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The Honorable Lawrence H. Summers
United States Secretary of the Treasury

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Introduction

Chairman William J. McDonough

We have the great honor today to have the new Secretary of the Treasury, Lawrence Summers, give his first major domestic policy speech at the Economic Club of New York. We are all very familiar with Larry Summer's brilliant career, but in public service it is even important, more important to be wise. I can assure you after six years of working very closely with the Secretary in his rise through the Treasury Department that he is a man of profoundly good judgment and great wisdom. And therefore, it is my distinct pleasure to welcome him to the Economic Club of New York, the Honorable Lawrence Summers. (Applause)

The Honorable Lawrence H. Summers

United States Secretary of the Treasury

Bill, thank you very much for that kind introduction. One of the rewards of being an economist who is in public service is that you have the good fortune to be introduced without an economist joke. (Laughter) It wasn't so long ago that I was introduced by a fellow who said, "Mr. Summers, do you know what it takes to succeed as an economist?" And I said no. And he said, "An economist is someone who is pretty good with figures, but doesn't quite have the personality to be an accountant." (Laughter) What was interesting was that that was in Moscow and they didn't really get the joke. (Laughter)

I am very glad to have the honor of speaking before the Economic Club of New York and seeing so many old friends and so many people who have done so much to strengthen this nation's economy. We come together at what I think is a very special moment for the American economy. Times in many ways are better than they have been in a very long time. If we as a country – families, businesses, and government – are to take the right advantage of this moment, it's crucial to understand how we got here, not to take today's good fortune for granted, and to make prudent choices for our economic future. I want to focus today on the question of the right strategy for maximizing the growth and the well-being of all Americans, because this has to be the primary aim of any Treasury Department and because the performance of our economy is crucial, not only for family incomes and business profits, but also our ability to attain a range of our national goals from reducing crime to maintaining a strong national defense.

Today my focus will be on our domestic economic strategy. Clearly, the performance of the American economy cannot be separated from the global economy. And as I've often stressed, the right international economic policy is a critical component of our overall economic strategy. But because there will be other occasions to address international economic policy, because what we do in the United States is so important for itself, and for the example that it provides to the global economy, I want to concentrate on domestic economic strategy.

I think it's fair to say that economic discussions at the beginning of this decade did not even remotely foresee the issues that we are grappling with today. Today's forecasting debates are about how low unemployment will go and how fast productivity will grow, not about how high unemployment will remain and how long the productivity slowdown will last. Today's question is how to handle projected federal budget surpluses, not how to prevent budget deficits from spiraling completely out of control. And financial experts worry today about too few Treasury bonds for liquidity, not about too many bonds crowding out other issuers. Today there is the concern in some quarters that there may be cases in which markets overvalue distant revenue prospects. A decade ago the consensus was that financial markets were forcing dangerous short-term-ism on American business. Today the world looks at the United States and worries whether it will use its economic power well, not as it did a decade ago whether it will soon be overtaken by its major industrial trading partners.

These new developments reflect an economy that is in many ways new and also a new economic strategy that we have been pursuing in recent years. It cannot be an accident that communism, planning ministries throughout the developing world, and large corporations run by command and control all ran into a brick wall in the same decade and had to be restructured. New technologies have forced profound changes in the way economic life is organized, putting a higher premium on flexibility and greater penalties on attempts at centralized coordination. In this new environment, America's traditions of flexibility and market competition have served us well.

Financial markets have ensured that U.S. companies were forced early to undergo painful reengineering and restructuring, permitting them to emerge faster and stronger in their fields. Our financial system with its emphasis on competition and diversity has helped to channel funds to new businesses through, in part, a venture capital sector that makes this country the only one where an entrepreneur with the right idea can raise his first $100 million before buying his first suit. And we have succeeded in this way in creating a post-industrial economy where Americans are leaders in almost every area, from fast food to accounting, from management consulting to retailing, from higher education to mass entertainment.

