

**U.S. CONFERENCE OF MAYORS PLENARY SESSION
“THE U.S. ECONOMY, NOW AND FOR THE LONGER TERM”
JANUARY 23, 2008
WASHINGTON, DC**

I am delighted to be with you today. My grandfather was the leader of a political club in Brooklyn many, many decades ago, and I grew up listening to stories about politics in which the mayor was the king of the relevant political universe. New York politics and urban politics have changed a great deal since then, but what has not changed is the central and closely felt role mayors play in the lives of their constituents. And, that position empowers mayors to contribute powerfully to our nation’s economic future, the subject I was asked to discuss today.

You, as our country’s mayors, have a relationship to your constituents that especially enables you to inform them about the extraordinary challenges our economy faces for the more immediate period and for the longer term. And, that can contribute meaningful to creating an informed electorate that holds all levels of our political system accountable for rising to meet those challenges. Beyond that, cities, regions and states have local knowledge that best equips them to meet many of the critical economic needs of our nation.

Let me also add that I’ve long held this view that our cities are central to the economic health of our nation. When I was at the Treasury Department, we set up an office of community development, both to more coherently promote a broad array of initiatives with respect to urban economic growth and also to convey the message that community development was a major economic issue. And, when I stepped down from

Treasury, my first subsequent activity was to take up the opportunity to become Chairman of the Board of the Local Initiatives Support Corporation. LISC, as many of you know, provides capital and technical assistance to neighborhood-led community development efforts around the country, and this past year LISC distributed over a billion dollars to inner cities and distressed rural areas. The economic health of our cities involves all socio-economic groups, and activities from the highest end to lower-wage. But, as to the inner-city dimension of urban life, I have long believed that bringing the economically disadvantaged into the economic mainstream is not only a moral issue but a powerful economic imperative, with enormous potential for savings in social costs and for increasing national productivity.

With that, let me now turn to our economy.

To start with the short term, as all of you well know, we are experiencing significant risk to our economy for the year ahead, and many families – especially lower-income families – face the terrible possibility of losing their homes due to sub prime mortgage foreclosure.

The economic risks began manifesting themselves in the middle of last year. Significant disruptions developed in sub prime mortgages and leveraged finance of private equities, and then spread to other credit markets. These disruptions were the product of a lengthy period during which risk was increasingly underweighted by historic standards in the valuation of almost all asset classes in the United States, including credit extension. Free market financial systems, like the United States has, provide great benefits to an economy. But, they have a history of seemingly inevitable periodic excess leading to periodic disruption, with today's events just the latest example. And, part of

what makes all of this so complicated for policymakers and investors is that judgments at any given time about whether markets are overvalued can easily be wrong, and timing is always unpredictable – markets in excess may disrupt in the near term or those excesses may go on for years.

Having said that, the credit markets have now been significantly disrupted for some time. The pressing question is how much these disruptions will affect the economy and affect families facing the possibility of foreclosure. The key economic risk is whether consumption will significantly weaken, due to increasing mortgage defaults, tighter credit, the reset provisions on adjustable rate mortgages, high oil prices, softening housing prices and a zero personal savings rate. Another concern is that constriction in credit may be spreading to areas other than mortgages. And, there is also the possibility that our longer-term risks, such as our multiple financial imbalances or geopolitical events, could materialize in the short term, as for example, in a destabilized dollar or a terrorist act. There is a great deal of controversy right now as to how serious the various shorter-term risks are. Some thoughtful observers predict a relatively high probability of serious and extended difficulty; others agree on the likelihood of serious difficulty but believe it will be short-lived; and still others think that a more limited slowdown is more likely. I don't have a strong opinion as between these views, but, I do think the risk of more serious difficulty is sufficient to call for policymakers to be highly proactive in working to reduce that risk. In that context, I believe the Federal Reserve Board has on the whole – and leaving aside debates about any one decision or another – acted soundly and sensibly with respect to interest rates and to other less noticed actions on liquidity. Going forward, the Fed faces difficult decisions, because actions addressing difficulties

in the economy and in the credit markets could create unwanted problems for an already soft dollar or could simply not have much impact because lenders chose not to lend or borrowers chose not to borrow.

In any case, there is also much that the Administration on its own, and the Administration and Congress acting together, could do. These actions include increasing and broadening use of the Federal Housing Authority, temporarily increasing jumbo loan limits with respect to Freddie Mac and Fannie Mae, which unfortunately has gotten caught up in legitimate but longer debates about reform of these institutions, and potentially most powerfully, putting in place various measures to catalyze renegotiations between borrowers and lenders with respect to sub prime and other mortgages. Mayors are well positioned to energize mortgage renegotiation by helping organize local community organizations and by working with the resources of the cities.

