troubles at Continental Illinois. Gerry is a Fordham trained economist. He spent 12 years at the New York Fed before being named President of the Federal Reserve Bank of Minneapolis in 1980. When he was chosen, a little over a year ago, as President of the New York Bank, he was still only 43 years old. So I guess that makes him one of the younger members of the Economic Club of New York. Gerry, we are delighted that you are with us here tonight, ladies and gentlemen, the President of the Federal Reserve Bank of New York. E. Gerald Corrigan. (Applause)

The Honorable E. Gerald Corrigan

President, Federal Reserve Bank of New York.

Thank you Dwayne that was very kind indeed. Let me say, if I may, Mr. President and Mr. Attorney General, and distinguished members of the dais, ladies and gentlemen, as I sat here tonight and took a gander at the dais, I had a little bit of a feeling that my life was kind of passing in front of me. I looked over my right shoulder and I saw Frank Wright, a prominent banker from Waterbury Connecticut where I was born and brought up. I looked to my left and I saw Malcolm Wilson, one of the most prominent and distinguished graduates of Fordham University. I spent a little time there. And I looked around a bit again, and I saw G.G. Michelson, who in my early incarnations at the Federal Reserve Bank of New York was one of our Directors, and indeed became the Vice Chairperson at the bank. I looked to my right and I saw Dwayne, who for 25 years or more was one of the pillars of Minneapolis and for those of you who know me well, you know something of my affection for Minneapolis. I turned to my left, and you will excuse me Jack, and I saw Jack Welch, the Chairman of General Electric, and one of my current directors at the Federal Reserve Bank of New York. Shy and reserved as he is, Jack manages to contribute. (Laughter) I turned further to my right, and I saw the distinguished Attorney General, and I got a little concerned. I looked over my shoulder and I said, my God he may be upset, about junk bonds or something else. (Laughter) And I looked out in the audience and I saw a group of my distinguished colleagues from the Federal Reserve Bank of New York and indeed, if I can put it that way, that does cover a very important part, indeed, in some ways the essence of my life. So Mr. President, I am delighted to be here.

But it is also, if I may say, a particularly apt time for my appearance before the Economic Club

of New York because it is that time of the year when most economist pundits render their judgments about the outlook for the year ahead. And as I look at those, the consensus seems to suggest that we are looking forward to a year of moderate growth and restrained inflation. Coming on the heels of three years of expansion, and considerable progress in containing inflation, that outlook should be music to our ears. And indeed, looked at, in the context of the gains in the stock and bond prices in late 1985 and the recent signs of strength Jack in employment and retail sales and housing that relatively happy view of 1986 is perhaps not all that surprising, but having said that, let me hasten to add that I am not so sure of the outcome, that I think any of us can afford to take the year off. To the contrary. I believe the challenges we face in seeking to sustain non-inflationary growth in the U.S. and around the world are growing, not receding.

I say that with full awareness that the performance of the past three years had been better than most would have guessed. Indeed who among us back in those very difficult days of 1981 and 1982 would have been willing to say with confidence that we would be well into the fourth year of an economic recovery in which the growth of domestic demand has been very strong, with inflation remaining below 4%. Yet, neither the progress of the last three years, nor the good economic statistics of the past three weeks, should divert our attention from the presence of serious and persistent imbalances in the U.S. and the world economy.

To put it differently, if we are to capture that elusive goal of sustained prosperity, more work,

much more work needs to be done. When I speak of imbalances I have in mind several areas of particular concern. First, the budget deficit is still there. Second, our external deficits are still there. Third, the LDC debt problem is still there. Fourth, sluggish growth in the other industrialized countries of the world is still there. These imbalances and potential sources of instability are not new, in fact, they have been with us for some time. That being the case, two questions suggest themselves. First, is how do we reconcile their longstanding presence with the relatively good performance of the U.S. economy over the past three years. The answer to that, of course, is that these imbalances have already been very costly. In part, they have created a two-tiered economy in which some sectors are doing well and others are in rather dire straits. Beyond that, even greater costs have been papered over by an unsustainable dependence on foreign savings.

The second question that they raise is how do we reconcile the presence and scope of those imbalances with that consensus economic outlook I described earlier. One possible answer is that our heads are in the sand. While we cannot rule that out completely, I want to suggest another more positive interpretation. Namely, that the events of the last several months may be giving rise to a sense that concrete initiatives are now on the table, which hold out some promise for coming to grips with these problems in more decisive ways.

Allow me, therefore to focus the thrust of my remarks on where we stand in our efforts to deal with those imbalances. As a point of departure I want to stress once again, that the budget deficit

and our external deficits are closely interrelated. The nature of that relationship and its policy implications can be best illustrated by looking at the current picture in the U.S. regarding the sources and uses of savings. For 1985 for example, our net domestic savings flows amounted to about 8% of GNP. In that same time period, the financing requirements of the budget deficit were 4.75% of GNP, while the financing of total net domestic investment was about 5.75% of GNP. Thus, the combined public and private financing needs of about 10.5% of GNP, relative to those meager domestic savings flows, the savings flows on the domestic side were about $100 billion or the equivalent of 2.5% of GNP, smaller than the savings we actually used. That savings gap which is of unprecedented proportions in the modern history of the United States was of course filled by foreign savings. Looked at, in that light, our dependency on foreign savings can be reduced only and I emphasize this, only by some combination of higher domestic savings, lower domestic investment or lower federal deficit.

Since a near term rise in domestic savings is not at all likely, and since a drop in domestic investment is clearly not a good answer, reducing the deficit is the only real alternative we had. And even that, will not yield quick and easy results. Faced with that reality, some would seem to suggest or advocate a quick fix via the exchange rate or via protectionism. However, seeking to reduce the trade and current account deficits to a near term and sharp fall in the exchange rate, or even worse, by erecting artificial barriers to imports, will not do the job. Since neither of these tactics, whatever their many other limitations are capable of filling the domestic savings gap that is there, so long as the budget deficit remains. Indeed, taken by themselves, either or both of

those approaches run clear risks of triggering a disorderly adjustment which would take the form of higher interest rates, lower investment and higher inflation.

