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The Honorable George P. Shultz

Distinguished Fellow, Hoover Institution, Stanford University

Former U.S. Secretary of State

Questioners: Alan S. Blinder

Professor of Economics and
Public Affairs, Princeton University

R. Glenn Hubbard

Dean, Columbia University, Graduate School of Business

Introduction

Andrew Tisch, Chairman

Good evening everyone. I'll be very brief. My name is Andrew Tisch. I'm Chairman of the Economic Club of New York and I want to welcome you all. Before we begin, let me just tell you a quick little bit about this evening. First we're going to eat and then we will hear from Secretary Schulz. Dessert will follow the program in another part of the ballroom. So why don't you enjoy dinner and then right after the main course is served, we will get on with the program. Bon appetit.

DINNER

Andrew Tisch: Can I have your attention please? We're going to get started. Continue enjoying your meal, but I think we're going to get started so we don't run late. Anyway I want to welcome you to the 417th meeting of the Economic Club of New York. This is our 104th year. The Economic Club of New York is the nation's foremost, nonpartisan forum for economic policy speeches. More than 1,000 guest speakers have appeared before this club over the last century and have established a strong tradition of excellence. First I want to thank the 156 members of the Centennial Society. These are club members who have made special contributions to ensure that the financial stability of the club is guaranteed. Their names are in your program and on our website. I'd also like to welcome the students from Yeshiva

University's Sims School of Business, from Fairleigh Dickinson University, Rutgers University, and Fordham University who are with us tonight. As part of our program, we try to have students at every one of our meetings.

Tonight we're going to present the first Economic Club of New York Award for Leadership Excellence to George Shultz. The award and prize are going to be given biennially to an individual who has exhibited excellence in leadership in economic policy. The prize committee made up of Roger Ferguson, Glenn Hubbard, Henry Kaufman, Jane Hartley, and Susan Hullin unanimously chose Secretary Shultz as the first recipient of this award.

The prize and the award are made possible by a generous gift from Pete Peterson, former Chairman of the Economic Club of New York. Pete is a former Commerce Secretary and served in the cabinet with George Shultz. Pete founded Blackstone and started the Peter G. Peterson Foundation. He is one of the first voices in the country to speak out on government overspending. What we're hearing now, Pete has been saying for years. And we owe him a great debt of gratitude for that and for establishing the gift in Leadership Excellence for the Economic Club. And Pete, thank you very much.

Pete will introduce Secretary Shultz and present the award after the Secretary's remarks and questions. The Secretary will be questioned by two members of the club. And if you have any questions you can email them to the club's President, Jan Hopkins at questions@econclubny.org.

First, to set the stage for tonight we have an excerpt of the fabulous PBS documentary about Mr. Shultz called, Turmoil and Triumph: The George Shultz Years. So if we can run the tape please.

DOCUMENTARY - NOT TRANSCRIBED

Andrew Tisch: I give you Pete Peterson.

Peter G. Peterson: Thank you Andrew. You know it's all too rare in life when a decision is made about which one has no ambivalence. This is how I felt when I was informed that George was the recipient of the Economic Club of New York Award for Leadership Excellence.

We have been close associates and old, dear friends for over 50 years. We were fellow faculty members at the University of Chicago School of Business, though I hasten to add that I was a mere lecturer and he was dean of the school. We were colleagues in the Nixon administration. Indeed George recruited me in the first place. We worked as partners throughout those years and once again I was surely the junior partner.

Public service has defined George's life. First as a Marine, his service in the Marine Corps, and then George served with distinction in four different cabinet posts as Secretary of Labor, Director of the Office of Management and Budget, Secretary of the Treasury, and Secretary of

State.

Then George also brought his talents to the business world as President of the Bechtel Group. And like a true renaissance man, he has a distinguished academic record: Princeton University, a PhD in industrial economics from MIT, and now at the Hoover Institution and at the Stanford Institute for Economic Policy Research, the organization to which he is contributing his award.

George's personal qualities defy the laws of compound probabilities. I know no one that combines his qualities of humility, of integrity, of discretion, and of intelligence, and of leadership. And at 90 years of age, George is actively participating in public policy debates, a true inspiration to young people like me.

