The Economic Club of New York

Lawrence H. Summers
President Emeritus, Harvard University

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Introduction

Chairman Terry J. Lundgren

Thank you very much. Good morning. I'm Terry Lundgren, Chairman of the Economic Club and recently-retired Chairman and CEO of Macy's Inc. And I'm very pleased to introduce our special guest and fellow club member, Larry Summers, the Charles W. Eliot University Professor and President Emeritus of Harvard University. During the past two decades, he served in a series of senior policy positions in Washington, D.C. including the 71st Secretary of the Treasury under President Clinton and Director of the National Economic Council for President Obama. Larry received his undergraduate degree at MIT and then went on to receive his PhD from Harvard and then went to Washington shortly after that to have the position of Domestic Policy Economist for the President's Council of Economic Advisers. In '83, he returned to Harvard as a Professor of Economics and became among the youngest individuals in recent history to be named to a tenured position at that university.

After receiving numerous recognition awards, he took leave from Harvard in '91 to return to Washington again as Vice President of Development Economics and Chief Economist for the World Bank. In '93, Larry was named as the nation's Under Secretary of the Treasury for International Affairs to Secretary Lloyd Bentsen. In '95, then Secretary Robert Rubin promoted him to the department's number two post, Deputy Secretary of the Treasury. And on July 2 of 1999, the United States Senate confirmed Larry as Secretary of the Treasury. In that capacity, he served as the principal economic adviser to President Clinton, where he was awarded the Alexander Hamilton Medal, the Treasury Department's highest honor.

After leaving the Treasury Department in 2001, he served as the Arthur Okun Distinguished Fellow in Economics, Globalization, and Governance at the Brookings Institution in Washington. And then shortly thereafter, on July 1, 2001, Larry took office as the 27th President of Harvard University. In 2002, Larry was elected to the National Academy of Sciences, and in 2006 he served as one of the co-chairs of the World Economic Forum in Davos. Larry was appointed to serve as the Director of the National Economic Council for the Obama Administration in 2009 and Assistant to the President for Economic Policy. He returned to Harvard in early 2011.

Larry is a member of the boards of Square, the Brookings Institution, Broad Foundation, Teach for America, ONE, the Center for Global Development, the Institute for International Economics, the Partnership for Public Service, and he is also a Senior Advisor for Andreessen Horowitz in San Francisco. And he holds memberships in the Council on Foreign Relations, the Trilateral Commission, the Bretton Woods Committee, the Group of Thirty, the Council on Competitiveness, and the UNCTAD Panel of Eminent Persons. Other than that, he has absolutely nothing going on. (Laughter) But he does write regular columns for several publications including the *Financial Times,* the *Washington Post,* and Reuters, and you see him frequently on numerous media programs sharing his point of view on wide ranges of subjects.
So, Larry, welcome to you. Larry is going to start off by making some initial comments and then we're going to have our own Dr. Peter Henry ask some questions. And this is on-the-record, so the media is here and we'll all enjoy this breakfast and his comments. Larry, welcome to the

Club. (Applause)

Lawrence H. Summers

President Emeritus, Harvard University

Terry, thank you very much for that kind introduction. You mentioned that I had – as you introduced me – that I had gone back and forth a bit between the university and Washington. When I first got to Washington, people asked me what was different about being a Treasury official than being a professor at Harvard? And I said that as a professor at Harvard the worst thing you could do was to sign your name to something you had not written yourself. On the other hand, as a rising bureaucrat within the Treasury Department, roughly speaking, signing your name to something you had not written yourself as frequently as possible was a mark of effectiveness. And then some years later, I returned from Washington to Harvard and people asked me, well, what was different about being the Treasury Secretary than being the President of Harvard? And in those early days I gave an answer that in retrospect was breathtaking in its naivete. I used to say Washington is so political. There's opposition that tries to bring you down. Everybody doesn't always work together in Washington. Well, I'm not sure I'd give precisely the same answer about universities today. In any event, I am very glad to have this chance to be at the New York Economic Club and I'm very flattered by the number of distinguished people who have come out this morning.

