A Nobel Round Table

You gotta be there to get the full flavor of one of Michael Milken's Global Conference tête-à-têtes with Nobel Prize winners in economics. But here's a heavily edited (for space and syntax) sampling from this year's conference, held March 20-21 in Los Angeles.

— Peter Passell

DONALD STRASZHEIM (President of the Milken Institute): Let me start by introducing the Nobelists.

On your left is **Gary Becker** from the University of Chicago. Gary got his prize in 1992, and just last year was awarded the National Medal of Science. Next is **James Heckman**, also from the University of Chicago, who received his Nobel Prize last year. Next is **Lawrence Klein** (Nobel class of 1980) who is a professor from the University of Pennsylvania and, incidentally, my old boss at Wharton Econometrics. And last, **Douglass North**, professor at Washington University at St. Louis, who received his Nobel in 1993.

Now, everybody knows the moderator, **Mike Milken**. But no one here knows everything, really, that he has done. He is ranked by *Worth* magazine as the sixth leading philanthropist in the country. He founded CaP CURE, the prostate cancer research and fund-raising organization that has raised some-

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thing like $75 million for prostate cancer research in the last seven years, and is now the largest private funder of prostate cancer research in the world.

Mike also chairs the Milken Institute. As if that weren't enough, Mike is the co-founder of Knowledge Universe, a company whose mission is to incubate and invest in companies that enable the New Economy. And he is also the author of a unique series of cookbooks, *The Taste for Living*, designed to provide guidance for a healthier diet.

MICHAEL MILKEN: Thank you, Don. Well, it is March of 2001 and what a difference a year makes. A year ago, for one brief moment, Cisco Systems had the highest value of any corporation in the world. But when you called your broker and told him to buy the stock, did you ask him to buy Cisco, the telecommunications network company, or Sysco, the restaurant supply company?

Had your broker understood it as the restaurant supply company, your stock would now be up 40 percent. Had he misunderstood you, and thought you meant the network equipment maker, you would have lost 60 percent.

One of the points I want to make today, one I first raised 30 years ago, is that we have a market of stocks – not a stock market. All stocks are not equal, and the Cisco/Sysco confusion brings that home.

Are we moving in the direction of 1974? You might remember that famous headline in one of the leading business news magazines of that December: "No one will ever buy a stock again." The stock market fell almost 50 percent in two years – only to go up 80 percent in the following two years. Or are we going to spend a long time trying to get back to where we once were?

Gary, would you like to start us off?

GARY BECKER: Let me preface my remarks by saying economists are very poor short-term forecasters. But I think one has to draw a distinction between stock values and the real economy. And the stock market – the Nasdaq, not so much the Dow – has had an enormous fall. The Nasdaq is down, what – 60 percent or so from its peak?

But the real economy, the major determinant of the well-being of most people, is measured by employment and productivity. And while the growth of the economy has slowed, unemployment remains quite low.

My own forecast – and remember my first remark about economists' forecasts – is that this will be a relatively sharp but short recession. The fact that the stock market has tanked does not mean that the economy will end up in a similarly disastrous situation.

MILKEN: You are suggesting that the real economy continues forward and we have had a reevaluation of the future growth of the technology sector. Jim, what's your view?

JAMES HECKMAN: I agree with Gary about the fundamentals. Looking at productivity growth in the last four or five years, we have seen a very important sustained increase – one that goes above the trend between 1970 and the early 1990s. I do not see any substantial impairment in the fundamentals at this point.

MILKEN: Four years ago, the chairman of the Federal Reserve said that there was an "irrational exuberance" in the marketplace. At that time, the Dow Jones Industrials were selling at 6,400 and the Nasdaq was at 1,300.

We have had a great deal of volatility since. Yet both of these marketplaces are still up 50 percent. Doug, are we still in a period of irrational exuberance?

DOUGLASS NORTH: Oh, I think we are going to come down some more. The question that interests me as an economic historian, is whether this is like past cyclical phenomena.

MILKEN: It took 25 years for the stock market to get back to where it was in 1929 [after the Great Depression struck]. Where do you see us on a historical basis?

NORTH: Certainly, the information revolution of the past 25 years has some parallels with other great expansions – like the boom following the invention of the automobile or the dynamo in the 1920s. But I am not sure that we have a parallel from the past that tells us what is going to happen this time. I am sure we are still in the midst of the revolution in information technology. I think that makes a difference with respect to what is going to happen. We may have a very sharp recession. But underlying the cycle, there are still possibilities for expansion related to as-yet-unexploited technologies.

BECKER: Mike, you mentioned 1929 and the long time it took to recover. But the really important events of that period were not in the stock market. The economy tanked for a decade; the 1939 unemployment rate was still over 20 percent. In large part, the stock market was not driving the economy. The economy was in terrible shape for a full decade, and the stock market reflected what was happening to it.