I have searched hard for even one situation where George ever disappointed me. I can think of only one. We were frequent golf partners and against other teams our track record was unblemished by a single success. George and I differ, though, on our respective contributions to this dismal record. George, my friend, you have played a unique role in steering the country through some tumultuous times. We look forward to hearing what lessons you have learned that would help us through today's daunting challenges. The floor is yours, George, and I'm sure you won't need a Mulligan.

The Honorable George P. Shultz

Thank you Pete. It is a great honor for me to receive this award from the New York Economic Club. This is the premier organization of its time in the world. And so to have this award is very special, and to be introduced by Pete is also special because we've been friends a long time. And Pete is the kind of friend who is always there for you. You just know it. So thank you Pete.

And I also have lots of friends here in this audience, great friends for a long time, people I've served with, people I've been associated with for many years. So it's a warm, sort of homecoming in a way. You probably know I was born in New York City so I'm not a total stranger here even though I've lived in California a long time.

Think of the last century. It's been a century with wars, two big world wars, depression, social upheaval, tough times. But it's also, particularly in the years since World War II, been a time of unprecedented progress in the human condition. Huge decreases in poverty. People are living longer, they're healthier, due in some considerable part to the breathtaking research on how the human body works and the production of pharmaceutical products and procedures and so on, and much of it emanating from the United States.

I also think it is fair to say that there has been created a kind of global commons in economic and security terms. And the leading role in creating that commons has been that of the United States.

We've benefitted tremendously from it and so have most of the people around the world.

Now we are at a time of tremendous change, seismic change in many ways around the world, that needs coping to try to create the right kind of global commons for this new world. And right now the United States is, to coin a phrase, leading from behind. To a certain extent, it reflects our economy, to a great extent. You can't lead if your economy is in the doldrums as ours is.

So what I thought I would do tonight is two things. Number one, to briefly suggest to you some of the underlying deep changes that have the world awash in change. What are they? And then I want to tell you what I think should be done to get our economy back on track. And I'm going to use two stories from my own experience to draw on in that set of prescriptions.

First of all, the world awash in change. Reason number one is demography. It's stunning to look across the world and see what's happening. In most developed countries, fertility is very low, way below replacement level. Longevity is rising. The labor force in proportion to the total is shrinking. These developments are bound to have an impact on outlook and capability. Germany, Italy, Spain, France, much of Europe, in Russia fertility is low, longevity for men is 66.0. We're going to live 12 years longer than men do in Russia. They're drinking themselves to death. It's a demographic catastrophe they have on their hands.

If you look across at Asia, Korea, Japan, Japan is the most rapidly aging country right now.

China has in some ways the most interesting demography because beginning about 30 years ago fertility dropped like a stone. So they have had a rising labor pool, I say labor pool rather than labor force because there's so much underemployment in China, but nevertheless they've had a rising labor pool, a shrinking number of people that labor pool has to support. Call it a demographic dividend.

Beginning very shortly, in the next year or two, it's almost like throwing a switch, there's going to be a shift. And the labor pool will start to decline and the number of people that the labor force has to support will start rising, after a while quite rapidly, as these demographics work themselves through. So the idea that China can continue the kind of broad economic growth that they've had overall is simply not possible. These kinds of projections are ridiculous.

Then if you look at Africa, the Middle East, the Maghreb, you see a different picture. Fertility has come down somewhat but it's still very high. And they've organized themselves in such a way that all these huge numbers of young people don't have much to do in many of these countries. So that's the demographic picture. The picture right after World War II is totally different now than it was then.

Then you have the impact of the information and communication revolution. This is a big deep development and it means that people in most parts of the world can find out whatever they want pretty easily. They can communicate with each other. And what this does is change the problem of governance. Probably not so much for countries that have been, have representative type governments, but where you have an autocratic form of government that's been there a long time, corrupt, it's devastating.

So we see the toxic mix in the Middle East and the Maghreb, lots of young people with nothing to do, finding out what they can easily find out, communicating with each other. They're not allowed into the economy in many cases. It's interesting to remember that the guy who in some way sparked off what I call the Arab Awakening was a little entrepreneur, wanted to have a little business selling fruit. And the regime squashed him, they wouldn't let him in the economy.