What I want to remark on this morning is what I would call the secular stagnation dilemma, which I think is still very much with us. At one level, you can say how could we still be talking about secular stagnation, the unemployment rate is 3.9%, the economy is expected to grow at an above potential rate this year, why would anybody be talking about stagnation? And certainly, describing the current economy as stagnant in the United States or in much of the industrialized world would not be right. But I think if we one thinks about what Alvin Hansen had in mind when he spoke about secular stagnation and what I had in mind when I sought to revive the idea four and a half years ago, the major issue is still with us. And I would put that issue in this way: a variety of forces have operated to raise the natural propensity to save of the private sector of our economies. People are living longer. Their retirements are more uncertain. A larger fraction of income is going to wealthy people. A larger fraction of income is showing up as corporate profits which are disproportionately saved. There's a larger supply of saving coming from emerging markets that are either building up reserves or experiencing capital flight.

So, on the one hand, there seems to have been a structural increase in the propensity to save. On the other, there has been – I would argue – a structural decline in the dollar volume of investment. A more slowly growing labor force requires less investment to equip new workers and to house newly formed families. A more uncertain environment and a more heavily regulated financial sector operates to discourage borrowing and investing.

Most importantly, profound structural changes in the economy have led to what might be called demassification. My Smartphone has more computing power than a $50 million Cray supercomputer did the day Bill Clinton was elected as president. Law firms used to need 1,200 square feet of space per lawyer. Today, they need 600 square feet because there's fewer filing cabinets and paralegals and more that is stored in the Cloud. Better inventory control means less need for warehouses. Stronger use of e-commerce means less need for malls. My children's generation is much more enthusiastic about small apartments in big cities than it is about big houses in small suburbs and that reduces the demand for investment.

When you have a big increase in the propensity to save and a big decrease in the propensity to invest, there is a natural change in the market clearing real interest rate. Market clearing real interest rates, what has come in short-term financial parlance to be referred to as our star has quite likely declined quite substantially for structural reasons. The failure to appreciate that is the reason why the pace of monetary tightening and the pace of increasing interest rates has been substantially overstated by forecasters for almost all of the last decade.

And I would suggest that if you buy what I've just said, the right interpretation is that, that neutral or normal real interest rate is likely to be substantially lower over the future interval as well as over the recent past. And that's certainly what markets believe. If one looks at 10-year TIPS or 30-year TIPS, they're suggesting that long-term real interest rates which probably embody some term premium are below 1% suggesting, given the term premium, that future short-term real interest rates are likely to be in the neighborhood of 50 basis points. And I think for understanding the economic and financial landscape, recognizing this reality is central.

And I want to highlight three implications. First, the achievement of reasonable economic growth currently and in the future is likely to require policy settings that are unsound as judged by traditional metrics. Yes, we are enjoying 2.5% growth in the United States right now. Some of you might think that it was 2.8% growth. But think about what it takes to achieve that. We have deficits, measured on a cyclically adjusted basis, of an unprecedented scale. We have unprecedentedly generous treatment of capital investment under the corporate tax. We have real fed funds rates at far lower rates than we've observed before at moments of cyclical strength. We have substantially inflated asset values on many metrics, and we have continuing increases in leverage. And all of that together gets you 2.5% growth. Where would we be if we had normal policy settings? I would suggest that much of what people regard as policy choices are better understood as the natural policy response to this environment of high saving and low investment and the need to achieve full employment. And, of course, what I say about the United States is even more true of the industrial world as a whole, where long-term real interest rates are – as estimated in the indexed bond market – averaging close to zero and where the difficulty in achieving a 2% inflation target is that much more serious.

So, the first implication that I would highlight is that we are going to have considerable difficulty in achieving continuing growth with what we have traditionally regarded as sustainable policy settings.