MILKEN: So the point here is that the economy has not changed that much. And that ultimately, the market adjusts to where the economy is – not the other way around.

LAWRENCE KLEIN: I think one should look at what has happened in comparison to 1987. Just a week ago, I was on the trading floor for a mock, after-hours trading session at the New York Stock Exchange. I asked a trader if he thought that last week's break was anything like October 1987. And he said, "No comparison. This one was much easier to handle."

Much easier because of the technology in clearing trades and handling very large transactions. And that is really the key.

I think we are all agreed that the growth in productivity is something of medium- or long-term significance. The real economy is not in such bad shape, though it is not in its best condition. The financial economy was irrational. There were very foolish valuations for a lot of startup companies without any profits in sight.

MILKEN: Let's take a quick look at the world's second-largest economy, which has been acting very differently than the U.S. economy. Unemployment has been drifting up through the past decade in Japan. It is still relatively low by our standards – in the 4 to 5 percent range. But for them, this is a dramatic increase.

Whereas government debt has dropped considerably as a percentage of GDP in both the United States and the European Union, Japan has had a significant increase.

And if we take at look at their interest rates, we notice they just lowered the rate to zero. So one could borrow the yen-equivalent of billions or trillions of dollars at zero cost. Many of us think we could find opportunities to put that money to work at a positive spread.

KLEIN: I would not say that. If you look at that slide of interest rates, you see a classical example of a "liquidity trap," which Keynes talked about 60 or 70 years ago. What Japan really needs is a lot of Keynesian medicine.

MILKEN: So if you were going to go to the Ministry of Finance today, what would you recommend?

KLEIN: Japan did quite well around 1995-1996, when the head of the Economic Planning Agency went very heavily into public works and the traditional kind of infrastructure spending. That was successful for a couple of years.

But now I would say it is human capital that Japan needs. And if they would revamp their university system as a massive public works effort, they would do very well. Japanese K-12 education is fine. It is not so good at the university level.

MILKEN: Are their best and brightest going someplace else in the world for education?

KLEIN: We handle them at the Wharton School every day.

MILKEN: Are they returning to Japan?

KLEIN: Well, no.

MILKEN: Do you think those students from the Wharton School could solve Japan's problem?

KLEIN: Wharton is not that big.

MILKEN: Doug, what's your reaction?

NORTH: Lorrie [Larry Klein] is suggesting a long-run solution. But I think in the short run, you have got to restructure the banking system, the whole capital market in Japan, to make it viable. And they are a long way from doing that. The political system has been very reluctant to make fundamental adjustments.

An enormous percentage of banks are, in fact, bankrupt in Japan today. And until it faces up to that, I don't think Japan is going to come back.

MILKEN: Bank lending in Japan has actually decreased. So in spite of interest rates between zero and two percent, more loans have been paid off than taken out.

BECKER: The real interest rate is a bit higher than that, because Japan is one of the few countries that has experienced significant deflation in recent years.

Jim Heckman (in glasses) explains it all to Gary Becker

But I agree with Doug that their banking system is in terrible shape. They are not lending because equity in the banking system is very low.

I do not believe that Keynesian medicine would work. I think they've tried it, and it did not work. Their debt increase was partly the result of running large deficits in order to jump-start the economy. Japan now has a government debt-to-GDP ratio of about 1.4 or so – one of the highest in the developed economies.

Their higher education system needs reform, although as Doug says, that is more a long-term problem. Japan had enormous growth from 1960 to 1990. We should not forget that. There are great strengths in Japanese human capital: hard-working people, good K-12 education. Maybe not good higher education, but they do send one of the largest percentages of high school graduates into higher education of any country in the world.

I think human capital is a good forecaster of potential, and I am still bullish in the long run about Japan.

MILKEN: We can see what has happened to their stock market. And what you are suggesting here, really, is that their stock market has followed their economy over this period.

BECKER: Yes. I think they need to do several things – among them restructuring their financial system and allowing easier access to foreign banks. There is capital out there that might be attracted to Japan if it opened up its economy. Japan is still a closed economy in many sectors, particularly in services and some manufacturing.

I agree with Lorrie: improving their higher education system would help. But it is not going to do much in the short run.

MILKEN: Look at the issues facing Japan: one of the oldest and most rapidly aging populations in the world. High but badly deployed savings. Hundreds of trillions of yen invested at negative rates of return. Equities at their lowest levels in 20 years. Interest rates near zero. Nine governments in 10 years.

BECKER: Let me just say one last thing. I think Japan has had a good tradition of taking the best and the brightest, and steering them into the best schools. So I do not believe it is true that Japan is not a meritocracy.