Then you have the emergence of violence that's more widespread than we certainly would like. And random violence done on a terrorism basis, a lot of it is sparked by radical Islam. And we're paying a heavy price in terms of what we're doing as a result.

And finally, think of the state system. You think of the world as organized into states that in some ways deal with each other, but you have to recognize that there are large areas of the world where there's a line somebody drew around on a map, but it's basically ungoverned. And there are many other areas that have a sense of government but no genuine sovereign capacity to do anything.

Then you have the ancient nation states of Europe and it's a little hard to say whether it's a state or whether it's the European community, or whether it's the Euro Zone, or where they are exactly. Right now they're kind of debating, are we going to diminish our sovereignty even further by some sort of joint fiscal union? Or are we going to go back to more national identities? But at any rate, there's no good address.

So I say the world is awash in change, and it needs help. Right now we're not there. We're drifting. And I think it's essential that we get our economy into shape. So what should we be doing? Let me tell you two stories.
During the Johnson administration, the guns and butter administration, people worried about inflation justifiably and out comes this notion of guidelines for wage and price changes. I'm at the University of Chicago, and like all the University of Chicago guys, I'm scratching my head about this. It seems like the conceptual precursor to wage and price controls to me. I ran a conference and all the big names on the subject came. It was terrific. We published a book on the subject.

Then I went into government, and by 1970 I'm Director of the Budget. And time goes along, inflation was about six percent, and it was worrying people. For some reason, the business community weighed in heavily. They thought we could have wage controls but not price controls so they were lobbying. The Congress passed a law giving the president the authority to impose wage and price controls, kind of a dare. And I'm sitting there worried and worried.

So I give a speech entitled, "Steady As You Go." And the argument was we have the budget under control, we have a good monetary policy with a lag, inflation will come down, steady as you go. Don't change. Obviously I lost, big time, and wage and price controls were imposed. It was a huge intervention in the economy. And somehow the Federal Reserve seemed to think that something was being done about inflation and monetary policy was probably looser than it might have been. At any rate, the 1970s were terrible, a bad decade in economics in this country. So that's one story, steady as you go. I coined the phrase, "An economist's lag is a politician's nightmare." Politicians want instant results. But the way the economy works, it doesn't work that way. You've got to make some input and then it's got to take hold, and give it time.

So I became a friend of Ronald Reagan and before long, during the campaign, and then for a year and a half in his administration, I was the chairman of an economic advisory board. And let me give you an idea of the kind of stuff we thought when I tell you who was on the board. Milton Friedman, Walter Reston, Alan Greenspan, Art Laffer, Arthur Burns, Bill Simon, and there were others. And there was a little difference between who was in the campaign and who later, but mostly there was overlap.

We were Ronald Reagan's pals from the campaign so when he was in office he listened to us. We met fairly frequently and we didn't tell him anything that he didn't realize, but we sort of reinforced his views, and we codified.

We wrote a report to him in December, between the election and the inauguration, laying out what we thought was a good program which basically he agreed with. So what did he do? The first thing he did was end the price controls on oil and gas, bingo, gone. Everybody was, oh, don't do that, the prices will go up. What happened? There was a little flurry for a while, markets kicked in, and the next thing you knew, prices are going down. What do you know? The market is a better regulator than the government. He did it. And he declared something of a, the same thing on other regulatory aspects that were out of hand.

Then we went after taxes. There was a big reduction in taxes. Kennedy, you remember, got it down, Kennedy-Johnson, from 90 to 70, the marginal rate. Reagan got it down to 50. That was a big change. And the seeds of what became the 1986 Tax Act got planted in late '82, early '83. It took him time to work that through the process. So a tax regime was put into place. We argued that if you put these kinds of policies in place and you leave them there, they'll work.

Now what about inflation? He inherited an economy where inflation was in the teens. The prime rate was in the 20s. It seemed out of control. In that written report we made to him, we said there's no way you can have a decent economy unless you have a monetary policy that's consistent with having inflation under control.

So he in effect put a political umbrella over Paul Volcker and Paul did what he knew to be done. And I can remember political people coming into Reagan and saying you've got to do something. He's got these policies, they're going to cause a recession, it's going to be bad news.