This flexibility and this dynamism has helped to build an economy that is new in many ways. But a new economy could not emerge except on a foundation of old virtues. Our economic success has also been made possible by President Clinton and Vice President Gore's determination, working with the Congress to forge a new national consensus in support of sound macroeconomic policies. Respect for the independence of the Federal Reserve has enhanced its credibility and so helped us as a nation to achieve price stability and maximum output. Consistently recognizing that a strong currency is in our national interest has helped us to hold down inflationary pressures and capital costs. And most important, we have been able to establish a new paradigm for the management of our nation's budget with enormous cumulative benefits for our economy and our citizens.

It has become commonplace to remark on how exceptional today's 4.2% unemployment rate is relative to any expectation at the beginning of the decade. It is no less remarkable that today after

8 ½ years of expansion, long-term interest rates are about two percentage points lower than they were at its start. This, in turn, has much to do with why the expansion has been investment-led, capacity-creating, and long-lived with capacity utilization, even today, not far from historic norms. Real investment as a share of GNP is today higher than it has been at any time in the post-war period. And along with the opportunities created by information technology, this strength can be traced to the dramatic changes we have seen in our budget policies.

Economic doctrine must adapt to economic experience. The traditional Keynesian idea that budget deficits can stimulate demand and increase output in an economy with high unemployment producing well short of its capacity, along with excess savings, does capture an important truth. But at the same time, it has become clear a more relevant truth, that in an economy plagued by low savings where output is not chronically constrained by demand, systemic budget deficits raise capital costs, retard growth, and lower employment.

Structural deficit policies give rise to vicious cycles. With underlying deficits and rising debts and interest burdens, interest rates increase leading in turn to falling investment and slowing growth, reducing revenues further, increasing deficits, and restarting the cycle. The process leads to steadily decreasing national saving and deteriorating economic performance – what we saw in the late 1980s and early 1990s. On the other hand, surpluses give rise to what might be called a virtuous circle of declining debt, increasing national savings, lower interest rates, greater investment, more growth, more revenues, further fiscal improvement, and a restarting of the cycle.

While there are many other factors and certainly difficult issues of causation, I think it bears emphasis that if one looks at the broad sweep of U.S. post-World War II history, the period of up to the mid-1970s coincided with a fallen ratio of debt to GNP, high national savings, and strong economic performance. By contrast, the weakest years from the mid-1970s until the early 1990s were the ones in which the debt ratio was also on the rise. It is this consideration that overriding national economic importance of moving from a vicious cycle to a virtuous circle that has shaped our administration's economic policy choices with a focus initially on deficit reduction and more recently on achieving and preserving budget surpluses.

American savers have had to absorb more than $1.7 trillion less in government debt since 1993 than they would have if the budget projections made in that year had been realized. That is more than $1.7 trillion available for new investment in America's future. While projections always need to be treated with great care, the complete elimination, about $3.5 trillion national debt is now within prospect over the next two decades – a prospect if we make the right choices today.

History is important for the understanding that it affords but equally for the humility that it imposes. Just as today's world looks so very different from the world as we saw it in 1989 and the world then looked so very different than the world ten years before that, so just as surely will the world look very different a decade from now. We cannot know what our economy will look like in decades hence. What we do know is that we are now enjoying a very prosperous moment. The reality for all of us, for companies, for households, for government, is that we cannot be complacent and take these good times for granted.

Indeed, complacency can itself be a threat to good times if it leads to excessive borrowing or lending, unsustainable spending plans or a failure on the part of consumers, businesses, and government to recognize and plan for the uncertainties that are inevitable in economic life. This suggests some core priorities for economic policy going forward. Nothing is more important to maximize the prospect for continued expansion and continuing the fiscal strategy that brought us to this point by assuring that the lion's share of projected unified surpluses are used to pay down debt.

Paying down the debt supports long-term growth and prosperity in four ways. First, it maintains the virtuous circle we have worked so hard to achieve, providing for high rates of investment in capacity growth that maximize productivity growth and reduce inflationary pressure.

Second, paying down debt by raising the pool of domestic saving avoids the painful choice that we would otherwise face between reducing domestic investment and increasing even further our reliance on foreign finance and the trade imbalance associated with that reliance.