To go back to the federal level for the moment, reestablishing long-term fiscal discipline is absolutely critical, but I agree with the broadly-held support for a short-term fiscal stimulus involving temporary spending and temporary tax cuts well targeted to maximize timely impact. However, it is very important to distinguish between temporary short-term stimulus to generate demand, and restoring sound long-term fiscal conditions to keep interest rates lower, increase savings, heighten business and consumer confidence, reduce the risk of market disruption, and strengthens our currency. There has been a question whether our political system would provide a stimulus that is timely, well targeted and temporary; or whether all sorts of other agendas would derail or pollute this effort. At present, the political prospects appear hopeful. However, even with the seeming agreement around the principles for a stimulus, there still is a big debate about

whether the full rebate should go to the 50 million workers whose incomes are too low to create adequate income tax liability, although they do pay payroll taxes. I believe the rebate should include those low-income workers, not for income redistribution purposes but because low-income workers will spend the highest proportion of what they receive, creating the most demand for our economy per dollar of rebate.

Looking forward, our mortgage system also needs improved protection for consumers and against systemic economic risk. However, those measures must strike the right balance between increasing those protections and preserving the benefits of our free market financial system. Thus far, leaving aside the Federal Reserve Board, our political system has done relatively little along most of the lines I just set out, without regard to how you attribute the blame. As mayors, you can lead your constituents in demanding effective action now.

With that, let me now turn to the longer-term.

To start, I believe that the global economy and the global competitive environment are undergoing a transformation of truly historic proportions, a change in epochs. The United States can do very well in this new environment, but, to do so, we must meet our challenges. This global economic transformation includes rapid and profoundly important technological development; ever greater integration across national borders with respect to trade, investment and capital flows; the adoption of market-based economics and effective productivity policies in many emerging market countries around the globe; and finally as a result of all this, the emergence of India and China and other emerging market countries as major competitive forces. In addition, there is a vast shift of wealth to the oil-producing countries and to the Asian countries with large trade

surpluses, producing massive pools of capital. That wealth shift could significantly change the ownership of the world's resources, productive assets and business enterprises over the longer run.

Everything I just said is widely recognized. However, in my view, very, very few investors or policymakers have truly internalized how profound this transformation and its ramifications are likely to be over the years and decades ahead. When I look out the window of my office, I often think to myself that the realities of the global economy are shifting powerfully and rapidly underneath the feet of the people walking by, and that the future of those people and of generations to come in our country depends on our political system rising to do a far better job in meeting our critical challenges.

As mayors you deal daily with the economic difficulties and anxieties that most Americans are experiencing in today's global economy. Median real wages have been roughly stagnant for all of this decade, inequality favoring a very small tier at the top has increased greatly, and economic insecurity has grown. Technology, and to a far lesser extent, trade, globalization and the rapid success of China, India and other emerging market countries, have increased pressure in all of these areas. The resultant backlash against trade is understandable. But, I don't think there is any question that all of these forces of change – technology, trade and the growth of China, India and other emerging-market countries – have greatly benefited the American economy and the great preponderance of our people through lower consumer prices, lower input prices to producers, greater productivity, lower inflation, lower interest rates, and larger markets for our exports. Moreover, globalization will continue moving forward with or without us. The only question is whether we will be inside or outside the ever-expanding network

of preferential trade arrangements. But, the economic problems most Americans are experiencing and the competitive pressures for our economy and our people are also real. So, policies supporting a market-based economic system and trade must be combined with a powerful domestic agenda – along the lines I’ll discuss in a moment – to promote competitiveness, growth, widespread sharing of the benefits of growth and increased economic security.

The United States’ economy has great strengths: a dynamic culture of embracing change, the willingness to take risk, flexible labor and capital markets, a relative openness to trade and immigration, and huge critical mass in both capabilities and markets. With these enormous strengths, we can thrive in a rapidly-changing global economy in the years and decades ahead. But, to realize that potential, there is much difficult work to do. And too often our political system is mired in an unwillingness to reach across party lines to find common ground, in an unwillingness to set aside ideology in favor of facts and analysis, and in an unwillingness to make critically important decisions that are politically tough. And that is our nation’s most fundamental challenge: to substantially improve the effectiveness of our political system.

I think of our economic challenges as falling into four baskets. These baskets are: 1) our multiple financial imbalances; 2) serious shortfalls in the functions that government must provide as critical underpinnings to a market-based economy for growth, widespread sharing of that growth and increased economic security; for example, quality public education, basic research, infrastructure, energy policy, health care reform, bringing the poor to the economic mainstream, helping dislocated workers and much else; 3) the cost benefit excesses in our regulatory and litigation regimes; and 4) sound

international economic policy with respect to trade, immigration, flexible exchange rates, response to global financial disruptions when they occur and other matters. At the same time, we must also address a new generation of national security risks that could severely affect our economy, including nuclear proliferation, terrorism, an oil shock and much else.

