Larry Summers: The Economy Hasn't Grown Rapidly "in a Financially Sustainable Way" for a Long Time The former Treasury secretary on WhatsApp vs. Sony and why we need the Export-Import bank

Danny Vinik

Larry Summmers is the Charles W. Eliot professor at Harvard and the former treasury secretary for President Clinton. We talked recently about secular stagnation, the Export-Import bank and the trade deals Obama is working on. This interview has been edited and condensed.

Danny Vinik: Can you start by briefly explaining what secular stagnation is and why we should be so worried about it?

Larry Summers: Secular stagnation is an old idea in economics that goes back to the early American Keynesian Alvin Hansen. In its original form, it referred to the idea that there may be a chronic deficiency of investment relative tc savings creating a natural tendency for economies to drift and fall short of a full employment. Today, I think there are risks of what I've called the new secular stagnation. By that I mean that in the industrialized world economies, it may be very difficult for investment to absorb all saving. Or if that is made possible by the provision of extraordinary liquidity, it will come along with substantial risk of financial bubbles or financial instability.

What is the evidence that there are risks of secular stagnation? Start in the United States. The core financial crisis risk of failing banks and the like was successfully staunched and contained five years ago. And yet, since that time growth has averaged less than 2 percent below almost anyone's estimate of potential. So we're not really filling any ot the vast hole in output that came as a result of the crisis.

There could be many reasons for that, but perhaps an even more troubling aspect of the situation comes from looking at the growth performance of the crisis pre-crisis, perhaps from 2003 to 2007. The economy had the mother of all financial bubbles with vast erosion of credit standards and extraordinary run up in artificial wealth creation in houses and what have subsequently been criticized as overly easy monetary and fiscal policies. And all of those accelerants were only enough to lift growth to an adequate level. It has been a long time since the American economy has grown rapidly in a financially sustainable way.

The question that this account leaves open so far is why, if there is a tendency for savings to exceed investment, why can't lower but still reasonable interest rates balance things out? Here I think there are a number of answers both on the savings side and on the investment side. On the savings side, there's a tendency towards increased saving because of greater wealth inequality and a rising share of profits increased the share of income going to those with high savings propensities; because increased uncertainty and greater indebtedness encouraged savings to repair balance sheets; because an expectation of lower returns leads to people or pension funds needing to put aside more money to prepare for their retirement or to send their kids to college or whatever their savings target is. All of that tends to lead to an excess of savings.

On the investment side, you have a tendency for substantial reductions in the price of capital goods, particularly those associated with information technology. You have a change in the capital requirements for starting a business. Contrast WhatsApp, worth $19 billion, with 55 people in a big room with Sony, worth $18 [billion], and owning lots of factories and office buildings and the like. Or think about Google and Apple, major leaders in scale on the stock market, but with vast cash hordes. That operates to reduce investment.

All of this operates to reduce normal levels of interest rates and therefore to make the balance between adequate and sustained growth and financial stability more difficult than it has been traditionally.

DV: I want to ask about one misconception that I think exists within the media's idea of secular stagnation, that this is a permanent state that we're bound to be in absent government action. In other words, without fiscal stimulus, we will be doomed to low growth or adequate growth with financial instability. But that's not exactly correct, right?

LS: Why do you say that?

DV: I remember from an op-ed you published recently that over time, you said that over time, we could exit secular stagnation, but it would take many years of low growth until we ate through the excess in the system.

LS: I think it's usually a mistake in economics or in most kinds of forecasting to proclaim anything new as permanent. Hansen did not forecast World War II when he wrote about secular stagnation. And many during World War II did not forecast the pent up demand for housing and consumer appliances and the like that would occur during the years of rationing during the World War II and push the economy forward. It does not seem prudent to make a judgment about all the forces that will impact investment and savings in 2040. But it does seem to me that the balance of forces that we can foresee points towards greater tensions, unless something is done, between adequate growth and financial stability over the foreseeable horizon than we have been accustomed to.

DV: Your main proposal to combat secular stagnation is fiscal stimulus. What are your thoughts on monetary offset? That is, that if we had a big round of fiscal stimulus, the Fed will tighten policy and that will reduce the boost from fiscal stimulus. Is that a concern?

LS: Fiscal stimulus is one important aspect but there are others such as export promotion and removal of barriers to private investment that are important to achieving increased output and employment. I think it's highly situational. For most of the last five years, Federal Reserve policy has seen to be importantly constrained by the zero-lower bound on nominal interest rates. There isn't a reason to suppose that if fiscal policy were more expansionary, the Federal Reserve would necessarily pursue a policy of higher interest rates since they probably would have preferred that it would've been possible to pursue a policy of lower interest rates than the one they were pursuing.

Clearly, matters are becoming more complicated as the economy gets closer to capacity levels of output. Part of the argument is that a given level of demand achieved with more public investment or more private investment and somewhat higher interest rates would be more conducive to financial stability than a given level of demand achieved only through extraordinary monetary measures. The achieving demand only through extraordinarily easy money has problematic aspects in terms of efficacy. It has questions of the efficiency of the investments. Just how good will the investments be if you need extraordinarily low interest rates to call them forth? It has questions of fairness. Low interest rates operate to inflate asset prices and it's primarily the most fortunate who hold capital assets. It has questions of uncertainty generation since it involves interest rates and levels of liquidity that we don't have substantially historical experience with. And it places responsibility for financial stability on so-called macro prudential tools which we also don't have extensive successful experience with and which may move prove more difficult to use than is currently hoped.