Third, just as we used to point out that deficit spending was not an alternative to spending cuts or tax increases, but only a means of deferring them with interest, debt reduction is tantamount to a tax cut because it reduces future principal repayments that the government would otherwise have to make. Federal interest costs in 1999 will be $230 billion, more than the federal government will spend on Medicare and five times as much as it will spend on education and training. Reduced debt also means lower interest rates which in turn means lower borrowing costs and puts income in people's pockets just like a tax cut. Even a one percentage point reduction in interest rates translates into more than $250 billion in mortgage savings over the next decade.

Fourth, paying down debt prepares the government to respond to future contingencies such as recessions or threats from overseas. In a sense, it reloads the fiscal cannon. As recent economic history around the world reminds us, an improved fiscal position reduces a country's vulnerability to changes in international market sentiment and a strategy of paying down debt also reduces our vulnerability in one final sense. It assures our fiscal health even if, as what happened all too often in the past, fiscal projections need to be revised in the face of a changing economy.

For all these reasons, the most constructive thing that we can do as budgets are debated is to assure that the currently projected surpluses are not dissipated by large scale new tax or spending commitments outside of a sound economic framework. As President Clinton has recognized, we can do much to assure our future fiscal health by taking steps today to assure that the $2 trillion that we will accumulate in the Social Security and Medicare Trust Funds over the next ten years goes to promote net reductions in federal debt that are not offset elsewhere. And that as much as possible, that money helps to commit, helps to strengthen the commitment that these programs represent to our seniors.

Paying down debt has to be our first fiscal priority because it is the best fiscal action the government can take to keep the economy going forward. But even within a framework in which debt can be expected to remain on a downward path, we face crucial choices on taxes and expenditures. The President's approach is the right one. And we have grave concerns about the approach that is reflected in the budget proposals that were passed by the Congressional majority this summer.

The right choices for our country are analogous to the right choices for a household or a company at a moment of economic strength. Make sure that past obligations are satisfied, assure that future obligations that you know you will face can be met, and provide for a realistic and sustainable path going forward. That is the idea behind the President's approach. No prudent company would believe that a healthcare program that was the right one for its employees 34 years ago was likely to be the right one for them today, or that an unfunded, unreformed pension system was the right one to carry the company through to a period of sharply rising retirement rates. That is why it is crucial that we act to dedicate a portion of the resources that we are enjoying for this special moment to ensure the long-term solvency of Medicare and Social Security.

Making limited strategic public investments in a 21st century America in science and basic technology, in a modern defense system, and above all, an education, is crucial. At a time of such prosperity, it is wrong that in today's America there are schools where children have to eat lunch in shifts beginning at 9:00 in the morning and where the electric system is too old for children to safely plug in a classroom computer. We need also to maintain core public services by ensuring the continued adequacy of everything from the national parks to the Secret Service. Make no mistake; we do not live in an era of big government. The federal workforce is today 14% or nearly 700,000 smaller people than it was in 1993. To take an example closer to home for me, despite a growing economy, substantially increased international trade across our borders, the Treasury Department now has 9,000 fewer employees than it did in 1993.

Logic and history both demonstrate that budget surpluses premised on unrealistic expenditure plans simply will lead to budget deficits as infeasible spending cuts fail to materialize. Budget framework in which we propose to operate addresses the nation's economic priorities and does so in a context of continued declines in the size of government by about 10% after correcting for inflation over the next ten years.

What about tax reductions? The administration's framework shows how it is possible to pay down debt on a large scale and reduce future interest costs, strengthen Social Security and Medicare, and provide for the maintenance of basic government services while providing room for prudent, limited tax cuts targeted to helping families. We believe that of particular importance within that tax cut is measures to extend the benefits of tax-favored savings to the 70 million Americans who do not have access to pensions, 401Ks, or other tax-favored savings.

The President has, however, made clear that he will veto that tax cut that passed the Congress in the summer. Large tax cuts would deny the nation the full benefits of debt reduction that I have described. Depending on economic circumstances, they could force deep and dangerous cuts in core government or Social Security and Medicare. Indeed, projections that assume robust and adequate spending on national defense and separation of the Social Security Trust Fund suggest that tax cuts on the scale and vision in the Congressional legislation could lead to real cuts in basic domestic government spending of close to 50% by the end of the next ten years.