A second implication that I would argue is that we are likely setting the stage for substantial financial challenges down the road. The thrust of my argument is that safe real interest rates have declined substantially over time. There's room for argument about what's happened to risk premiums, but looking at the level of markets, looking at the inevitable tendency of investors discouraged with low safe rates to take on increased risk, I find it more plausible that risk premiums are abnormally low right now than I find it that risk premiums are abnormally high. If you combine a decrease, from say 20 years ago, on the order of 250 or 300 basis points in normal safe rates with a decline in risk premiums, you conclude that the portfolio expected return on plausible portfolios has declined by perhaps 300 or 400 basis points. No assumption of that kind is built into the payout policy of any endowment of which I am aware, nor is any assumption of that kind built into the financial programming of most pension funds or other institutional portfolios. Of course, returns have been stronger in recent years, but that is a natural response to the market's discovery that what I said is true, because as discount factors decline, asset prices increase. But those asset price increases are not harbingers of future higher returns, they are harbingers of future lower returns as they represent the capitalization of the news that returns are going to decline into asset prices.

The third implication that I would draw from the secular stagnation dilemma is that our current prosperity is brittle. If one looks at the history in the United States or throughout the industrialized world, I think two statements are broadly fair, although econometricians could, and would, argue about the details. The first is that if the economy is not in recession and has not recently exited recession the odds that it will go into recession in the next 12 months are about 20% and that's fairly independent of how long the expansion has been going. Correlated, or associated with that observation, is the observation that when the next recession comes, it's very unlikely that it was successfully predicted nine months or a year in advance. They never are. *The Economist* magazine did a study a couple of years ago in which they looked at all the occasions on which a country was country in year T and was shrinking – less than zero growth – in year T plus 1, and they found that there were 186 such occasions. And they asked, in how many of them did the IMF forecast in April of year T that the economy would be declining in year T plus 1? And the answer was zero. And so that 20% a year, and we won't know it, is a good assumption.

A second lesson of history is that getting out of recessions – there is a proven formula for getting out of recessions, which doesn't always work and doesn't always work quickly, but it is the formula for essentially every recession in every major country in the last five years, the last 50 years. And that is a 500-basis point cut in the federal funds rate. And if you believe anything like what I have said, then you'll recognize that there's not going to be anything like 500 basis points of room to cut the fed funds rate when the next recession comes – not in the United States and even less in Europe and Japan.

So, it seems to me that the preoccupation of macro-financial policymakers and analysts should be less the size of the future U.S. government budget deficit, unsustainable as it likely is, and should be more how we are going to manage this new and quite different world we live in, in which structurally high savings and structurally low investment will mean very low returns for financial investors and will mean that it is very difficult using conventional policy instruments to maintain full employment with policy settings that are sustainable and leave comfort. And if I leave you with the impression that this should both worry you as you look at the future outlook and should be a major focus of thought and analysis about how we can do better, I will have served my purpose this morning. Thank you very much. (Applause)

QUESTION AND ANSWER PERIOD

PETER HENRY: Thank you, Larry. So, I can't help but start where you ended, which is you posed this question for us, and I think you convincingly argued that there is a structural decline in investment and a structural increase in savings. What single, or what set of policy changes – if you could wave a magic wand – would you wave, in fact, to get at this issue? Or are we just, should we just be resigned to having to lower our star?