With that perspective in mind, deficit targets along the line contemplated in Gramm-Rudman, provide a framework for getting the bulk of the problem behind us, providing of course those targets are hit. For example, those targets contemplate a 1988 budget deficit of about 2% of GNP. In those circumstances, and even with domestic savings and investment running at about their current rates, we could absorb a significant drop in foreign savings inflows without engendering undue risks of an interest rate or an exchange rate response that would be damaging to the U.S. and the world economy.

Now all of that merely underscores the critical importance of securing a near term outlook in the budget along the lines contemplated by Gramm-Rudman. Even if each of us has our questions and doubts, whether impractical or constitutional grounds as to whether the formulas and mechanics in Gramm-Rudman are the optimal way to achieve that result. Indeed, what seems to me important right now is that we have a broad-based consensus in the Congress and in the country at large to the effect that the budget deficit simply must come down and come down decisively. But let us also keep firmly in mind that an intellectual consensus is one thing, actions to back that consensus are quite another. Particularly when the economics of the situation suggest that the lion's share of the adjustment must come from politically charged cuts in government spending.

Now while the burden of adjustment rests heavily on our success in reducing the deficit, it can be eased by complimentary developments in the international arena. We have already seen evidence of progress in this regard in the form of the G5 understandings reached here in New York in late September. Since that time, we have witnessed a pronounced and generally orderly appreciation in the value of other major currencies relative to the dollar. While recognizing the risks I mentioned earlier that a precipitous and disorderly fall in the dollar exchange rate would pose, I consider the post-September 22 developments in the exchange markets to be broadly constructive. Having said that, we must be cautious in our assessment about what has been achieved and realistic in our assessment as to what more needs to be done. Thus, at the use of a purely hypothetical example, if the trade deficit were to be reduced by about 30% from its fourth quarter 1985 annual rate, it still would be $100 billion a year. In that setting, many of our domestic industry would still be under severe pressures and our external debt would still be growing at a rate that in my view is unsustainable. Looked at in that light, and even assuming the fundamentals of policy in the United States are working in the right direction, the horns of the dilemma are sharp indeed. For the needed adjustment in the U.S. trade account can only come about in the context of a significant reordering of world trade patterns. And, that reordering cannot take place largely at the expense for the trade surpluses of the developing countries. Such a result would impair their ability to earn the foreign exchange they need to satisfy their financial obligations, thereby introducing still another and a still greater source of instability.

Thus, the adjustment in the U.S. trade deficit must come importantly from smaller trade deficits

with our industrial country trading partners. And the only way that can occur while maintaining and hopefully increasing growth in those countries is by faster growth in domestic demand in those nations. To put it differently, faster domestic growth in the other industrial countries is not a luxury, it is a necessity. Now to date, and despite very high rates of unemployment in most cases, the authorities in those industrial counties have been reluctant to adopt more stimulative policies. That reluctance seems to be based on two factors, first, most are waging their own battle of the budget and in a number of cases they are winning. Against that background and the background of already large public sectors, most are quite reluctant to adopt fiscal measures that even temporarily run the risk of reversing the gains they have made in lowering their deficits and reducing the size of government. On top of that, concerns remain about rekindling inflation, especially in a context in which lower interest rates in those countries might be associated with renewed depreciation in their currencies.

Yet, in a setting in which the U.S. budget deficit is finally coming down and inducing an orderly adjustment in interest and exchange rates over time, there clearly would be greater opportunity for more growth oriented policies in those industrial countries. In fact, there are scattered signs that suggest in some cases that growth may already be strengthening a bit.

I certainly hope that is the case, for looking at the world economy it is very difficult to see how we can reduce the U.S. external imbalances and sustain needed growth and world trade unless we have more rapid domestic expansion in the other industrial countries.

Now the remaining element in the equation is the outlook for the developing countries. With special emphasis on the debt burdened nations in this hemisphere. And let me be brief here. I don't believe it is at all necessary to recount for this audience the enormous strides that have already been made over the past three years in this area. But here too, more work needs to be done. And in recognition of that, Treasury Secretary Baker has outlined a framework for dealing with the next phases of restoring economic and financial stability to the LDC's. That approach contemplates growth and structure reform in the LDC's themselves, increased financing by the World Bank and the other multilateral development banks, and modest increases in lending by the world community of commercial banks.

The approach suggested by Secretary Baker deserves and is receiving broad-based support. The President of the World Bank, the Managing Director of the IMF, the G5 Finance Ministers, the Governors of the G10 Central Banks, and a broad cross section of banks here in the U.S. and around the world have all expressed their support for the initiative. What is needed now, of course, is for the individual developing countries to come forward with their respective economic and financial plans so that the implementation phase of the approach can proceed.

Now as I said a moment ago, the approach suggested by Secretary Baker has received broad-based support, but it is also fair to say that there are some skeptics. Skeptics who say it simply can't work. The fact of the matter is it can work and work well under quite reasonable assumptions. For example, within a framework of moderate growth in the OECD countries, over

the ‘85 to ‘88 period, the economic and financial results for Latin American countries and for the world economy could be surprisingly good. By way of illustration, those assumptions and the added financing contemplated by the Baker Plan could support an outcome in which the Latin economies are growing by 5% per year and one in which the ratio of interest payments to exports falls significantly and one in which there is a sharp recovery in Latin American imports, including imports from the United States.

In short, the arithmetic does work, but only if appropriate economic policies are followed in the developing countries. The payback for sound policies is substantial and clear. But so too, are the consequences of economic mismanagement, which fosters inefficiencies, capital flight, inflation, and instability. The stark contrast between these two alternatives, provides a powerful incentive for all parties, the LDC’s, the multinational financial institutions, the banks, creditor governments and the business community at large, to do their part in seeing to it that the cooperative efforts needed to achieve those gains are indeed forth coming.

Now to come full circle, I spoke at the outset of my remarks about four areas of serious imbalances in the world economy. In elaborating on the nature of those imbalances I have tried to suggest that while they are serious, policy initiatives are underway to deal with them. Still, when one steps back from the specifics, two overriding considerations emerge. The first is that the problems and their solutions are interrelated. Thus, if we fail to deal with any one of them, our success in meeting the others will be seriously impaired.