And Reagan in effect said, if not us, who? If not now, when? So we took it, a recession, at a bad midterm election. However, think of it as an investment in good economic policy. Inflation was brought under control, had some incentives in the economy. By late '82, early '83, the economy started to take off.

So what lesson do I learn from these experiences? The lesson I learned, particularly when listening to my friend, Milton Friedman, is that you want to do things, set policies in place that are consistent with prosperity without inflation, and make them permanent. You remember the massive research that Milton did in consumption. And from it he concluded, this is not an ideology, this is not some point of view, this is a finding. And the finding is very clear and powerful. Namely, that what Milton called transitory income does not have any impact on your behavior. It takes permanent income. So, do things that are permanent and you'll have an impact. Things that are temporary maybe move things around a little bit, but they don't have an impact. And if you do things that are permanent, something else happens. Namely, people begin to feel they can trust the government, that these are the policies, I can count on it. I know it's not going to be shifted.

So what should we do right now given these lessons that at least I feel I've learned? Number one, let's have tax reform. It's obvious. Jim Baker says the tax system is an insult to your intelligence. It's loaded with preferences. So I think it's well known. Tax experts can in a flash give you all the numbers. Clean out the preferences, lower the marginal tax rate, and say, okay, this is the tax system now. We're not going to change it. Do the same thing with the corporate rate. Lots of preferences, clean them out. Lower the rate. Get the rate down at least to 20 percent. Then people can repatriate their earnings. And we get some of that money here. We need the money here to finance our own investment. So that's step one.

Step two is spending. What should be, how do you know where you should go? Well, let somebody calculate what the revenues would be from this tax system if the economy were operating at a good level? You can ballpark that number reasonably easily. That should be your aiming point. So you've got the expenditures now. And I hear people talk about saving one trillion, two trillion, four trillion over ten years, and as a budget director, I say I don't get it. When I was budget director, we worried about this year's spending and next year's spending. We made projections of things but that's what you can control. We have no control today, zero, none, about what people are going to do ten years from now. So when I say, to paraphrase a well known statement, ask not what a Congress ten years from now will spend, ask what you will spend this year and next year, and whether next year will be less than this year. Get the line going down. Then maybe we can get somewhere. These multi-trillion dollar things leave me cold.

But once we begin to work on spending, we also have to get back to going about it in a proper and constitutional way. The government has been operating on continuing resolutions now for I think about three years. That's dumb, because the economy, everything is dynamic. And if you keep having the same thing year after year, you don't have any room to maneuver. So the right way to have a budget is that the president takes a proposal, it's a real proposal, the Congress holds hearings, puts down a number, distributes it among the committees. The committees hold hearings. They authorize and appropriate. And this is people who then have knowledge and they can set priorities and so on, and out of that comes the budget. That's the way to do it. So we've got to get back to that method of doing it. It's the only way it makes any sense. The continuing resolutions make no sense at all.

So then, of course, what about Social Security and healthcare? What can we do about them? Well, Social Security is probably the easiest thing to cure that exists. All you have to do is change from wage indexing to price indexing. Don't change anything for anybody 55 years old or older, so demagogues, get off my back. If you do that, you make the system solvent.

And I say stop playing around with the payroll tax which is the way you finance the thing. If you keep reducing it for a year here and a year there, you're undermining what you're trying to do. Personally I would go for voluntary private accounts, but that's not, that's not really the solvency issue. I would also do a few things in Social Security if I had my way that will help keep people in the labor force longer.

Here's an example. Right now your benefits are calculated on the basis of high years out of the first 35. Let it be 40. Some of your high years are probably in the later years. And then say, like a private insurance, say after 40 years of paying in, you're paid up. That's enough. That means that from your standpoint your take-home pay is higher. From your employer's standpoint, you're less costly. You narrow the wedge dramatically between what you cost the employer and what you get. So more people will work under those circumstances and you'll probably more than make up, now there's no way to be sure, but we've tried to estimate as best we could. You'd lose some money from the payroll tax but you'd gain probably other revenue in other ways from this change. So it would be revenue-neutral. So these are things that are pretty obvious. I almost hate to talk to you about them, they're so obvious. But anyway, they could be done easily, quickly. You don't have to do any more big research. You don't need any more commissions or anything. Just do it.