I believe that achieving through a more balanced fiscal-monetary approach is likely to be the sounder strategy. That is not to say that given the alternative, and with no change in fiscal policy, that tightening monetary policy is a better course because that could have highly adverse consequences immediately for output and employment.

DV: I want to turn to your op-ed in the *Financial Times* on July 6 on the U.S. global stance on economic issues. In particular, you expressed support for the Export-Import bank and said that eliminating it would be an act of unilateral disarmament. Can you explain that?

LS: Probably at this moment, the greatest threat to open market capitalism comes from state-driven mercantilism capitalism, often carried on by authoritarian governments. They do not seek a level playing field. They seek a playing field that is tilted in their favor through the use of a variety of kinds of subsidized credits. The best and most credible way of deterring and limiting that behavior is to have a capacity to respond so that it does not produce commercial advantages. That's what the Ex-Im bank enables us to do.

There are some who believe that it is good for everybody globally to subsidize exports. I'm not among them. I'm in favor of negotiations that would move towards a system where you didn't have every country racing to compete with subsidies. But unilaterally renouncing our subsidies would be a source of great satisfaction in important parts of the world with which we compete and I do not think would be a productive way to bring about a more rules-based system.

DV: Does it concern you at all that after Eric Cantor lost his primary, Boeing's share price dropped 2 percent next day, largely attributable to the fact that Cantor was a big supporter of the Ex-Im bank and that his defeat signaled that the bank was in trouble?

LS: I haven't done a careful study of the evolution of Boeing's stock price, but I don't think so. I think that the elimination of the Ex-Im bank would be an adverse development for American exporters. Because of the business it's in, Boeing would be perhaps the most substantially affected. I would read it as market evidence for the proposition that Boeing would in fact would lose sales to Airbus and it seems to me like that that would be an adverse development. If middle class taxpayers across the country were sacrificing in order that Boeing's shareholders did better, that would surely be problematic. But if the Ex-Im bank does not impose a cost and may even provide a benefit for taxpayers and if the production of airplanes provides large numbers of middle-class jobs at a time where those are in short supply, I don't see this as a particularly important datum. But insofar as there is any information content in it, it is corroboration of the view that the Ex-Im bank is sometimes the difference between successful efforts to export and less successful efforts to export.

DV: Another thing you talked about in the FT op-ed was the Trans Pacific Partnership, the trade deal. One component of the deal is to bring down tariffs between all countries involved, but tariffs are already very low between these countries, particularly with the United States. The other pieces of the deal are things like stronger protection for intellectual property. How do you balance the importance of lowering economic barriers versus coordinating things like intellectual property laws?

LS: You'll have to talk to others about the detailed provisions of the TPP. Obviously, any ultimate judgment on the TPP has to rest on the particular agreement that is negotiated. I'd make these points. First, relatively unrecognized in debates over trade policy is what you acknowledged in your question. The United States already has very low tariff barriers, much lower tariff barriers than its trading partners. So our increased U.S. exports from any trade agreement is likely to exceed an increase in U.S. imports.

Second, it is true as you recognized that the trade agenda is an agenda that is moving beyond the traditional areas of tariffs and quotas to cover all kinds of business practices and rules regarding business practices. That needs to be approached with great care. There is certainly a tendency for all business advocates of more favorable rules to put their agendas under the auspices of free trade. Probably the greatest trade policy mistake that the United States has made in the past 20 years was what is now universally seen as the excessive emphasis on intellectual property rights that resulted in pharmaceutical companies being permitted to charge what now are seen as outrageous prices for Aids medicine in some of the poorest countries in the world.

I think we have to be very careful in the intellectual property area. I think we have to be very careful not to undermine the capacity to regulate health and safety. I've been peripherally involved in discussions over tobacco and believe it's very important that the TPP not act in a way that makes it more difficult to regulate to protect consumers against the dangers of cigarettes.

As a general principle though, the idea of national treatment seems to be a powerful one—that countries should be permitted to make whatever judgment they want up to and including banning cigarettes or banning any particular commercial practice. But it is problematic when they make rules that treat domestic and foreign firms in substantially different ways. The agenda for trade negotiations should not be agenda of what type of economic or health and safety or environmental regulations are appropriate, but instead should be an agenda of non-discrimination that seeks to enable whatever rules countries desire, but asks only that they applied in fair-minded ways with respect to domestic and foreign firms.

DV: There are situations then where the Trans Pacific Partnership would include certain provisions that would make you oppose the deal?

LS: You can never reach a definite judgment on any contract or agreement until you have read the fine print so of course it is possible. At the same time, I think reaching an overall agreement has a variety of compelling benefits, not just economically but also broadly geopolitically in terms of the American presence in Asia. It would not be the case that just because I saw, in an ultimate agreement, some imperfection or some provision that would not be the one that I would prefer, that that would not necessarily become a reason for opposing the overall agreement. As always in life, one has to balance.