The second, flows from the first. Namely, fitting together these ingredients for sustained prosperity is going to require a heightened degree of international cooperation and a greater worldliness on the part of all to cast aside narrow conceptions of what is or what is not appropriate in favor of that longer, broader vision of sustained prosperity. In saying this, it should also be emphasized that the clock is ticking. We cannot wait another year to get on with the task of implementing policies to deal with these problems. To do so, would only elevate further the dangers that adjustment will be forced on us in a painful and destabilizing manner.

In closing, let me state what I hope is obvious. That is, in our efforts to achieve that sustained prosperity we simply cannot permit a re-emergence of inflationary forces to develop in our economy. The terms inflation and sustained prosperity are mutually exclusive. I stress that because sooner or later we will reach that point in the business cycle. Weak oil prices notwithstanding. When it becomes all too easy to be seduced into the belief that a little more inflation is manageable. The difficulty with this is that the inflationary process by its very nature is such that a little more inflation tends to build on itself and become a lot more inflation. Let us also keep in mind that an inflation rate of even 4% is a long way from our historic view of price stability. To put it differently, inflation may be down, but I don't think it is at all prudent to conclude that it is out. Thus, the imperatives of financial discipline remain. A discipline which must start with the maintenance of non-inflationary monetary policies, but must also encompass prudence and caution in the management and operation of our financial institutions and markets. A breakdown in either of those elements of financial discipline would seriously impair, if not

irreversibly reverse our prospects for dealing with these other problems and endeavors. Central bankers have a natural and continuing interest and indeed a responsibility to see to it that financial discipline is maintained, and as one central banker, let me say to you as forcefully as I can, that we intend to do our part in seeking to maintain that discipline. Thank you. (Applause)

Dwayne O. Andreas, Chairman: Thank you Gerry for those most enlightening remarks. I am sorry that you felt sort of in a state of siege here, but I assure you, you are among friends. Have no fear. Our next speaker has been called the most interesting Attorney General and the one closest to his president since Robert Kennedy. He has also been called the one with the most ambitious agenda since Franklin D. Roosevelt's Robert Jackson. One thing he has never been called is a shrinking violet. To my mind he is also one of the most refreshing figures in official Washington. We have all known political people who consult polls before they consult their conscience, Ed Meese does not. When he finds that he is out of step with the crowd he explains to the crowd with impeccable logic why it should get in step with him. He is a man of principle who believes in fighting for his principles. And he does so with good grace, with dignity, and with decency. He is a graduate of Yale and Berkeley, a former law school professor, a former public prosecutor. But it has been as the strong right arm of Ronald Reagan, or as some say, the keeper of President Reagan's conservative conscience, that he has become a major national figure. He was Chief of Staff to Governor Reagan in Sacramento. He was Chief of Staff to Candidate Reagan in 1980. And then he was Counselor to the President as a member of Reagan's Cabinet in the White House. Whatever touched President Reagan's policy agenda at the White

House was Ed Meese's business and it still is. Since last February he has been the nation's chief law enforcement officer as Attorney General. And he has also been a member of the National Security Council and Chairman of the President's Domestic Policy Council. When Ed Meese speaks, the President listens. And tonight it is our privilege to listen too. Ladies and gentlemen, the Attorney General of the United States, the Honorable Edwin Meese, III.

The Honorable Edwin Meese, III

U.S. Attorney General

Thank you very much Dwayne for your very generous introduction. And thank you ladies and gentlemen for your warm welcome. I am particularly pleased to be here this evening at what I have found is the inaugural meeting of your new President, Ray Price. Ray is an old friend, as a matter of fact; it was from Ray Price in our Yale Political Union days many years ago that I learned that I was conservative. A fact which was invaluable to me when Governor Reagan asked me to work for him in California. (Laughter) And Gerald Corrigan, I was tremendously impressed with the message you brought to us tonight. And also the challenge that was there, which I know the Federal Reserve system will certainly live up to its challenge, I only hope that those of us in the Executive Branch and our colleagues in the Legislative Branch can do as well. I want to assure you that we are not at all upset about junk bonds and I hope you are not upset about nonbank banks. (Laughter and applause)

I recognize that I am probably one of the few lawyers here this evening. (Laughter) That is not a new experience. It was kind of that way in the White House. And believe me, it is the other way around, Dwayne, it is when President Reagan speaks, I listen. And one of the things I listen to is what he has to say by way of humor, as Alan Greenspan and I were discussing. Because he has the finest repertoire of lawyer jokes of anyone I know. It wasn't long ago that he told one about the lawyer who had passed away and went to heaven. And as he was approaching the pearly gates he was quite astounded because there was quite a crowd gathered there. And in addition to the crowd, Saint Peter himself was in attendance, and beyond that, the heavenly equivalent of the Mormon Tabernacle Choir was there to provide music for the occasion. And he went up and he said to Saint Peter, I don't understand, what is this all about. And Saint Peter said, well Sir, it is for you. And he said, for me, I don't understand this. I can't believe it. I have been a relatively good man in my life, but nothing that deserves anything like this. Well Saint Peter said…well there are a couple of reasons. First of all, we don't get all that many lawyers up here. (Laughter) And we have never had one before who is 274 years old. Well the lawyer said to Saint Peter, there must be some mistake, I remember distinctly on my last birthday I was 63. No, said Saint Peter, there is no mistake, you are 274. We verified your age by counting up the hours on the time sheets you used to bill your clients. (Laughter)

Well I am sure that it is no secret to this group, that President Reagan and this administration has some definite views regarding economic philosophy. A fundamental confidence in the productivity and the justice of a free-market system, a free-enterprise economy underlies many

of our policies. But the importance of economics has been rediscovered by others too. Debates over economic theory abound both inside and outside the government, on a number of questions of public importance, and in recent years, more and more these have become a very celebrated aspect of our national political dialogue. This is as it should be, as was revealed in the very important remarks of the previous speaker.