Now the healthcare area is harder. And I don't like the healthcare law and I hope something can be done about it. But in the meantime, we don't have to stand around limp and do nothing. There are things you can do that will improve the situation. One of them is the healthcare arena is very opaque compared with almost any other industry. And it is possible to take Medicare records and so treat them that private individual information is totally stripped down, nobody's privacy is intruded on, but you can make it clear what's happening to prices and outcomes with different doctors and hospitals. The variations are stunning. If you got that information out there, consumers can react to it and also you've identified the people who are really doing well and you can identify the laggards and maybe that will make the laggards do a little bit better.

So information isn't there in any great quantity and it can be put there easily. At least as far as I can see, the HHS is kind of dragging its feet on that. It's authorized by law. You don't have to get the Congress to do anything. It can be done administratively. Let's get it done.

And you could do a simple thing like let people buy insurance across state lines. That shouldn't be difficult to do. Why is that? Well, in most states some combination of insurance companies and providers have gotten together and most states say if you're going to sell insurance in this state, it mandates that you sell it on these big lists of things. That makes it more expensive. But if you're a 25-year old, young woman or man, healthy, do you want all this list of things? No. What do you want? You want insurance for a catastrophic medical event. That's what you want. But you can't buy it because of all these mandates. So if you let people buy insurance across state lines some states would say, hey, we're going to really be competitive, and all of a sudden you'll get some competition into this. Then you'll get a different picture.

I love that ad on TV, you've probably seen it, with this cute girl who is selling automobile insurance and she says to the guy, now I'm going to design an insurance policy for you. Well, you could have an insurance policy designed for you, what your problems are. And the problems of the young person are different from the problems of an older person, and so they're going to want different insurance packages. Make it possible. I'm sure there are other things you can do. But anyway, that's something, these are things you can do to start getting this under control.

And I also think there are going to be technological developments, I know of one in particular, that are going to make a difference. And so we work on these things and we start to get the spending under control.

So what about monetary policy? Monetary policy is contributing to the uncertainty. Everybody says every time they meet or somebody makes a speech, what are they going to do next? They've done huge things. Let's get back to a rules-based monetary policy. So that doesn't mean the Fed has to just follow the rule all the time, but if they want to deviate from the rule, they should explain why. If they'd followed the Taylor rule over the last quarter of a century, we would have had better monetary policy than we've had. And I'd like to hear an explanation of how the Fed is going to unwind this gigantic balance sheet they've got. How are they going to do that? And I hope somehow they can avoid being the Treasury's banker because the amount of debt that's coming at the market is astronomical. And if the Treasury, if the Fed winds up buying it all, we're lost. So that means there's going to be some reality put into the situation.

So this is the kind of program, there are a lot of other things I could talk about, long-run essential, the K through 12 system needs fixing. We all know that. We all know pretty much what it takes to fix it. I think energy is a subject that needs to be addressed. I won't go into these things, but you can see where I'm going. It's steady as you go with a set of policies that are consistent with prosperity without inflation.

As you can tell, I'm a Reagan guy. And you remember about ten years before he died, he learned that he had Alzheimer's disease. And he wrote with his own handwriting a beautiful letter to all of us, his beloved American people. And the last two sentences of that letter said, "I now start the journey into the sunset of my life, but I know that for America there will always be a bright dawn ahead." So I say, let's put these Reagan-esque kind of policies into place. If we do, the economy will respond, and we'll win one more for the Gipper. Thank you.

QUESTION AND ANSWER PERIOD

ANDREW TISCH: Joining the Secretary up front tonight are our questioners, Alan Blinder, who is Professor of Economics and Public Affairs at Princeton University and former Vice-Chair of the Federal Reserve, and Glenn Hubbard, a former Chair of this club and Dean of the Business School at Columbia University, and former Head of the Council of Economic Advisors. Alan, I'm going to let you go first.

THE HONORABLE GEORGE P. SHULTZ: I'm intimidated by the questioners.