Our financial imbalances are a serious threat to our future well being, but far greater public understanding of that threat is necessary to provide the political context for addressing these imbalances. These imbalances begin with past, current and projected fiscal deficits instead of the budget surpluses we should have had, given the surpluses at the beginning of the decade and what are probably temporary increases in tax revenues due to high corporate profits and other factors. We also face huge projected future increases in entitlements; a miniscule national savings rate and vast trade and current account deficits. The serious effects our financial imbalances could have had on interest rates and our currency have been avoided due to massive capital inflows from China, Japan and elsewhere. These inflows were motivated largely by a desire to support the dollar in order to promote exports. But, these inflows are exceedingly unlikely to continue indefinitely. Therefore, we must face the brutal politics around reestablishing sound fiscal conditions, because that lies at the core of addressing our imbalances. And, at the same time, making this even more difficult, we must also create budgetary room for public investment in critically important areas like education and others I mentioned earlier.

Let me turn now to the functions that government must provide. They are, at I said, critical underpinnings in order for a market-based economic system to succeed. The federal government is obviously key in many areas, but, cities are also central here.

Cities best understand their local strengths, and cities can build around those strengths more effectively in many ways than efforts directed from Washington. And, diversified local initiatives also provide the opportunity to evaluate different approaches to common problems to develop best practices grounded in actual experience. (In all of these respects, the federal government can further enhance local efforts through funding.)

The paramount area of local engagement, public education at levels K through 12, is absolutely key to our nation's future competitiveness and economic success. Adequate financial resources are requisite. But, virtually all education experts say that serious reforms are also essential; and mayors like Mike Bloomberg and Richard Daley are pioneering here by taking on such politically complicated matters as teacher selection, compensation and promotion. Hopefully, lessons from efforts like this can then be applied more broadly.

Our obsolescing and increasingly inadequate infrastructure is another economically critical area where local governments can and should play a special role. Local governments often have a better sense of what is needed and what should be done, for example, on water systems, air transport and mass transit to relieve urban traffic congestion. And, in an era of constrained federal and local fiscal resources, localities can employ many creative approaches to financing; for example, moving well-located municipal functions to less expensive real estate, and receive the one-time gains from the land sale in one-time expenditures on infrastructure, or –though with issues that need to be managed –privatizing existing infrastructure, and then reinvesting those proceeds in new infrastructure; or creating new infrastructure in this privatized mode.

To carry this one step further, the areas I've just mentioned – quality public education and infrastructure – are one powerful aspect of what cities can do to build around local strengths to catalyze economic activity, new industries and job creation. As another example of building around local strengths, there is immense potential for cities, regions and states in strengthening activities at universities and colleges that attract private businesses seeking interaction with university research and faculty. And, that can be tied into whatever local economies specialize in; for example, agriculture or financial services. Beyond that, cities have enormous natural advantages as metropolitan population centers that can support cultural activities, restaurants, and the many other aspects of robust urban life that attract the professionals and skilled people for today's knowledge-based industries and thereby attract the industries themselves. And, cities can act to enhance those activities. Moreover, that is true not just of large cities, but also small towns. For example, in Montana, whose river banks I have coated with miscast flys, small towns provide urban advantages in an outdoors environment that also appeals to many high-skilled workers.

This strategy of building around local strengths also applies to attracting manufacturing, transaction processing, and the like, by harnessing, such local advantages as rail, air and road transportation hubs and by providing public schools and community colleges to produce a well-prepared workforce. As a final point on building local economies, local initiatives could play a major role in developing energy alternatives and energy conservation as industries for the future; for example, through highly targeted aid for research at local universities to attract private sector activity; public/private

partnerships for pilot projects in innovative technologies; and special technical schools or university programs to prepare skilled personnel for these industries.

Mayors who take up the challenge of promoting the nation's growth through local initiative can draw on serious intellectual work product by your own U.S. Conference of Mayors, by the National Governors' Association and by various think tanks such as Bruce Katz's Metropolitan Project at The Brookings Institution. A good example of drawing on this work product is the summer scholarship program that Mayor Bill White of Houston based on a paper by The Hamilton Project, a source of pragmatic centrist economic policy thinking begun by a group of policy analysts and financial people, including myself, a few years ago.

Let me conclude by saying that my remarks today focus largely on our challenges – both in relation to current conditions and for the longer term – because, as I have said, how they are addressed is so central to our economy's future. But the U.S. economy has enormous strengths, the changes in the global economy present great opportunities for us, and our country has a history of resilience in rising to meet the difficult challenges of the times. Today's transforming global economy creates a powerful imperative that we do so once again. And there, our mayors can be a powerful force for good, through their leadership in informing and mobilizing public opinion and through their actions in many key areas. Thank you.