Interestingly, many of the more significant participants in these debates on economic policy as well as some of the government's key economic decision makers, turn out to be lawyers. And I realize that, that might give many of you pause, but as we look at it really economics is more and more being thought of in some ways as a science rather than an art. And with increased technical means, mathematical tools are becoming an even more important and more sophisticated part of the economist's craft. And as you know, there is a suspicion that lawyers do not usually distinguish themselves with numbers. As a matter of fact there is a story that goes around the law schools whenever financial matters come up, where one student says to another, don't ask me to figure it out, if I could count, I would have gone to business school instead.

But even acknowledging this handicap, it remains true that regulating economic institutions has always been a preoccupation of the law. In Roman times there developed a very sophisticated legal system emphasizing the distinction between personal and real property and between the concept of ownership as opposed to mere possession. In Medieval England the growth of the common law was in large part a development of the law of title and inheritance, of determining

rights to the possession and enjoyment of the land. By the time of the American Revolution legal thinking about economics centered on a philosophy of natural rights, and again, the right to property.

Blackstone and Kent whose writings greatly influenced the founding generation of our country declared that the three absolute rights of man included personal security, personal liberty, and personal property. And it is by propitious coincidence that 1776 was the year in which there was the publication of both the American Declaration of Independence and Adam Smith's book, "The Wealth of Nations". Well today as we approach and prepare to celebrate the 200th anniversary of the Constitution, most public and editorial discussion of our great charter focuses on the importance of the constitution as a blueprint for government and as a protection of individual rights. And certainly the framers deserve our eternal gratitude on both of these counts. But focusing only on these aspects tells only a part of the story. It forgets that the Constitutional Convention in Philadelphia, and several of the most important provisions that are in the Constitution, actually grew from the founding fathers dismay over the national economic situation and the way in which national economic affairs were conducted under the articles of Confederation, when that instrument prescribed the first attempt of our nation at a national government.

The Constitution reflects to a great extent the concerns of the framers with the well-being of this republic. One historian has noted that the Constitutional Convention was called because the

Articles of Confederation had not given to the central Federal Government any power to regulate commerce. The biographer of John Marshall adds that although it must be said that statesmanship guided its turbulent councils, finance, commerce and business assemble the historic Philadelphia convention. More than one commentator has opined that perhaps the greatest achievement of the Constitution was that it prevented that new collection of states from becoming insular, vulcanized fiefdoms of economic limitation by making possible a truly national economy.

The Constitution is quite explicit as I am sure many of you know, about some basic economic rights and the promotion of commerce in a number of its provisions. Section VIII for example of Article I gives Congress the power to regulate commerce. The same Section empowers Congress to coin money, to establish uniform bankruptcy laws and to borrow on the credit of the national government. I think Gerald, that is where it all got started. Section IX prohibits the states from impairing the obligation of contracts. And the Fifth Amendment requires that when the Federal Government takes private property for public use, it must give the owner just compensation. I would suggest to you that taken together these provisions clearly show the framers concern with commerce and trade with the sanctity of property rights and with the freedom of contract. Another words very important economic aspects of its provisions. Thus, it would be a mistake to view these provisions as merely some odd bed fellows that happen to creep into a document concerned primarily with individual rights.

The framers were interested in a vibrant national economy. But more importantly, they perceived that property rights and economic rights were among the basic rights of man. We see the same philosophy, interestingly enough, among those who frame the post civil war amendments to the Constitution. In protecting civil rights from racial discrimination, the framers of the 14th Amendment understood that the concept of civil rights taken as a whole included important economic rights as well. At the Civil Rights Act of 1866 was the forerunner and laid the basis for the 14th Amendment which was adopted in 1868. And that Civil Rights Act of 1866 provided specifically that citizens of every race shall have the same right in every state and territory to make and enforce contracts to sue or be sued, to be parties and give evidence, to inherit, purchase, lease, sell, hold and convey real and personal property...(CHANGED AUDIO SIDES) ....on a full and equal basis, in the economic life of this country.

Well, there has been a great deal of debate over the years about just what these economic rights should be. From around the turn of the century until approximately the time of the New Deal for example, courts employed a doctrine of substantiative due process to strike down the ability of the Federal Government in its many attempts to regulate the economy. Not everyone agreed that that was the right way or that this was compelled by the Constitution. Indeed, Justice Holmes once chastised his colleagues in a particular case by saying “The Constitution does not enact Mr. Spenser’s social statistics”. But this doctrine did not endure. And as we know with the New Deal, the government itself got more and more involved in the active management of the economy. And as we also know the court went along with it.

Initial Supreme Court opposition to the New Deal programs melted when the famous so called Switch in Time found the court deciding generally to uphold New Deal programs and thus taking the steam out of President Franklin Roosevelt's attempt to so call pack the Supreme Court.

Coming forward a half century, there are several arenas today in which sound economics and the law have sometimes been in conflict. Let me touch on just a few of these in my remarks tonight. We might first look at antitrust law. Although originally enacted to promote consumer welfare the antitrust statutes were almost from their inception subjected to overly expansive interpretations by the Federal enforcement agencies, as well as by private plaintiffs who were seeking a competitive advantage. In many instances, these theories actually had as their object the inhibiting of vigorous competition, so as to protect less efficient competitors. Also a problem was that many of the judges originally hearing the antitrust cases often lacked any type of business experience, let alone any real knowledge or formal training in economics. So the seemingly inevitable result of this combination of circumstances and incentives was the development of numerous antitrust doctrines which reduced, rather than enhanced the consumer welfare. Over the years, some of these doctrines have been modified by legislation or case law, but today there are many experts and many observers who feel that a number of antitrust concepts are not appropriate in an age of global markets and rapidly advancing technology. Indeed, your Chairman, Dwayne Andreas recently headed a task force which came to that conclusion. And even more recently, Secretary of Commerce, Malcolm Baldrige suggested that Section VII of the Clayton Act ought to be repealed in its entirely. And that got a little bit of

attention around the country. In an effort to modernize antitrust laws and to ensure that they are not used to hinder legitimate competitive activities, President Reagan last year directed our Cabinet to review, analyze, and propose necessary changes in the antitrust statutes and regulations. This work was completed toward the end of last year, approved by the President and now several proposals to reform the antitrust laws will be introduced in Congress this session. These proposals are designed to modernize the nations antitrust and related international trade laws in four important areas.

