

around the world want to purchase. This, in turn, can only come about if we do not have a regulatory regime in this country, which discourages risk-taking and limits the ability of entrepreneurs to raise capital from our domestic exchanges.

We also have to avoid the blame game. China's success in becoming the world's factory—producing high-quality, low-cost consumer goods—has been a boon to millions of American consumers. Steadily declining prices have also been an important factor in keeping inflation in check, even as energy prices have skyrocketed. It is easy for politicians here to blame China for the trade deficit but conveniently ignore how U.S. manufacturers could be exporting a number of

high-value, high-technology products to China—leading to a far more balanced trading relationship. But manufacturers are hemmed in by a continuing web of export restrictions that remain inflexible in their application. Meanwhile, China simply purchases these types of products from other suppliers.

None of these recommendations are particularly new or earth-shattering. Indeed, a number of the world's recent economic success stories followed this advice. Other countries are doing the things we preached. It is time for us to preach to ourselves for a change. □

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## No Free Lunch

Peter G. Peterson

ON THE military side of things, the United States is unquestionably the world's pre-eminent power and will retain that position for the foreseeable future. However, as someone once said, when economics gets important enough, it becomes political.

And, over the longer term, I have never seen a time—and I've been around for a long time—in which this many daunting, long-term economic challenges—very large elephants, if you will, that one could characterize as romping in our economic boudoir—that we pretend not to see and hope others are not rude enough to mention.

It seems to me quite obvious that these daunting, long-term challenges are undeniable, unsustainable but, in the current political context, untouchable. Unlike times past in American history, we want it all. We want it now. And, we

don't seem to want to give up or pay for anything. Shared sacrifice is considered politically incorrect, if not terminal.

I give you four examples: First, the entitlement explosion. Given an aggravated sense of societal "short-termitis", these fiscal cancers, which will soon metastasize at an extraordinary rate, are, as I said, denied. We are anesthetized to this coming explosion by soporific-like, fictional "trust funds" that will allegedly keep Social Security and Medicare "solvent" for years.

Contrary to the trust-fund oxymoron, these trust funds should not be trusted and are not funded. Indeed, the unfunded liabilities, in today's dollars, have been variously estimated at about \$40 trillion, or three times the GDP of the entire country.

Or, if you prefer to think in terms of projected tax increases on our future

economy and your children and mine, official estimates project a doubling of payroll taxes from about 15 percent to 30 percent of pay to cover Social Security and Medicare. Does anybody seriously believe that this economy, not to mention the American public, can absorb and fund these kinds of unprecedented taxes and debts to finance not investment, but as pure a consumption expenditure as any I can think of?

The second is our unprecedented current account deficits. These are now at record levels, nearing 7 percent of GDP—twice the previous record in the 1980s, when the dollar fell by roughly 50 percent against the major currencies over a three-year period.

And what of the cumulative effects of such unprecedented current account deficits? Bill Cline, a leading expert at the Peterson Institute for International Economics, (some would say that the institute is not very well-named!), projects that our net international liabilities would soar from 25 percent of GDP in 2006 to 75 percent by 2016 and 145 percent by 2026. Many experts feel that anything over a 50 percent foreign-debt level for the United States is imprudent and simply not safe.

Given our pathetically low net national-savings rate and, indeed, our negative personal-savings rate, we have become dangerously, dysfunctionally dependent on foreign capital on the order of \$8 billion every work day to finance our current account deficits and over half of our critically needed domestic investment. Doesn't that meet any reasonable definition of "unsustainable?"

The third: metastasizing health-care costs. Now at 16 percent of GDP, absent some profound changes in our body politic, these health-care costs seem to be heading quite inexorably toward 20 percent of GDP. We already spend over twice as much per capita as other developed nations, with no significant difference in health outcomes or longevity.

Our open-ended, cost-plus Medicare system is unique in the world, and we are certainly paying the price for it in so many ways, including, of course, our economic competitiveness—as seen daily and graphically in Detroit.

To be sure, there are some promising cost-reduction reforms in the form of information technology and so-called best practices, but there is a fundamental and currently politically untouchable issue we have not dared to confront; namely, that Medicare reform will require some of us to give up some medical treatment that may have some benefit.

Finally, our energy gluttony—and the related issue of global warming. With less than 5 percent of the world's population, we consume 25 percent of the world's oil. We consume over four times the gasoline per capita as our developed-country partners who, by the way, impose a gasoline tax about ten times the size of ours.

We import about \$300 billion dollars per year from some of the most unstable and unfriendly sources, fueling, if you will, not only our current account deficits, but their terrorism to boot. In addition, given some of the depressing Middle East scenarios our foreign-policy friends talk about, like a possible regionalizing of the Iraq War that could leave some Islamic extremist regimes in charge of large supplies of the world's oil—who knows what they could do to spike oil prices?