LAWRENCE H. SUMMERS: I think there probably are three crucial parts of the answer, but I pose the question in part because I don't think it has a complete answer. First, I think we have to be prepared to accept and recognize that we're going to have lower real interest rates in the future than we have in the past. We need to think about a monetary policy framework that will enable that. I think the Fed's growing emphasis on symmetry is very appropriate in this regard. After all, if we have a 2% inflation target and we're supposed to miss that target to an equal extent on the low side and the high side, when we're in the 9th year of a recovery, the unemployment rate is 3.9%, we've fallen short of the 2% target for nine years in a row, if that's not the moment when we're going to move above 2%, when would that moment ever be? So, I think that the notion of more accommodative monetary policies that allow for the 2% target to be symmetric, not a ceiling, is, I think, a minimal adjustment. I think over time consideration should be given to moving to price level targeting or moving to a nominal GDP targeting that would permit a somewhat greater level of nominal interest rates. Second, I think the arguments that I've made make a compelling case for increased public investment. It is much harder – it seems to me – to argue for an excess of public investment than it is an excess of private investment. You know, if you want the simplest story that illustrates why interest rates are low and are going to be low for a long time, think about Apple. It's the most successful company in the world. It's extraordinarily dynamic and innovative and yet it's principal business problem is what to do with all the excess cash that it's generating. In a world where cutting edge technology companies have as a central problem what to do with all their cash, that's going to be a world of inherently low interest rates. On the other hand, it's not like we can't identify public investment projects that fairly plausibly would have a quite high level, high rate of return. I used to joke, until Joe Biden stole the line, is anybody proud of LaGuardia Airport? (Laughter) If, you know, we talk a lot about STEM education in this country, it's been estimated that 20% of high school chemistry labs make the kids sick because the ventilation systems don't work. The American Society of Civil Engineers estimates that if we fix the potholes in a feasible way, it would be the equivalent of a 75-cent a gallon cut in the gasoline tax in terms of the reduced cost of repair. So, I think there's a compelling case for a substantial increase in infrastructure investment. And I think a lot of the fiscal responsibility arguments that people make against it are basically wrong. Who knows, and I'm certainly not a highway engineer, but the people who are tell me that if you defer maintaining a road five years longer than you should have, the cost can rise by as much as a factor of two. If that's true, the real interest rate on deferred maintenance liabilities is something like 14%. And so, it seems to me if we substitute a bunch of 1% debt to deal with a bunch of 14% deferred maintenance liability costs we're now paying, we're taking a burden off my children's generation, not putting a burden on my children's education. So, I think the second implication of this is a much more substantial focus on supporting necessary infrastructure investment. And it seems to me that to be responsible, that focus has to look, yes, at the quantity of infrastructure investment, but it has to also look at the way we do the infrastructure investment. I'm told that the Second Avenue subway in New York costs five times as much per mile as the Paris Metro, and France is not known as a government that is highly courageous in standing up to union power when it does investment projects. Some of you have some familiarity with the Harvard area. There's a bridge connecting Harvard Square and Allston, it's 362 feet long. It needed to be repaired. It really did need to be repaired, but I can't help but wonder whether traffic needed to be closed on one lane of that bridge for 62 months in order to repair that bridge. Just to establish a possibly relevant standard, I did a little bit of research. Our bridge was 362 feet long, there's a span of the Rhine that is 2,200 feet long and Julius Caesar – who, after all, didn't have access to some of our technology – Julius Caesar, when there was no bridge at all to repair, when there needed to be a whole new bridge to be built, he built it in nine days.

And it took us 62 months. So, I think that there needs to be an approach to infrastructure investment that combines more resources with reasonable streamlining and efficiency that we don't always, that we don't always achieve. And I think, so I think those two steps, one on the savings side, one on the investment side, would be helpful. And then I think the third, the third piece would be the full set of structural reforms that would operate to increase the efficiency of the economy and to increase the underlying growth rate of the economy would operate to raise normal real interest rates. But I think we are going to need a lot of thinking about whole questions of what constitutes appropriate levels of debt and borrowing in a world where normal interest rates are likely to be much lower than they've been in the past.

PETER HENRY: So, let's go to that point. You mentioned that we've got to get used to thinking about a policy world in which policies that we normally would think about 15, 20 years ago as being way out of whack may not be so out of whack. What's your view in terms of where we are in that spectrum of sort of you, you know, just coming, having to get used to a new normal versus using – if you will – new conditions to overstate the appropriateness of current policy with respect to, for instance, fiscal issues? How far off are we?