ALAN S. BLINDER: Well, this is, you shouldn't be intimidated because I'm a graduate of Princeton as you are so I was tempted to make the first question your opinion of Yale and Harvard. Given the subjects that you spoke about, George, I want to ask you about the budget. And in particular you emphasized the need to focus on this year and next year.

THE HONORABLE GEORGE P. SHULTZ: That's the only thing we have any power to do anything about.

ALAN S. BLINDER: How in this environment of extreme partisanship, I would say, and I think most people say, would you think we could effect a budget compromise in the near term?

THE HONORABLE GEORGE P. SHULTZ: Well, I don't know. It was possible in my day to do these things. I thought the Bowles-Simpson thing was a pretty impressive document. Why the president didn't pick it up is beyond me. It was something to work with. So I think there are all kinds of things that are there if you will go and work with the Congress.

I was reading over this report that my group made to President Reagan before the inauguration. And one of the things we said was appoint a Secretary of the Treasury-designate right now, quick. And in addition to deciding what we should do, have him talk to members of Congress, because there's obviously a critical moment here. Inflation way up there and so on. And start listening to them and talking to them. And at least in my experience you start by saying to people, look, we've got a problem, right? It's a big problem. Now how are we going to get at this problem? We have to get at it. There's no alternative. We can't just sit there. And here's some thoughts. What are your thoughts? And you begin to...that must be what Simpson-Bowles did, and they got somewhere. I think there are a lot of adults in the Congress, and you could work with them. So try, instead of constantly dissing each other all the time.

ALAN S. BLINDER: You talked a lot in your opening, as almost ____ to long-term growth and policy being steady as she goes, and you gave great examples for monetary policy. We went through a period in the 2007 - 2009 financial crisis where policy was incredibly activist. Many would say might have even amplified some of the uncertainty in the economy. What could we, or should we have done differently in that period?

THE HONORABLE GEORGE P. SHULTZ: Well, going back I think two mistakes that were made. Monetary policy was too loose, and there was a huge government push to get people into houses. Banks were induced and the Fannie Mae and Freddie Mac were to the point where no down payment, no questions asked, and you're laying the groundwork for a problem.

Then you have securitization. And what that means is you wind up with loans and nobody has skin in the game because the guy who makes the loan gets a commission for making the loan and he's out of it, no skin in the game, and so on. Unless you have people with skin the game, you're in trouble. There's no substitute for it.

So I think those are mistakes that were made and as far as I can see we haven't done anything effective about Fannie Mae or Freddie Mac yet. And a reason why the housing market is still a problem is we keep fiddling around with it and we don't let it find itself. So I think those things were a mistake. I wasn't there so I don't know what I would have done about all these interventions, but I thought it was way overdone.

I remember, of course, it was a different time, but when I became Director of the Budget in 1970, I found that there was an organization called Penn Central. It was a big financial organization that was about to go bankrupt. It mismanaged its affairs. And Arthur Burns, who was my mentor, and you probably knew Arthur, he was a fantastic guy, and he had a presence. Helmut Schmidt called him the Pope of Economics. When he spoke, that was it. And he was terrified that if Penn Central went down, it would have big repercussions in the financial markets.

And he had somehow managed to get through the Pentagon a large sum of money that would bail out the Penn Central. I never quite understood how this was going to work, but that was what he was going to do. So I'm arguing with Arthur, half of me was saying what am I doing arguing with Arthur Burns about the financial markets, but in walks a guy named Bryce Harlow. Maybe you remember him. He was the savviest congressional relations, political advisor anybody ever had.

He walks in, he says, Mr. President, in its infinite wisdom the Penn Central has hired your old law firm to represent them in this matter. Under the circumstances you can't touch this with a ten-foot pole. So out went the bailout. The Penn Central failed. Guess what? No dominoes fell. In fact, it ____ the system because people looked at their hole cards and said, hey, we'd better be a little more careful.

And I also give Arthur a lot of credit because he had studied very carefully what some of the possible repercussions would be and he used every tool he had in the Fed arsenal, not just liquidity, but other things, to be sure that it was kept on an even keel. So I think it's possible to manage these things if you have some foresight.

Looking back, the AIG bailout, really, was that really a good idea now in hindsight? We had political bailouts of GM and Chrysler. What about a Rule of Law bailout? Why wouldn't that have been better? So I think there were a lot of mistakes made.