Can we all reach agreement on a way going forward? Yes, we can, if all sides can agree to put what we all know are first things first – assuring that debt is paid down, that Social Security and Medicare are protected, and that basic government is provided for. If we can accept the need to meet these priorities first, we can then reach agreement on a tax cut that fits in to an overall framework for these projected surpluses. That would be best. But the President is convinced that the country's interests would be far better served by paying down debt this year and not making future commitments than by making unbalanced and nearly irreversible commitments to either large scale new spending or tax cuts outside an agreed framework that assures debt reductions.

The right fiscal and monetary policies can lift a large burden from our economy, but without additional public actions to support the market system as it evolves, will not able to realize for the American people the full potential of our economy. We have, in many ways, moved to a new paradigm of public policy in recent years, one based on supporting, not supplanting the market. In a sense, one that is based not only on the invisible hand and certainly not on the heavy hand, but on a helping hand of government. That is an approach that we will continue to need to adapt and refine in the face of changing economic conditions.

Let me just illustrate this strategy with three examples of areas where Treasury has been active and will need to be more active in the future. At a time when information technology is transforming our economy, we need to assure that we confront 21st century market challenges with the right kind of regulation, regulation that seeks to harness market forces, not to distort them. That is the approach we should take to modernizing our financial system in a way that provides for business choice and competitive freedom, but at the same time, that safeguards privacy and strengthens communities. And it is the approach that we need to take as we work towards a financial architecture that maximizes the benefits and minimizes the risks that modern financial innovation brings.

At a time when labor shortages have replaced chronic unemployment as the primary labor market problem in many areas of our country, and where we have come to a greater appreciation of the dangers of long-term dependency, we have made and must continue to make great progress in strengthening support for the working poor. Under the policy that was in place in the mid-1980s, low income working families would have been eligible in total for only $5 million of support. By 1999, with the policy changes such as the earned income tax credit, the child credit that we have put in place, we are doing far more to help the working poor, nearly ten times as much. A substantial part is the result of the tax changes that have been enacted successively in the 1990s.

A final illustration of the use of market incentives, rather than a heavy-handed approach, to address crucial problems is the efforts to democratize the access to capital and to bring capital and private entrepreneurship to distressed urban and rural areas that mainstream business and investors might otherwise have overlooked. This was the central objective of the President's New Markets Initiative and his New Markets Tour last summer where we have seen very clearly that at a time of such economic strength, it is particularly important to include all the areas of our country.

And we have learned about democratizing access to capital, it's much more than making available funds for people to borrow. Equity, not debt, is often the constraint, and even more the constraint is the ability to attract the right kind of borrowers and to give them the skills that they need to manage money well. This is an area where Erskine Bowles made tremendous contributions during his time at the Small Business Administration. That is a theme that we have picked up and continued. And I believe it is a theme where we should be able to find the right ways to cooperate in a bipartisan way this year to make real progress.

These are encouraging examples of how this new approach can make a new economy work for people. But just as we can never afford to be complacent about the macro-economy, we cannot afford to be complacent about the micro-economy. With 40 million Americans still without health insurance and when a child born in many parts of this city is less likely to live to the age of five than a child born in Shanghai, our work is cut out for us.

I began today by remarking on how different economic policy discussions at the end of the decade are from the discussions at the start. No doubt much of what seems evident today will seem much less clear years from now. But if we can remember that we are fortunate to be operating at a very special moment, we can act to preserve our economy’s dynamism and flexibility, to reduce the debt that we bequeath our children, to fund our continuing obligations, and to effectively pursue the public purpose of making the economy work right for all Americans. If we can act to achieve these things, we, I believe, will have taken the right advantage of this special moment in our economic history. Thank you very much. (Applause)

QUESTION AND ANSWER PERIOD

CHAIRMAN WILLIAM J. MCDONOUGH: Thank you Mr. Secretary. We will now continue the club’s tradition of having two questioners who are club members Henry Kaufman on my left, a noted economist, and John Whitehead on my right, a great civil servant and former head of Goldman Sachs, who now, I am very happy to say, is Chairman of the Board of Directors of the Federal Reserve Bank of New York, for which I thank him. We will begin our questions with Henry Kaufman and then we will rotate questioners. And, Mr. Secretary, you're back to work.