LAWRENCE H. SUMMERS: We should have – there are plenty of judgments I've made in the past that were wrong, but this one I actually think I made right – we should have been spending, borrowing and spending much more to prime the pump and get the economy moving between 2010 and 2016. And our failure to do so was an important mistake. And the American establishment – if I might use that term – the kind of thinking that, if I might be honest, is broadly represented within the New York Economic Club, that in 2011, when the unemployment rate was 8-some percent, and the economy was growing very slowly and social problems were festering, the kind of thinking that devoted primary attention to cutting Social Security benefits in 2030, through the Bowles-Simpson kind of process, was a diversion from what was important and was a costly diversion from what was important. And the concern that prevailed at that time about spiking long-term real interest rates has been revealed by subsequent events to have been nonsense. And the claims that were made at that time that if we didn't get entitlements under control, interest rates would spike, were wrong. It might be that they're right today, but we've now had eight years since that process and interest rates have not spiked, have not spiked around the world. So, I think at that point, the obsession with long-run deficits was really quite badly misplaced and quite costly. And I think it represents a failure of the elites that is not entirely unrelated to the political outcomes that we have seen, that voters reached to judgment about elites who fundamentally had something to do with the fact that there was a financial crisis and then stuck with the same things they believed before the financial crisis and had a fair amount to do with the fact that recovery was as slow as it was. From my perspective, I think that the right priorities are the public investment that I spoke about. I think there's an additional priority which is not on the political radar screen right now, which is that we have worked ourselves into a situation where the government structurally and chronically does not have enough revenue to do what it has to do. Over time revenues as a share of GDP at the federal level have been 19%. We've now locked in 17%, is what we've locked in with this tax cut. Many people think that that

19 is a kind of natural and normal benchmark. But if you think about it, that's probably wrong. Why? A much larger fraction of us are aged than has been the case historically and half the federal budget goes, in one way or another, to support the aged. And so, if we want to meet the standard we've met historically, then we're going to have to have a larger federal government. What does the federal government buy? The federal government buys things like healthcare and education. If you look at the consumer price indices, hear this fact. The relative price of a television set and a room in a hospital has changed by a factor of 100 since 1983. All the consumer price indices were set to be 100 in 1983. Television sets, 6, hospital rooms 600. If you're the guys who buy hospital rooms, it sort of figures that your total spending is going to have to increase. It's not what people on my side of the aisle tend to say, but if you look at the trends in the military spending of those countries one would tend to classify as natural U.S. allies and those countries one would tend to classify as potential U.S. adversaries, the latter are growing at 10% a year and the former are flat. And it's hard to believe that we're going to continue to be able to maintain military spending at current levels in real terms. So, it seems to me that, and then there's the infrastructure and there's the R&D and there's the problems with under-investment in education, it seems to me overwhelmingly likely that the United States is going to have to devote a larger share of its GDP to public functions in the future than it has in the past. And that's another reason why the revenue base of the federal government is inadequate. So, I would prefer to see a focus on the adverse consequences of a starved effort to meet basic public responsibilities. And we can debate whether there should be more emphasis on private schemes and providing saving or whether more of it should done publicly, we can debate

what the right way to manage and organize the healthcare system is. We can debate what the right role of the private sector is versus the public sector in providing primary and secondary education. But the conclusion that we're going to have to be devoting more of our total incomes to the things we have regarded as public functions seems to me to be hard to argue with. And that seems to me to be a much more appropriate focus given our current situation than the focus on the level of debt. And I have to say that I can't imagine a better political strategy for assuring the continuity of highly populist government than a focus at this moment on entitlements. And a group of people in, like the people in this room, all getting together and saying we need to be highly courageous and that our definition of high courage is to cut a Social Security program whose maximum benefit that anybody can receive is $40,000 in a year, I think that's a prescription for a growing estrangement between all of us and the broad country. So, I'd focus on growth. I'd focus on assuring adequate revenue. I'd focus on these issues that I talked about in connection with stagnation. Those would be my areas of emphasis. And I think a focus on the growing federal debt when, after all, that borrowing cost is less than 1% in real terms should be very much subordinate among our concerns.

PETER HENRY: I want to turn to the international dimensions of the structural stagnation. One of your jobs when you were at the Treasury was being a key diplomat champion of structural reform – broadly speaking – in various parts of the world, particularly when you were Under Secretary. As you look at the world right now, and I agree with you, we're seeing relatively subdued growth, relative to what we had a decade ago, and you think about rising interest rates in the United States and emerging markets really comprising roughly 60% of growth today, what set of policies, if you had to choose three things, would you be saying we should be arguing that emerging markets should be thinking about, whether it's Argentina, Puerto Rico, some of our own emerging markets in our own backyard, African countries facing incipient debt crises, what should these countries be thinking about in order to raise investment?