First, remedies, secondly, merger analysis, third, interlocking directorates and fourth import relief. And I will very briefly summarize some of the proposals this evening. We believe, for example, that the time has come to reform private antitrust remedies. Our remedies proposal will address several related problems that exist in the incentives and disincentives that are now facing antitrust litigants. At the outset of this discussion I should emphasize very clearly that the administration recognizes the positive role that private antitrust litigation can play in punishing wrongdoers as well as in deterring antitrust violations. But the current system of incentives to sue and settle antitrust cases does not distinguish between those private cases that are likely to promote competition and those suits designed only to advance the interest of one or more competitors, often at the expense of competition itself.

Therefore, we propose changes in the rules pertaining to treble damages, attorney's fees, and the amount of claims. By limiting the treble damage remedy, to consumers or businesses which have

actually been injured by reason over overcharges or perhaps undercharges, we will properly focus the full deterrent force of private treble damage enforcement on unambiguously anti-competitive practices. Victims of these practices will thereby retain the needed incentive to discover and challenge clearly harmful behavior. In cases alleging other types of harm, however, limiting recovery to full compensation addresses the over deterrence problem but does not deprive a plaintiff with a just cause of a complete recovery.

Next, our remedies proposal would also address the current imbalance in antitrust laws regarding the awarding of attorneys fees. Currently, as many of you know, only prevailing plaintiffs are entitled to reasonable attorneys fees. To prevent lawsuits that are aimed at harassment, rather than relief from anti-competitive practices, our legislation will also provide for the award of costs including reasonable attorney's fees, to a substantially prevailing antitrust defendant upon a finding that the plaintiff’s conduct was frivolous, unreasonable, without foundation or in bad faith.

The final piece of our remedies reform proposal is claims reduction, in which we will address that ancient problem of joint and several liability and seek to develop a more equitable sharing of damages. Without a doubt, the administration’s suggested revisions to Section VII of the Clayton Act have been the most widely discussed aspect of these new developments. The legislation to be proposed is designed to codify advances in merger case law and in economic analysis. The revised Section VII would make sure that the lawfulness or unlawfulness of a merger is based on

a real probability rather than a mere possibility of its having anti-competitive effects. In addition to these changes to Section VII, our legislation will also go into the area of international trade and will seek to amend the Trade Act of 1974 in order to provide a new form of relief for domestic industries that have been hurt by import competition. We propose to give the president authority to grant a limited Section VII exemption to mergers and acquisitions among firms in an injured industry as an alternative to protectionist relief under the Trade Act.

Finally, we will also seek to amend Section VIII of the Clayton Act which now generally prohibits service by any person as a director of two or more competing corporations if any one of those corporations has capital surplus and undivided profits of more than $1 million. Our proposal would raise the jurisdictional amount for statutory coverage and perhaps more importantly would establish explicitly a de minimus standard for analyzing competitive overlaps between companies.

Well in briefly reviewing these proposals I have not of course been able to include all of the provisions that we intend to present to the Congress or to expand on the details or intricacies of the legislation being developed. But I hope it does give a general picture of our plans to try to bring into conformity the antitrust laws into conformity with the demands of a modern international economy.

Another kind of problem exists in the field of tort law. The last two decades have featured an

extraordinary growth in the size and number of damage awards. This has been accompanied by an erosion of some of the most basic precepts of tort law itself. For most of our history the purposes of tort law were relatively simple; compensation for the victim and some deterrents for the tortfeasor. In rare cases punitive damages were awarded to add an extra dose of deterrents. In any event, the concept of tort liability was clearly tied to the idea of fault. You had to do something wrong before you had to pay. Unfortunately in too many cases this is no longer true. Unrealistic notions of extended liability, invented bases for new causes of action, and exaggerated awards of punitive damages, have transformed tort law into an unpredictable and unstable quagmire in our legal system.

Some developments in the tort law seemed to have reflected changes in how some people think about the law itself and even how some courts think about the law. Indeed, some of the cases seem to make it appear that there are those who feel that the law and the court should act to affect transfers of wealth within our society. Moreover, redistribution under the guise of individual judgments is less susceptible to measurement and scrutiny than transfers that are made through the conscious decision making of the political process.

Awards are made that greatly enrich particular plaintiffs or at least their attorneys, but which wreak havoc with the public good as well as with important sectors of the economy. At the current time, a special tort policy working group at the Department of Justice is examining these problems of tort law as are similar groups around the legal community. In part, we are using the

tools of economic analysis to assess whether or not tort law is actually compensating and determining injuries as well as in determining its harmful ramifications. We intend, once our complete review of the Federal situation is concerned, is to broaden our thrust and perhaps act as a catalyst to engage outside the government many more organizations in a very careful examination of proposals for remedy in this very critical field of the law.

Well while antitrust and tort law are the two areas that have been getting the most public and legal attention, I would very briefly like to mention another area of the law which has received comparatively little attention. Indeed we have seen not only changing fundamental assumptions but a radical redefinition of one of the key concepts within our economic and political system. And that is, the idea of what is property. In the last several decades and increasingly it seems important court decisions have redefined property rights to include what are called expectancies in government benefits. Social Security, Food Stamps and a plethora of other benefits are now called entitlements. At one time such benefits were viewed as the gratuitous payments by government as part of an enlightened social welfare policy. But as they became permanent fixtures, courts have begun to describe them as rights, and have invented a so called property interest in the beneficiaries' ability to receive them. This has led to expanded and costly litigation, confusion in administrative procedures, and decreased flexibility in how governments at all levels are able to allocate limited social service resources. Even in the area of this due process revolution as some have called it, there is some cause for hope. Some recent cases have moved away from imposing inflexible due process standards on government decisions and of

course this is a trend which we will certainly follow and encourage both through litigation and through legislation.

Finally, let me say that I believe there is a new and fruitful interaction between economics and the law in the process of framing new laws and regulations. In the last few years, with regulatory reform being the watchword in Washington, consumers have benefitted from deregulation in a number of areas including transportation and energy. Government it seems is learning that the invisible hand of the market is often preferable to the heavy hand of regulation.