Everybody says Lehman Brothers is what started the crisis, but if you look at the spreads, it was holding. At least I think that the day that the Secretary of the Treasury went before the Congress and said the sky is falling, I need $700 billion to use for something that was transparently impossible, that's when you say, oh, my God. And, of course, the purpose he said it was for, it was impossible. They used it for something else.

So I think people went a little haywire myself and it could have been a little calmer and a little more...and this is why I think it's so important to start with an idea, with a strategy. And you could see fairly early on that there was this financial crisis coming. And it was interesting, for a long while it was there but the real economy kept going. And it was only after a while that the financial thing undermined the real economy. So that was a time when a candid description and a set of policies to deal with it on a fundamental basis might have made a big difference, but I hate to say things like that because I wasn't there and I know how difficult it is. But I know what I did when I was confronted with these things.

R. GLENN HUBBARD: I'd like to take you back to a time you were there. You spent a lot of time in your talk talking about the virtues of tax reform in general, and in particular about the 1986 reform which I might add is my favorite piece of tax legislation of all time basically. But right now there's a lot of talk about tax reform. It's more focused on the corporate but it also spills over to the personal. And at the level of generalities, it's exactly as you spoke about, that is lower the, tighten up the loopholes, broaden the base, lower the rates, which is what tax reformers always want. My question to you is given the state of the economy right now, given the state of the budget right now, and given the state of the politics right now, is it realistic to do a tax reform which actually gains revenue on net? The 1986 reform did not, and that enabled the reformers to give as much as they were taking back. There was sugar and there was spinach. And they were....

THE HONORABLE GEORGE P. SHULTZ: I fight to the finish 'cause I ate my spinach. I'm Popeye, the sailor man.

R. GLENN HUBBARD: I remember that too. I don't know about the younger people. But that's the question right now. Some people are talking about tax reform as a net revenue generator and therefore a contributor to the budget, closing the budget deficit. What do you think about that?

THE HONORABLE GEORGE P. SHULTZ: Well, I think the way to do it is you clean out the preferences and you lower the rates, and you do it on a static scoring basis. So from the standpoint of the static calculations that people use all the time, it's revenue-neutral. But I am firmly of the opinion that if you do that, and you do the corporate tax reform and people begin to feel that actually spending is getting a little bit under control, which is to say tax prospects are getting under control, then that will have a very positive effect on the economy and actually you'll start generating a lot more revenue.

As we all know, you don't generate revenue particularly by raising tax rates. You generate revenue by having expansion. That's when it starts rolling in. And I know there's some people who say we shouldn't have any more revenue. Nonsense. That means they don't want the economy to expand. I want the economy to expand. So do your reform on a static basis and then we'll see what happens. And I think what happens is you will get revenue because you'll get expansion. You get expansion, then you start creating jobs.

R. GLENN HUBBARD: I'd like to take you to the subject of the policy process itself. You're a man with much experience. You have so many cabinet chairs, you have a dinette set, if not a banquet table. And you've talked a lot tonight about ideas in economic policy, but over the past few decades we've seen successful economic policy, we've seen great failures. Some of that is surely due to the good or bad ideas, but some may be due to process as well. Do we have the right process for economic policy in Washington? And if not, how would you fix it?

THE HONORABLE GEORGE P. SHULTZ: Well, first of all, I said my peace about how you do the spending. And you've got to get back to the constitutional process of having the committees have hearings and do their appropriations and so on, and that's the way you get sensible spending priorities set. So they need to get back to that. I think generally speaking we don't have our government organized to be effective. Not just in economic policy, but otherwise. Let me explain.

Nowadays, and this has been increasing, it's very prevalent currently, there are people in the White House who are sort of czars, and they're in all these different areas. And what's happened is the members of the cabinet sort of report to these people. And I've talked to members of the cabinet, they don't see the president for a year. So the members of the cabinet are usually, and if you do it right, can be very distinguished people in their field, and they also preside over departments that have in them civil servants who know a lot. And if you work with them, they'll work with you. So the process we now have of policy being made with the president and these people in the White House means you don't take advantage of the cabinet and all of the knowledge that's there that can help you.