LAWRENCE H. SUMMERS: Well, let me say, let me say first that if you buy into my broad theory of the case, then an additional broad policy approach is finding ways to create an economic environment where more capital can effectively flow from north to south because if there's a shortage of productive investment opportunities, because of demography, because of all the things I cited in our part of the, in the traditionally rich part of the world, then it's natural to think that if the economic environment improves, capital can flow from north to south, can earn higher returns and that can operate to raise normal returns and address various other problems that I described. I don't think there's any complete magic in this. I mean the things we've talked about for a long time, rule of law, sanctity of contract, protection of property rights, effective institutions, have a great deal to do with making investment productive in emerging markets. If I look, for example, at India, if India was able to establish those things more firmly, which goes in crucial ways to the integrity of government institutions, there are huge opportunities for the flow of capital and for productive investment in India. I think something similar is true in many parts of Latin America and I think it's certainly true in some – if not all – parts of Africa. I think there is a broad development challenge, which I don't know the answer to, and my colleague, Dani

Rodrik at Harvard, has written about, which is if you look at successful developing countries, the developing countries that have been most successful, the basic economic strategy has been t-shirts, steel, bicycles, ships, cars, planes. It's been manufacturing of products with upgraded sophistication and export of those products to the world. In different ways, every success in East Asia has that character. And the combination of rising protectionism and more importantly technological progress that has made all of those activities far less labor intensive than they were before raises a real question as to whether that strategy is going to be open to the emerging markets of the future in the way that it has been open to the emerging markets of the past. And what alternative strategy is going to replace it seems to me to be a very profound question to which I don't think the development institutions have yet formulated an entirely satisfactory answer. Look, the phenomenon of demassification that I described, you know, I was first put on to this almost 20 years ago by, maybe actually more than 20, about 25 years ago, Alan Greenspan gave a speech that some people thought was brilliant and some people thought was kind of nutty – and I was on the brilliant side – in which he put half the Fed staff together to work calculating the total tonnage of the U.S. GDP, all the stuff. And he calculated the total tonnage of everything that was produced and he showed that the total tonnage was trending downwards even as the GDP was trending upwards. Think about what a mobile phone weighs today and what a mobile phone weighed when mobile phones first came out. Think about what a tennis racquet weighs today and what the tennis racquet you played with 30 years ago weighed. Well, all of that has implications for the demand for commodities. And those implications are not favorable from the point of view of commodity exporting developing countries. So, I think the question of the, as yet not emerged, is a very, very important one to which I don't have the answer.

PETER HENRY: And just quickly, before I open it up to questions, I mentioned sort of our own local emerging market – Puerto Rico – sanctity, rule of law, debt, how do you think about the situation in Puerto Rico?

LAWRENCE H. SUMMERS: Look, I have followed this, not closely, but I have followed it on and off over the last years. I think it was implausible that a large fraction of the debt that Puerto Rico owed could be paid before Puerto Rico had a devastating hurricane. Now that Puerto Rico has had a devastating hurricane, I think the President's first instinct, which was to say that all the debt should be written off, was directionally right. Now I recognize that creditors have legal claims and that having given speeches about the rule of law, one can't simply suspend any attention to the rule of law and contractual terms when an exigency takes place. But when I look at forecasts of the Puerto Rican government and blessings from the control board suggesting faster growth in Puerto Rico out to 2022 or 2023 than was being projected before the hurricane, and a higher level of GDP in those years, it seems to me really quite implausible. And so I know how complicated these controversies are, but in general my instinct is that this will get resolved at some point but that it will require a considerably stronger imposition of outside control than we have today and that imposition of outside control will both force more structural reform on Puerto Rico by far than we have seen and will force more limits on what comes out to creditors than is currently priced into markets, that we have a kind of comfortable bid of pretend. Puerto Rico pretends that it doesn't have to reform. The creditors are able to pretend that substantial resources will come out within the current policy framework. Policymakers are able to pretend that it's all going to work out okay for the citizens of Puerto Rico. And it reminds me of the economic analysis that prevailed in Continental Europe of Greece in 2011 and that was condemned by Americans. And it seems to me that those who were quick to condemn the European Union's engagement with fantasy in the case of Greece in the early years of the financial crisis need to look at America's engagement with Puerto Rico through a similar lens.