Well in the final analysis, it would be wise, I think, for us to remember as many have said, ideas have consequences and that is particularly true of economic ideas. It is no coincidence I would suggest that today much of the world lives in political slavery in part due to the mistakes of two 19th century German pseudo-economists. While at the same time, in the United States, political freedom and economic freedom have flourished together.

In closing, and in the interest of impartiality, I turn to neither an economist nor a lawyer for a final saying, but to a man of science, who nevertheless managed to capture very well my own sentiments on the function of law. Everything, said Albert Einstein, that is really great and inspiring, is created by the individual who can labor in freedom. It is in order to create that opportunity that law and economics must join. Thank you. (Applause)

QUESTION AND ANSWER PERIOD

DWAYNE O. ANDREAS, CHAIRMAN: Ed, thank you very much for that very transient and thoughtful and well organized set of comments. At this point in the program, as it is our tradition, we will call on two distinguished members of the Club to put questions to our speakers. Our two questioners tonight are, James C. Goodale, on my left, an attorney with Debevoise and Plimpton. And formerly General Counsel and Vice Chairman of the New York Times Company. And on my right, Ralph F. Peters, Chairman and Chief Executive Officer of the Discount Corporation of New York, primary dealers in U.S. treasury securities. I will refrain from refereeing this question and answer session in order to give the maximum amount of time to the performers. I will only interfere in case any of you are out of order. Will you please try to alternate your questions and we would like to begin with a question from Mr. Goodell.

JAMES C. GOODALE: Mr. Meese, or Ed Meese, my introduction should have also included the fact that in 1953 you were the Head Librarian in Davenport College Yale University, and I was the Assistant Librarian in Davenport College and I have waited all these years to get even with you. (Laughter) We have heard from Mr. Corrigan about the damages that inflation can do to an economy and I want to ask you to address yourself to that point with respect to the proposals you have made for the amendment of the antitrust laws. Particularly I am interested in your views with respect to amending the Clayton Act to make mergers more feasible under that Act than they are presently. The purpose of the antitrust Act seems to be in some part is to promote

competition and thus drive the prices down, namely a deflationary affect and it seems to me that your proposal to permit mergers would have the reverse effect and increase inflation. Could you comment on that please?

THE HONORABLE EDWIN MEESE: We have an equal concern to Mr. Corrigan and to that implicit in your question about inflation. Indeed, it is one of the definite principles that I enunciated very briefly in my exposition of our proposed legislation that if the results of any merger was to produce the probability of anti-competitive practices or an anti-competitive situation, then that would be a basis for the merger to be, or acquisition to be unlawful and to be turned down. But what we have had in the past has often been a lack of economic analysis and a very rigid standard, that if even there was a mere possibility of some adverse impact in terms of changing the competitive situation, even though that probability was virtually nil, there were those within the antitrust division of the Department of Justice who in a very inflexible way would refuse to approve or would oppose such a merger. We think that one other aspect of this is that we have to go beyond thinking of mergers as we traditionally have, which has been what is the situation within the United States and that in an era, particularly in many of our larger and basic industries and also in the very highly technological industries, we have to look at these in the context of a global market. And therefore, it is for this reason that we think a standard of probability rather than mere possibility makes more sense. We think that properly enforced; it would not be inflationary and would be in the best interest of both creating more jobs in our country as well as in the best interest of the welfare of the consumer. (Applause)

RALPH F. PETERS: May I address my question to Mr. Gerald Corrigan. Gerry, I know why you like Minneapolis and that district, that is where the fly fishing is. I know that. Gerry, recent data seems to imply that the domestic economy has been picking up some steam. This could lead to expanding credit demands and in tandem with the decline in the dollar could be expected to spark some renewed upward price pressures. The price of gold has been rising lately. However, the recent sharp declines in the price of oil would seem to mitigate inflation psychology and may even lead to severe credit problems here and abroad. Additionally, there have been reports in the press of G5 and even possibly Secretary Baker advocacy of a U.S. led move to lower worldwide interest rates. How in your view should our monetary policy be conducted to cope with these seemingly divergent situations and pressures? In sum, what problems do you cite as reasons why the Federal Reserve has chosen to date not to lower its base lending rate effectively thereby placing a floor under U.S. and worldwide rates?

THE HONORABLE E. GERALD CORRIGAN: You have a way with words, Ralph. (Laughter)

RALPH F. PETERS: No one ever accused me of being short.

THE HONORABLE E. GERALD CORRIGAN: What I would like to point out Ralph, and you probably have heard from time to time that I have three important fringe benefits in my job. The first Mr. Attorney General as you know is I can't get involved in politics. The second is that I can't get involved in fund raising, and the third is that I can't talk about interest rates. (Laughter)

But with that in mind, the collage of circumstances you cite Ralph really do make for a very, very difficult environment for monetary policy, for business people and for securities dealers. In terms of the particulars, I think that there is perhaps a bit of a whiff of inflationary forces in the air, but I think that, that is probably not something that has any staying power to it, as best as I can judge. The gold price situation for example, as best as I can understand it, reflects a variety of legitimately technical considerations. And so too, the little strengthening we have seen, for example in raw commodity prices, particularly when you consider the levels they come from. But as I said in my prepared remarks I don't think we can afford to relax our vigilance on the inflation front one iota because I think that if you look back over a long period of time, there is a lot to suggest that the incipient initial problems on the inflationary front tend to be dismissed as technical factors. So while I don't see a problem, I genuinely don't, I think that what forces you are suggesting tell me, we have to be vigilant, very vigilant. Now as far as the economy itself is concerned, to be sure, we have had a burst of economic statistics in the last three or four weeks which look pretty good by any standard. And as far as I am concerned, that is good. I am not worried about that. I would worry in the opposite direction. But we, nevertheless do have a very delicate situation. When you look at the nexus that is there for example between interest rates, exchange rates and the world economy, and again, I think the Attorney General in his comments about certain aspects of antitrust policy has put his finger right on it. That we have to learn as a country to look beyond our own boundaries more than we have historically. We sat here fat and happy if I can put it that way, for the better part of two centuries not having to pay much attention at all to the externa side of our economy. Now we must pay a lot of attention to it. And