HENRY KAUFMAN: Thank you Mr. Chairman. I should remind you, though, that from the perspective of the audience I'm on your right, not on your left. (Laughter) Mr. Secretary, you stated that a strong currency is in our national interest. To achieve that, does that mean you would have needed to encourage the Fed to raise interest rates or propose a tighter fiscal policy or intervene in the FOREX markets or any combination of these actions?

THE HONORABLE LAWRENCE H. SUMMERS: I had a feeling this subject might come up. Henry, as for any near-term actions that we might or might not consider, I think it is always best not to comment. As for longer term situations, well, they're hypothetical and it's not a good idea to engage in speculation about it. Seriously, I think that the right broad framework for the United States to operate in is the one in which we have now been operating for many years with a flexible exchange rate. And part of the reason why that is an attractive framework is that it enables us to use the tools of macroeconomic policy to pursue the central objectives of price stability and reducing cyclical variability and maximizing employment. At the same time, I think that it is very clear that in an increasingly open world in which global capital flows are increasingly important, as we set the tools of economic policy, we can never fail to pay attention to the international dimension and to exchange rates. But I would caution that the best way for those of us involved in making economic policy to help our economy, I believe, is to focus not on managing to markets. That is a game in which public sectors do not have an enviable record. The right approach is to focus on strengthening the underlying fundamentals of the economy, its levels of saving, its levels of education, its levels of investment, the flexibility of its system that enables factors of production to come together. And I think that by focusing on the fundamentals we best serve the real economy and that in the long run that's what best serves financial markets.

JOHN WHITEHEAD: Mr. Secretary, I'm down here on your right. Henry's question about currency markets makes me think of stock markets, another kind of market. Last week Chairman Greenspan mentioned the stock market. And although his speeches are sometimes dangerous to interpret, I think he said that he was keeping his eye on the stock market and made the point that if the stock market should have a sharp drop in a short period of time that there was the possibility that it would affect consumer confidence, lead to a reduction of consumer spending, and bring on some domestic economic problems as a result of that. Do you agree with him on that statement? And if so, do you plan to do anything about it?

THE HONORABLE LAWRENCE H. SUMMERS: Well, let me just, let me say this. I think there's no question to anybody who looks in a careful way at our economy that what happens in asset markets in general and what happens in the stock market in particular does exert an influence on consumption decisions of households and does exert an influence on the investment decisions of firms. As we try to determine what the right fiscal policy is, as those charged with making monetary policy decisions – about which I don't comment – make their judgments, clearly asset markets are one of the variables that they will need to look at. And certainly as we assess the risks to the economy and we assess financial strains, that is also something that needs to be looked at and there will be moments when developments in financial markets will force, or make appropriate policy responses. Certainly last fall there were very dramatic developments in financial markets that made policy responses appropriate and I think those responses, both at the international and at the domestic level were constructive and contributed to a global economy that is today much healthier than I think many would have judged likely, would have judged likely a year ago. But I don't think it is appropriate for those of us in government, as I suggested, to try to manage to markets, to try to manage markets, or to try to substitute our judgment for the judgment of the large number of participants in markets. What we can best do, I think, is concentrating on strengthening the fundamentals of the economy while at the same time worrying about the various risk factors and being prepared to respond if any of them should arise.

HENRY KAUFMAN: Mr. Secretary, I know you devoted your talk today to domestic matters, but you do have important international responsibilities. And therefore, let me ask you, in view of the rampant corruption in Russia and the substantial flight of capital out of Russia, on what grounds do you believe the U.S. is supporting the IMF loans? And what steps, if any, are being taken perhaps to rectify the situation? As you know, we, in the financial markets, tend to say investigate before you invest. We may not do that very well most of the time or sometimes. How do you feel about this?