PETER HENRY: Let's move to questions from the floor. Bill Rhodes...

WILLIAM RHODES: Thank you, Larry. Thank you for your comments as always. I wanted to ask you specifically about the emerging markets which you touched on. Given the tremendous search and reach for yield we've seen because of the tremendous stimulus of the major central banks of the world – the developed world – particularly starting with the Fed, you had these tremendous binges of borrowing at these low interest rates by many emerging market countries, a number of which have high fiscal deficits. And as the Fed raises interest rates and quantitative easing is pushed back and reduced, are you concerned that the movie you and I worked on over the years could be repeated in the sense of these countries having problems in servicing their debt and not taking the necessary reforms as the interest rates tend to go up? And one final point is, as to whether we're going into some sort of mini-oil shock for importing countries on oil, with the situation, the collapse in Venezuela where production is going down daily, and also with the Iran sanctions, are you concerned at all about this phenomenon over the short term?

LAWRENCE H. SUMMERS: Let me address some aspects of that. First of all, the right answer for a prudent economic policymaker to all questions that begin with, are you concerned about, is yes. (Laughter) Because if you answer the question no – if you're concerned about it and it happens, well, then you forecast it, and if it doesn't happen, well, that's in part because you were concerned about it. So, the courageous answer is always the optimistic one, not the pessimistic one. The second thing I'd say is I've learned over the years there are a few things that tell me that trouble is going to come in two years. One is whenever a country, whenever a country or a place builds one of the world's tallest buildings, the Empire State Building committed in the late 1920s, the Sears Tower, Petronas in Kuala Lumpur, what's happening in parts of the Middle East, the world's tallest building, financial trouble in two years. Another indicator that's got the same character is a much-celebrated century bond. A country issues a much-celebrated century bond, watch out, there's going to be a problem. And I kind of had that, I had a gut feeling that if people were really thrilled about over-subscribing an Argentine century bond, that was a sign that all might not be well a year or two in advance. So, yes, Bill, I think that I'm not here to give investment advice with respect to specific emerging markets, but I think there are certainly, certainly the next few years are likely to be a period of more complexity with respect to the flow of capital to emerging markets than the last few unless something happens. If I'm right, in my broad secular stagnation view, then interest rates will rise less rather than more, and that will be a factor that other things equal will mitigate the risks to emerging markets. But if I'm wrong, which is certainly possible, then those risks will only increase. Is the world ready to handle the situation if we run into more situations like Mexico and Asia, I'm not altogether certain. I don't think the current government of the United States has distinguished itself with its robust commitment to international community and the international financial institutions. And I think if one looks at the resolution of past emerging market crises, whether it was Latin America in the 80s or the various experiences in the 1990s, U.S. leadership played a very important role. And whether the United States will be prepared to lead if and when problems come in the future is, I think, a very important question where I think all of us can usefully give warning. I think the steps taken in Argentina and by the international community in the weeks ahead will be very important. I think President Macri is an impressive figure whose leadership offers the potential for a profound change in Argentina from many years of problematic policy. But Argentina and the international community in its response will likely be tested going forward. My hope would be that Argentina will, as it has indicated it wants to, substantially accelerate its process of adjustment and that the international community will quickly and vigorously respond to Argentina at what I think is an important juncture.

PETER HENRY: We have time for one more question. The lady in the front...microphone please.

Good morning. I'm Melody Rawlings. Thank you, Dr. Summers, for coming. You spoke in your opening comments about the nature of monetary policy in the case of recession and the need for tools to counter the natural cycle, but you also commented on the difference in this expansionary cycle. Obviously, it's been longer than past cycles – higher productivity from labor, a lot more efficiencies in the production process, both with labor and capital and resources. So, how come, can you imagine what the potential future recession looks like, and will that be different? And maybe the magnitude of policy tools will be much smaller than the 500 basis points you referred to. So maybe monetary policy will not be a tool the way it has been in the past. So, what does the recession of the future look like? And also, I would tie in your comments on public/private partnerships. Maybe that is a tool, a mechanism that we haven't even considered.