HECKMAN: I would not agree with Gary that Japan is a pure meritocracy. Rather, it is a corrupt meritocracy with diminished incentives.

I think there is a tremendous amount of competition at the secondary level to get into prestigious schools. But once you get in, the incentives to perform are weak. You are pretty much set for life.

BECKER: But Jim, Japanese leaders come from as modest a set of backgrounds as their American counterparts.

HECKMAN: That is right. But once you get into a leading school, society becomes quite rigid.

KLEIN: One big obstacle is the lifetime employment system. That is exactly the opposite of our labor market, where people who got downsized in the 1980s found jobs in the new technology and service sectors.

HECKMAN: Lifetime employment is a stereotype. There is an amazing amount of labor flexibility in Japan, especially in the last decade.

BECKER: But they classify workers into "permanent" and "less permanent." The less permanent workers have a lot of turnover.

HECKMAN: And it is a substantial part of the economy.

NORTH: I was in Tokyo in December, and I had dinner with some CEOs who implied that the real unemployment rate would be substantially higher if they had the flexible employment system that we have in the United States.

MILKEN: It sounds to me like there is a consensus here that one of the major assets in the United States is our higher education system. And quite possibly, it has more than offset the deficiencies in our K-12 system.

The other area we've often talked about is the difference in savings rates. While their savings rates have backed off, they still are very high compared to the United States.

When you spoke about a liquidity trap,

Lorrie, how does that relate to the savings rate?

And Gary, you said foreign capital would be willing to invest in Japan. Well, there is $7 trillion in postal authority accounts, invested between zero and one percent. It does not seem like there is a lack of capital. It looks like there is a perception of lack of opportunity.

KLEIN: People have lost confidence in the government and they are putting their money in the postal savings system. And that is why that savings rate stops at a bottom that looks high to us, but is low for Japan.

MILKEN: In 1974, Americans lost confidence in America. We thought New York City was going to go bankrupt. The same for New York State, Con Ed and thousands of major corporations. And it took people from Canada to come down here and invest in our real estate.

In '89 and '90, we lost confidence in what is today the core of the most valuable financial institution in the world as measured by the marketplace – Citicorp. And it took a young sheik from Saudi Arabia to come in here and buy equity in it. Are you suggesting that it is going to take risk capital from outside of Japan to turn Japan around?

HECKMAN: I would not look for a white knight to ride into Japan. He would meet much regulatory resistance.

NORTH: I agree with Jim. When talking about potential reforms in Japan, foreign entry is one of the areas that I would put on high priority. It applies to the financial markets. It applies partially to the labor markets – although, as Jim said, they are more flexible than they appear. It applies, in general, to entry of foreign companies into retailing and other sectors.

Japan is not the same Japan as it was 10 or 15 years ago. But movement has been glacial. And I think that partly explains why they have been stagnating for a decade.

MILKEN: What is going to happen in the next 25 years with the one percent drop, after immigration, of people between 35 and 54 years old in the U.S.? Lorrie, do you think we are all going to be working until we are 90?

KLEIN: Or we could rely more on immigrants. Incidentally, that is one thing Japan refuses to do on a large scale.

MILKEN: Gary, I know you have done a lot of work on demographics. Why don't you tell us what is going on with the world's population today?

BECKER: The most striking development in the last decade has been this divide between the population haves and have-nots. Almost half the world's population is now in countries with birth rates that are below replacement – less than two children per woman. If this continues, these populations will begin to fall. Their growth rates have already slowed enormously.

We're talking here about every country of western Europe, much of eastern and central Europe including Russia, much of Asia, but particularly China and Japan, parts of Canada, Cuba and some other parts of the Western Hemisphere. The U.S. is just slightly below replacement. All told, that is a little less than half the world's population.

The countries with low birth rates are the rich countries. Those with rapid rates of growth are the relatively poor countries – all of Africa, India, and much of Latin America.

The countries with low fertility have aging populations, which makes it more difficult to finance traditional pay-as-you-go Social Security. That is one of the reasons why I favor individual account systems. It adds pressure to reduce the employment tax on older people. We have been moving in that direction in the United States, allowing people to continue to work at older ages without losing benefits. Europe has been very slow in moving in that direction, and people retire much younger.

It is a paradox. We are getting healthier, mentally and physically. Yet we are encouraging people to retire earlier.

Then there are migration issues. The arbitrage solution, if I may use financial terminology, would be to move people from poorer countries to richer countries. Some of that is going on, but there is enormous opposition to taking in immigrants in most rich countries.

You see that in the United States in our discussions with President Fox of Mexico. You see that in Europe, which resists immigration from northern Africa. You see it in European political parties whose main program is stopping immigration.