THE HONORABLE LAWRENCE H. SUMMERS: Bill, someday I hope, some years from now, I can have an opportunity to be a questioner at the New York Economic Club. (Laughter) Henry, let me speak to the broad question of economic reform and our support for economic reform in Russia. I think it's a truism that we, in the United States, have an enormous stake in the way in which Russia evolves. Not least because of the large numbers of nuclear weapons and nuclear materials that remain within its borders and because of its continuing geopolitical significance. And I think, and I'll get in a few moments to the problems, that we need to recognize that Russia is a different country than it was six years ago. It is a country that no longer targets the United States with nuclear weapons, that no longer has military troops in the Baltics, that has gone through one of history's largest reductions in military forces and military production capacity, that has in very substantial ways dismantled the apparatus of communism. I think we have a very great stake in all of that. We need, as we recognize that great stake, to always recognize that Russia will shape Russia's destiny. That we, in the United States, cannot want economic reform or market system, democracy, in any country more than the people who live there and their government. That our role needs to be in a hardheaded way to pursue what are our interests in Russia's evolution and to encourage the process where and how we can. It's been that philosophy that has guided our efforts to support Russia. As everyone in this room knows, the push towards economic reform and the creation of a market system in Russia suffered an enormously severe blow with the breakdown of the Russian financial system, the default on internal debt, and the large scale devaluation that took place a little more than a year ago with ripples that were felt throughout the international financial community. Since that time the priorities for Russia as defined by the Russians have shifted to maintaining a stable economy, avoiding the hyperinflation that was forecast, avoiding the kind of return to communism that many thought likely. The IMF did, in that context, resume lending to Russia in the middle of this summer. But it did so on a very specific basis. It did so on the basis of the provision of funds that represented a partial refinancing of the debt that Russia owed the IMF with the means of that financing designed so as to assure as a safeguard that the funds lent to Russia would be used directly to repay the IMF. It did so also on the basis of requirements that Russia provide an accounting of various practices at the Central Bank. And reports in that regard have been received and further reports will be received and are entrained. It is our policy to remain engaged with Russia but it is our policy to remain engaged and to support IMF's continuing engagement only on the basis of adequate safeguards that resources will not be misused and on the basis of satisfactory accounting....(recording stops and resumes)...remain engaged while at the same time working to assure that our interests in having support funds well used is the right approach and that the alternative that some would suggest of seeking to quarantine or write off or simply contain Russia is, as the history of Europe in the first half of this century suggests, not the approach that in the long run minimizes the risks and maximizes the benefits for our country.

JOHN WHITEHEAD: I, too, have a question about an international economic situation. It's about Japan. The Japanese economy, next to ours, is the largest economy in the world and certainly five or ten times the size of the Russian economy. The Japanese stock market has had a major turnaround, a major advance in recent months as you know I'm sure. The yen has been very strong in relation to the dollar in the last, in recent months. Are happy days here again for Japan? Do we not have to worry any longer about the status of the Japanese economy?

THE HONORABLE LAWRENCE H. SUMMERS: I think the priority for Japan going forward has to be what has been from our perspective the priority for some time now – the achievement of sustained domestic demand-led growth given that there is still a very substantial unused capacity in the Japanese economy and given that lack of income growth is reducing Japanese imports significantly below what they otherwise would be. There have been some signs that certainly have been encouraging in some of the growth statistics and in some of financial indicators and the progress that's been made on some banking issues. But at the same time, it seems to me that if the experience of the last decade teaches us anything, it is that there will always be fluctuations from quarter to quarter or even from half-year to half-year and that one needs to be very careful before pronouncing that sustained domestic demand-led growth has been achieved. And I think the Japanese authorities recognize the need to continue to monitor the performance of their economy very closely and recognize that there's likely to be a need for policy actions to assure, to assure or maximize the prospects for domestic demand-led growth for quite some time to come.

HENRY KAUFMAN: Mr. Secretary, the government has issue inflation index-linked bonds now for a little while. How do you view the success of this kind of financing strategy? And do these types of bonds provide a valuable insight into inflationary expectations?