Now the process is hurt badly by this insane method we have of making it very hard to get a political appointment through. If you say, yes, I'll take this job, then you submit endless pieces of paper. I might say if something is wrong on one of them, you're subject to criminal penalties. That's not a pleasant idea. And that takes a long time. Then your nomination goes up and it takes its time giving you a hearing. If you have a hearing and they want more stuff, and you are voted out to the full Senate, any senator can put a hold, and you're used as a hostage. They have nothing to do with you at all, just I won't let this go until you give me something over here. It's a shameful process. And we ought to identify it and do something about it.

One of my favorite all-time public servants was Paul Nitze. He was a really great man. I had the privilege of working with him. In his memoir he tells about how he entered public service. He was a partner in Dillon Read and his senior partner, Jim Forrestal, had been persuaded by FDR to come into the White House because Roosevelt realized he had no contact with business or finance and he could see the war clouds coming, and so Forrestal went in.

So Nitze says, I'm down in Texas doing some deal and I get a cable from Forrestal saying I need you here Monday morning at 10:00. So he shows up. Forrestal says, well, I have this room, this is my desk, this is your desk. There's a very competent woman out there who will help us. I've rented a house in Georgetown. There's a room for you. I have no money to pay you so you'll have to stay on the Dillon Read payroll, but you start now. So says Paul, in this completely illegal way, I started my career working with the federal government.

Well, I'm not suggesting that that's the way to do it, but I am suggesting that you ought to assume that honorable people want to serve honorably and have a reasonable process. An FBI and an IRS check can tell you most of what you need to do. It can be done very quickly. Anybody knows, if they have a lot of skeletons in their closet, they better not come because it'll come out. And then the Senate should pay attention and do its job. So that would get things on track.

But more on economic policy, I think the process that I had, and a different way than Bob Rubin had is a better way to run things than is being run now. When I became the first Director of the Office of Management and Budget, I remember President Nixon sat me down in the Oval Office and he said, your predecessor thought the budget was his budget and I always thought it was my budget. And I want to be sure that everybody realizes it's my budget so we're fixing a nice suite of offices for you in the West Wing and I want you to be there and hold your meetings there. And if you have more people at the meeting, use the Roosevelt Room, but have people come to the White House so they know it's my budget. So I got this nice office and I did that.

And then after a couple of years he moved me on to be Secretary of the Treasury and he said, keep your office, and be Assistant to the President for Economic Policy. So you're responsible for pulling people together who are interested in economics. And when you're having a Treasury meeting, you have it in the Treasury Room, but when you're having an inter-governmental, have it in the White House. And I did that and it worked very well.

I was in Washington, I was staying with Lally's mother, Kay, and she very nicely, Bob Rubin had been appointed Secretary of the Treasury, so he was invited over for breakfast, and Kay very nicely left and the two of us sat there. And I told Bob about this and said, hey, you ought to consider this possibility. And he called me up a month or so later and he said, well, I didn't do what you suggested but I sort of have the same thing because I'm the only guy who goes to all the morning White House meetings.

So the Secretary of the Treasury should be the coordinator for the President on economic policy. Probably you have somebody in the White House, but it isn't, this is all the same thing. If you have some czar in the White House, you denigrate everybody else and that's not good. The Treasury has the horses. If you're going to do something about tax policy, you'd better go to the Treasury because they know about it. So that's an overly long explanation or statement but I think a lot can be done could to improve the quality of government by changing the way we go about it.

ANDREW TISCH: Mr. Secretary, we're going to end the questioning here. Do we have the award here? Pete, would you join us up front please, why don't you present the award.

PETER G. PETERSON: My friend.

THE HONORABLE GEORGE P. SHULTZ: Thank you Pete.

ANDREW TISCH: And Mr. Secretary, thank you for your insights, for your memories, and for sharing them with us and being such a gracious recipient of our first award. We present you with this award check which has been made out to Stanford University already at your insistence. So thank you very much.

THE HONORABLE GEORGE P. SHULTZ: Anybody that wants to match it is welcome. They could use the money.

ANDREW TISCH: And we have dessert behind that curtain over there. So thank you all very much.