I think that pertains, if I may say in spades, in the context Ralph of your question, I put it altogether and my personal view is what it says to me is we better be careful. (Applause)

JAMES C. GOODALE: Mr. Corrigan, despite the Administrations opposition to the junk bond rules that the Fed proposed and put into effect, the fact of the matter is they seem quite narrow at least with respect to their impact on acquisition and mergers, only approximately 15% of leveraged buyouts and 1% of mergers actually use junk bonds. In view of the sudden decline in oil prices that has taken place in the last few days and the impact on the banking system, and our credit system that many think the lowering of oil prices will have, do you think you will have to revisit the question of credit as advanced by banks to mergers and acquisitions and perhaps redo your junk bond regulations or think of other forms of regulations to curb credit for mergers and acquisitions?

THE HONORABLE E. GERALD CORRIGAN: Perhaps there are grounds for compromise here between junk bonds and nonbank banks. This junk bond issue, I will not even attempt to deal with the legal aspects of it in the present company, but I do want to just say a word about the economics of it. Because when we look at what is happening, you know we can all have our views and our judgments on a microeconomic basis, and it is incredibly difficult to argue with the proposition. The invisible hand that says if somebody wants to pay $20 a share more than a share is worth on the exchange yesterday, there is nothing wrong with that. And I won't debate that in the narrow sense, but I think it is the macroeconomics of it that is potentially very

important indeed. And the macroeconomics of it is troubling. We have a situation in our economy, quite apart from the Federal sector in which debt, both in the consumer sector, and the business sector is growing very, very rapidly. In the business sector, just to take an example, over the past two years, we have and again, largely through the types of transactions you described, in the past two years we have retired more equity than was issued since the Korean War. That is in current dollars and it doesn't take into account retained earnings and all the rest of it, but anyway you cut it up, I think that has to be telling us something. And what it tells me or it suggests to me is that we better think through very carefully, both on a micro and a macroeconomic basis, what those debt burdens will mean in the context of a different set of economic conditions than we have now, in the context of higher interest rates or a recession or both. Now I am not forecasting either one of those. I would like to think we can avoid both, but I am not at all persuaded as a historian in my own right that any of us should sit here with the complacent sense that the business cycle is dead. I think that would be a big, big mistake. And if the business cycle is not dead, I think we have to be sensitive, at least in the amber light sense, as to what those trends could mean in the fulness of time. Now, as to your specific question, I am not sure which ways it cuts. But I don't think it cuts in the direction of sanctioning willy nilly still more debt.
(Applause)

RALPH F. PETERS: Gerry, I would like to give you a rest, Ed, let me address this to you Sir. Recently, the constitutionality question of the Gramm-Rudman-Hollings Amendment has been in the forefront of everyone's mind, no matter which sector of government or private industry one

is associated with. Would you please give us your assessment of the likely future course of events in addressing this question and concerning the Federal budgetary decisions for fiscal year 1987? Should planning continue to anticipate cuts of approximately $60 billion, or would it be wise to wait for further clarification.

THE HONORABLE EDWIN MEESE: Well like Mr. Corrigan I have three fringe benefits that go with my job. (Laughter) One is like his; I have to refrain from anything that is partisan and political. (Laughter) Secondly, I likewise do not attend fund-raisers and thirdly, I am not able to speculate on what the Supreme Court might do. However, let me say, that aside, the position that we have taken on Gramm-Rudman-Hollings, and I always add Hollings as you properly did ever since the other day when I was in Georgia and forgot it. We think that there is one part of the law which is a doubtful constitutionality, if not actually unconstitutional and that is, the part of the law which gives to the Controller General, the general accounting office the power to direct the President to make the 4.3% or whatever the percentage is, cuts, once they have been determined by either averaging or otherwise taking the information from the Congressional Budget Office and the Office of Management and Budget. We think that is true for reasons which really are not part of the Gramm-Rudman-Hollings Act as much as they are a preexisting legal battle in the government, and that is the Controller General is really a legislative official rather than an executive official in as much as he can be removed from office only by the Congress. So both by custom and mores well as by actual legal status, he is more of a legislative figure and Congress cannot delegate to a legislative officer the power to compel the Executive Branch to do anything

as an executive official. So therefore we feel that that is unconstitutional. The other constitutional attack is on, and let me before I pass that, let me just say there is a fallback position in the law and that is, that instead of the Controller General getting in the act, if it is found that, that is unconstitutional, there is another provision and that is that the figures developed by CBO and OMB would be put in a joint resolution passed by the two Houses and then go to the President for signature and then would have the same affect as otherwise it would with the Controller General. The other attack which has been levied on the law by some people is that to have this happen, to have the Congress by whatever means, designate a way in which the President has to make certain cuts in the budget of the Executive Branch, is an unlawful delegation of legislative authority. We do not feel that...we feel that the law is sufficiently specific as to the way it is done, and as to the way in which the numbers are derived, that it is more akin to the appropriations process and that it is a more ministerial act done then by the president so that this does not amount to a delegation of legislative authority. So our thought…and the law provides by the way…the Act provides for an expedited review. So we think when the three judge court rules as we hope that they will do very quickly, and then it can go directly to the Supreme Court. We are very hopeful that we might be able to squeeze out a ruling on the point that we are concerned about before the first of March when this has to go into affect. And if that happens, then there is no reason why, if the courts agree with us, the rest shouldn't happen. As I say, we are sailing in unchartered waters obviously, but we think that there is a good chance that the provisions, ultimately of the Gramm-Rudman-Hollings Act will be carried out in fiscal year '86 and then would be available for whatever happens in fiscal year '87. In answer to your question

though about how we get rid of that $60 billion. Let me say that it is a position of our Administration that having an across the board cut which would be a fairly significant proportions in those parts of the budget not exempted by the Act, is not the best way to go. And we think the best way to make the same reduction in the deficit for fiscal year 1987 would be for the Congress, by its own Act and not waiting for Gramm-Rudman-Hollings, to by its own Act to enact a budget similar to or at least with the same bottom line as the President will propose on the 3rd of February. (Applause)

JAMES C. GOODALE: Mr. Meese one matter that is very much on the minds of this audience is the question of directors and officers insurance. As the audience knows and you well know, it is virtually impossible, either to obtain DNO insurance or to obtain it at a reasonable price. You have talked about the program of looking into torts and seeing what can be done about it. The tort that most people in this room worry about as directors and officers are stockholder suits which take the form of tort actions. In your study, are you looking into the problem of DNO insurance and its impact on the ability of corporations to function with or without directors?