Most energy experts I know say that if the energy challenge is to be resolved over the near to mid term, it must be resolved, basically, on the demand side and not the supply side. Here, the most critical conservation steps are reforms such as a substantial energy tax that could be offset by an equivalent reduction in other taxes, say the payroll tax, tough mileage standards and, of course, shifting to nuclear power. (France, for example, gets about 80 percent of its power output from nuclear power.)

Instead, we hear painless, disingen-

uous, "comprehensive" energy plans, largely emphasizing alternative energy sources, which, however essential over the long run, will contribute very marginally to energy supplies in the near to mid term.

These four examples underline a basic philosophic question: Can our media-dominated, democratic society, fixated as we are on the short term and the next election and not wanting to give up or pay for anything we want, deal with a silent, slow-motion, long-term challenge that has no painful, palpable symptoms today? Or does it require a crisis? And a costly crisis it would be.

Earlier, I asked the question: Will the United States lose its position as the world's economic power? The answer depends largely, in turn, on the answer to some related questions. How do we educate and alert America's political leaders and, in particular, the American public to the magnitude of these daunting, long-term economic challenges? These represent a different kind of crisis, the silent, slow motion kind. Can, on a timely basis, both presidential and bipartisan leadership act together to persuade the American people to accept some fairly shared sacrifices for the common good, our common future and, indeed, our children's future? We have done so in times past, and I see no clear reason why we can't do it again.

So, are we headed for a day of reckoning and what would precipitate it?

If I were to pick one such precipitating factor, it would be some adverse political or economic factor that generates distrust or loss of confidence in America that jeopardizes this huge and unprecedented flow of foreign capital that we currently desperately, dangerously and dysfunctionally need to keep our economy afloat.

Any number of factors could trigger such a change. The onset of runaway budget deficits. Or, China's current ac-

count deficits and trade surpluses continue to soar and reach, say \$300 billion *vis-à-vis* the United States. The Congress, in a soft economy, imposes protectionist trade actions. Or, legislation that increases taxes on capital or imposes significant restrictions on foreign investment. Or, geopolitical events like a future conflict in the Taiwan Strait or a regionalizing of the Iraq War that is accompanied by a spike in oil prices. Or, countries that hold unprecedented sums of dollars decide to diversify substantially into other currencies.

These are all risks that this greatest of all countries should not be taking.

Will other countries supplant the United States as world leader? We are increasingly entering a multipolar world where the role of the United States will decline, in relative terms, *vis-à-vis* both traditional powers (mainly Europe) and especially rising powers (notably China). This is particularly true in economic and "soft power" terms.

China is the largest player on this stage. It is already the world's third economic superpower and will increasingly challenge the United States across the economic and, to some extent, military spectrums. Hence, U.S. relations with China will be the most important challenge for our foreign policy over the coming decades.

What should the United States do to restore our global power? There is nothing the United States can, or should, do to limit the rising economic power of other countries. We indeed benefit from their prosperity, and there is nothing we could responsibly do to stop them anyway. Our emphasis should therefore be in strengthening our own capabilities across this range of economic and political issues.

In economic terms, we must strengthen our competitiveness in a number of ways. Beyond getting our fiscal house in order, and, very importantly, increasing

our personal-savings rate, the most important is to improve our human capital through major reforms of our education, training and worker-assistance programs.

We must reject protectionism and seek to build a new domestic consensus that will permit us to, again, lead the world toward open markets, especially for certain service sectors where we are so competitive.

As to the fears of globalization, what is not much debated is our need to do two things: First, achieve substantial reforms of our educational system, particularly our output of technically trained people to augment our legendary innovativeness and entrepreneurialism. Second, we must beef up and improve our social safety nets (notably unemployment and wage insurance and trade-adjustment assistance) that cushion the inevitable transition costs for dislocated workers, rather than leaving them feeling victimized by globalization.

To be sure, America must import relatively less, consume and borrow relatively less, and save more and export more. But the rest of the world must be persuaded to do the opposite. They must import relatively more and consume more, and we must somehow persuade them that

they have to stimulate their own domestic demand. They cannot depend indefinitely on exports to the United States. This unsustainable and unhealthy symbiosis, a new version of supply-side economics—where they supply the goods and the money—must stop.

In terms of foreign policy, we must also strengthen our diplomacy, move away from our recent unilateralist tendencies and constructively address issues that are of paramount concern to other countries, such as immigration and foreign assistance. We must renew our efforts to create and strengthen multilateral institutions, especially in the economic area, where we can work effectively with both richer and poorer countries.

To achieve these reforms in the multipolar world, we must place a new premium on international cooperation as a critical means of restoring our own global economic and political influence. □

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