LAWRENCE H. SUMMERS: So, very quickly on public/private partnerships, I've always been surprised and never fully understood why it is that in capitalist America almost all the airports are owned by the public sector and in much less capitalist Europe, almost all the airports are owned by the private sector. And I don't precisely understand why that is. Part of it is that there are more rewards to accounting gimmickry in Europe where the gains in terms of deficit targets from privatizing things are greater given the way the accounting is done, but I don't think that's a complete explanation. And so, yes, I'm sympathetic to more well-designed public/private partnerships. What will the next recession look like? Look, historically there are two kinds of recessions that the world has. One kind of recession, which was characteristic of the period from the Korean War to the fall of the Berlin Wall was the economy overheats, the Fed feels the need to bring inflation under control, it forgets that there are, or isn't able to fully internalize the lags of monetary policy, and it's like scalding yourself in the shower, turning the heat up. You forget how long it, you don't recognize how long the lags are, and they over-adjust interest rates, and then the economy skids into recession. That's one pattern. A second pattern is that that doesn't happen and things are good and things are good and things are good. And people feel better and they feel better and they feel better and so asset prices go up and more and more people feel better and see that asset prices have gone up and they buy. And after a while they're buying less on a view of the fundamentals and more on a view of the future buyers. And at a certain point the supply of new buyers dries up and asset prices collapse. And when asset prices collapse, wealth goes down, and so people spend less. When asset prices are low, people create fewer new assets. And when asset prices go down, there are financial strains and the economy goes into recession. That's the story of the 1990 recession. That's the story of the 2001 internet bubble recession. And most dramatically, that's the story of the 2008 recession. Either is possible. The logic of my argument would be that when the next recession comes, it is more likely to be of the second kind than it is of the first kind. And, if anything, that probably means the need for more interest rate reduction, not less interest rate reduction, or at least it means that you're not starting to reduce interest rates from an abnormally high level. When you have the first kind of recession, you've sort of raised interest rates high to control the inflation and that gives you lots of room for the 500-basis point cut. When you have the second kind of recession, you don't have that aspect, and so to the extent that the second kind of recession is the more likely one going forward, then you really do have the problem in a large degree. And I might just say finally, and you'll each have your own opinion, my opinion is that if you imagine a scenario where the economy went into recession and the Fed reduced the fed funds rate back to zero, my guess is that if nobody did anything else, the 10-year would be at 1 ½. And so, the scope to layer effective forward guidance or effective QE on top of reducing the fed funds rate when you've got a 10-year that's starting at 1 ½ is going to be very, very low. And that reinforces my concern that we're without a monetary tool. And, of course, when we're running the government budget deficit up to the 6% of GDP range before the recession, the scope for the political process to decide that it wants to do fiscal policy is also more limited. And so, it seems to me that one should view the next recession with considerable trepidation. Now, look, nothing is certain in economics. And when I work myself up into the most pessimism about all this, I remind myself that Australia has been in expansion for 23 years. And so, it's not that it's an absolute given that the economy will go into recession, but on balance it seems to me we should be worried more than most people seem to be about the brittleness of the economy.

PETER HENRY: And just to be clear, you did not just say that we're going to have an expansion that lasts another 14 years. You did not say that.

LAWRENCE H. SUMMERS: I did not say that. I absolutely did not say that.

CHAIRMAN TERRY J. LUNDGREN: Larry, you gave us a lot to think about and, Peter, thanks for the questions. Very well done, gentlemen, thank you. (Applause) I also want to thank Barbara Van Allen and her terrific staff for making today possible. Thank you, Barbara, and the team here for the Economic Club. And please don't forget that tomorrow we have Canadian Prime Minister, Justin Trudeau, here for lunch. So, please join us. Tickets are still available. We hope to see you tomorrow. Thanks everyone.