THE HONORABLE LAWRENCE H. SUMMERS: We now have, Henry, about $75 billion outstanding in index-linked instruments. And it is, in many ways, a tribute to the success of our broader national policies that inflation insurance is not a central theme on the minds of investors in the way it would have been at some points in the past. But I do believe that the provision of securities that make inflation or purchasing power insurance possible does significantly increase our capital markets' capacity to share and spread risk. And while I certainly would not be so naive as to suggest that all of the fluctuations and the spread between index-linked instruments and nominal instruments reflect changes in a homogeneous market inflation expectation, I do believe that in a broader sense, the existence of both indexed bonds and non-indexed bonds does provide information as to the general level and general extent of inflation expectations. And I think it is a tribute to the way in which monetary policy primarily, but also the broader economic framework in this country has been managed that people are prepared to buy nominal 10-year or 30-year bonds at spreads of only about two percentage points above the yield that is required on inflation-indexed instruments. And I think that is a way of reflecting that we have changed the inflation psychology in our country very much from where it would have been a decade ago. And my guess is that if we were ever to make the set of mistakes that would bring back that inflation psychology, that indexed bond/nominal bond spread would be a little bit like the miner's canary and would be one of the first places where we would get a substantial indicator that something was amiss.

JOHN WHITEHEAD: My last question is one on sanctions, the use of economic sanctions as a tool of international economic policy. I would observe that we have sanctions in a lot of places that simply aren't working at all. We have sanctions in Iraq and Saddam Hussein is still flaunting U.S. policy. We have sanctions in Iran and there's little evidence that we've modified the government there. We have sanctions in Cuba for the last, what, 40 years. We have sanctions in Serbia and Mr. Milosevic has not seen the light yet. Do sanctions ever work? And are they a legitimate part of the sort of kit of economic policies that the United States has in its quiver, to mix a metaphor?

THE HONORABLE LAWRENCE H. SUMMERS: The topic of sanctions towards difficult nations is one that I hesitate to try to discuss with someone like yourself who is one of the most distinguished economic diplomats this country has had in many years. In a sense, John, the way you phrased the question is a little bit unfair since if sanctions succeed we take them off. And so if we observe ourselves to continue to have sanctions towards a country, that means that we are not yet in a situation where the country is doing the things that it needs to do. I certainly share the concern that too often sanctions policies are of the "stop or I'll shoot myself in the foot" variety where the major losers are U.S. exporters or U.S. institutions and the major winners are their competitors from other industrial countries. But I think at the same time one does have to, always in these things, ask about the question of alternatives. What would the right alternative have been after nuclear proliferation norms were flaunted? Should we encourage or support American companies enriching the coffers of a Mr. Khadafi? If we're not able to use a calibrated instrument like sanctions, how attractive are the alternatives of either turning the other cheek completely or engaging in military force? So I think that to some extent some of the sanctions policies, and possibly you may have found this in government, could only be defended with what might be called the democracy defense – the terrible alternative just better than all the alternatives. That said, I think that there is a general bipartisan consensus in the Congress that our sanctions policies have probably gotten a bit out of hand because in each case the sanctions may be attractive but the cumulative effect of the sanctions on our economic interests is something people never take adequate track of and there are ongoing discussions with respect to sanctions reform. My deputy, Stu Eizenstat, who worked very much on these issues in the State Department and is continuing to work on them in Treasury, is taking a lead in those discussions. And I think that we will find approaches that will be more limited and therefore more constructive in the pursuit of our national interests going forward. Thank you very much. (Applause)

CHAIRMAN WILLIAM J. MCDONOUGH: Mr. Secretary, thank you very much for a wonderful prepared speech and some fabulous answers to very difficult questions. Our process of questioning is that the questions are never frivolous. That doesn't mean that they are not difficult as they certainly were today. Thank you John. Thank you Henry. Ladies and gentlemen, the business portion of our meeting is adjourned. I hope that those of you who don't have to rush off to do your jobs, unfortunately the Secretary being one who does, will stay and enjoy lunch. Thank you for coming.