THE HONORABLE EDWIN MEESE: As a former corporate officer I shared the shudder that went through the crowd when you even brought up the subject. But we have not undertaken this because right now we are really looking at the Federal aspects of tort liability. There are other groups and I would anticipate that when we go on in a way that we haven't quite determined yet, how to involve others and private sector organizations in the whole study of tort liability. I am

sure this will be a topic. I have had a number of discussions with people in the insurance industry who have offered to help us in our deliberations and I know this is a very keen problem. It gets in again to what I discussed earlier, and that is this whole problem of what appears to be a redistribution of wealth, even when no actual fault exists in looking for a deep pocket wherever it can be found and it is a very troublesome area and I am hopeful that as part of what I think has to be a legal systemwide study that this will be one of the things that will be taken up, because otherwise, corporations are not going to be able to get outside directors and if that happens, then you are going to have the unfortunate thing that what everybody has talked about, all the commentators, to have that outside check on management will not be there. And you only, in my opinion, would then exacerbate a situation that you inferentially talked about in your remarks earlier, about this, the conflict between shareholders and management in regard to how the company is run and whether it is being run properly for the benefit of the shareholders.

RALPH F. PETERS: I would like to address this to you again, Gerry, if I may. This is not on monetary policy, you will be glad to know. On November 21st of last year, the government's securities clearance system broke down for about 24 hours, because of a massive computer problem at a large clearing bank in New York. This resulted in the Federal Reserve System supplying about $23 billion in discount window credit overnight and it might conceivably in a worse case have led to the closing of the Government's Securities Market. What steps have been taken and procedures implemented since that time to ensure that such an occurrence does not take place again?

THE HONORABLE E. GERALD CORRIGAN: There again Ralph, you have a way with words. I tend to remember that night rather well. The particular issue you refer to of course was a set of circumstances involving a mechanical problem, albeit a large one. But as you suggest, it got a little touchy. Now from my perspective, and I have a natural tendency as a bureaucrat to look for silver linings behind clouds. Now in this particular case, the silver lining behind the cloud, as far as I am concerned, is that it took from the arena of abstraction to the arena of reality, something that we in the Federal Reserve have been talking about frankly for years. And that is, that the clearance system, not just for government securities, but for all forms of large dollar payments, is something that should be of paramount concern to all participants, major participants in the financial markets. Again, to pick a number out of the air, and this New York money market, on a somewhat typical day, if you take the transactions that pass through the computers at the New York Fed and the computers at the New York Clearing House, which ultimately are handled by us as well, you can easily be talking about a $1 trillion in transactions. Now a trillion dollars is very hard to get your arms around, even my arms. (Laughter) But it is a thousand billion dollars. It is something like; I hope my arithmetic is right; it is something like 35 million dollars a second, over an eight hour day. Now, as Everett Dirksen once said, that is a few billions, pretty soon, you are talking real money, and we talking a trillion here. Now, there was a long period of time when that was thought of as kind of a back office thing. And I hope that this particular episode has served the purpose, if it hadn't already been served, of getting those concerns out of the back office and into the front office. As to what is being done, we have had in place, even

before that particular episode, a systematic program indeed, a voluntary program I might add, whereby all of the banking organizations, domestic and foreign, around the country, are right now in the process of establishing caps on so called daylight exposures that are a first step in putting some discipline into a system in which that intraday credit frankly has been a free good. Now, in addition to that and perhaps reinforced by the particular episode that you cite, we for example are taking a very aggressive look at our own backup systems, encouraging others to do the same. We are taking a hard look at bank supervisory procedures as they pertain to the activities of the major clearing banks which are so important to this. But we are kind of going beyond those things. The daylight overdraft in my judgment is a symptom, not a cause. Now what we have to do is better understand the circumstances that give rise to these things in the first place. And that in my judgement is gong to have to involve a very, very aggressive effort to get out in the marketplace and work with participants, all participants to see what we can do, perhaps even to look for opportunities to alter market practices in a way that can produce a smoother flow of payments during the day. One of the problems we have right now is that a very, very sizeable percentage of the transactions hit the system in the last half hour. So as I think Ralph you know, well right before Christmas we had a session with a lot of the dealers and the clearing banks. We are following up on that. We are basically trying to look at the thing soup to nuts. In cooperation with the entire marketplace because I think that when you are confronted with having to make a $22.6 billion loan at 3'o clock in the morning, that is a little unnerving. I guess it may have made the Guinness Book of Records in some sense at the largest overnight loan. But there is one other aspect of the loan that I think deserves mention in this day and age,

and that is, as big as it was, it had a very, very comfortable margin of excess collateral, and both the principle and interest were repaid on time. That don't seem to me to be bad principles. (Laughter and Applause)

DWAYNE O. ANDREAS, CHAIRMAN: As is our tradition, we promise our guests we will let them go by 10:00. To our distinguished speakers, Attorney General Meese and Gerald Corrigan, and to our distinguished questioners, Jim Goodale and Ralph Peters, many thanks and the club's thanks for giving us the most enlightening evening. I am delighted to think about the wonderful background you have given us against which to appraise the news in the months ahead. Now another of our Club traditions is this Steuben Apple which we have adopted as a symbol of the Economic Club. We would like each of our guest speakers to accept one, with our warmest thanks as a memento of this evening, and I hope that both of you have enjoyed being here as much as we have enjoyed having you. I want to give you this gift, Mr. Attorney General. Thank you very much for being here. (Applause) And one for you Gerry. Now thank you. This meeting of the Economic Club is adjourned.

END OF MEETING