MILKEN: With populations dropping throughout the developed world, is this going to continue?

BECKER: The opposition is mainly from unions and young workers who fear their wages will be affected.

Look at the United States. We have the H1B program that allows several hundred thousand high-tech people to enter each year under temporary visas. We should be expanding that program enormously. Here we get these high-tech, well-trained people from abroad, trained at the expense of other governments. Yet it is very hard to expand these programs.

MILKEN: But demographics are going to have a significant effect on the future. Think of Russia shrinking to 100 million people. Or Europe shrinking by 10 percent in the next 50 years. Do you think that is going to happen, Jim?

HECKMAN: Those projections are right. But I think there are a number of margins you can still work to offset the impact.

There is a lot of scope for migration, even within Europe. Look at migration from eastern Europe to western Europe. Look at Italy and the issue of internal migration. The entrepreneurs in the northeastern part of Italy – a very dynamic, vigorous region – are very short of workers, skilled and unskilled. Yet there are a huge number of people in Sicily in make-work government jobs. With some policy reforms, you could ease the labor pressures in northern Italy.

So I think that the barriers are not just between the developed and less-developed world. There is plenty of scope for adaptation and adjustment within the developed world, for promoting mobility.

NORTH: We are assuming that the projections are correct. I have grave doubts about the ability of demographers to predict very far out.

BECKER: There is no doubt they have made mistakes. But the mistakes have generally been in overstating fertility, not in understating it.

I was examining the U.N. forecast that just came out. Three years ago, the U.N. was projecting that the low levels of fertility were temporary. In the latest revisions, the U.N. says, "well, it's probably permanent."

In 1988, there were about 30 countries that had birth rates below replacement. Not a single one of those countries has moved above replacement since then. And they have been joined by another 30 countries.

Or take the poorer countries of the world. The U.N. recognized that their birth rates were coming down, but they assumed they would come down much more slowly. They are going to be wrong on this new forecast. But I think they are understating the rate at which birth rates are declining.

KLEIN: The Baby Boom generation was not foreseen and there was an enormous population increase in the United States, Europe and other countries. We do not always get errors on one side.

MILKEN: Jim, I want to come back to what you were saying. I believe Bulgaria has lost 20 percent of its educated people under 30 years old to western Europe. Who is moving to Bulgaria?

HECKMAN: If the environment were a little better for investment, a lot of Italian and German companies would move capital to Bulgaria.

Such countries have to come to terms with their environments for investment. Italians would like very much to invest more in Bulgaria, but they fear the regulatory environment. Bulgarian policymakers are going to have to adjust in one dimension or the other – and probably all dimensions – to really be competitive.

MILKEN: What I am hearing from the four of you is we have a lack of supply of human beings in the developed world and an excess of supply in the developing world. So if the developing world could get its act together, the developed world would invest in these areas and labor imbalances would not be an issue.

NORTH: You are sliding over the question of the degree to which institutional structures can adjust to solve problems.

In Germany and France, we still have unemployment rates near 10 percent. That reflects institutional rigidity. In the case of Germany, labor-management "cooperation" has produced the highest labor costs of any country in the world. I think we have to face the fact that there is no guarantee that institutional structures are going to adjust.

BECKER: If you want to equalize incomes, returns on capital or returns on labor, you can either do it by moving labor or by moving capital; you do not need to do both.

The problem is, there are important obstacles to movements of both types. Mexico went through significant reforms since the early '80s in opening up its economy: Nafta, deregulation in some sectors, privatization in some sectors. The response has been pretty dramatic.

True, Mexican workers still see better opportunities in the United States. But there is a lot of investment going into Mexico. And, in principle, these opportunities could be created in Bulgaria and in other parts of the world.

HECKMAN: If you look at what happened in England, there has been a major transformation in the institution of unionism. The workforce is still substantially unionized, but the form of unionism changed in response to a crisis in the late '70s.

Cycles of reform follow this pattern: you enter some kind of crisis before reforms are put in place.

KLEIN: Spain was the weak link among the continental countries, with 20 percent unemployment. Now Spain is in the neighborhood of 15 percent and probably coming down. So once a country starts moving, you can break through some of those institutional barriers.

The other part of the story for the U.K. is that it didn't join the common monetary system, and therefore didn't follow the restrictive fiscal and monetary rules for joining.

MILKEN: Would you call that supply-side economics?

KLEIN: Well, not in the sense that "supply-side economics" is commonly used – the crude sense. The correct sense is to look at productivity and the real economy – not just fool around with taxes.

BECKER: Go back to the issue of high unemployment in continental Europe. Why is Europe resisting the reforms that made such a difference in Britain?

In Europe, there are insiders and outsiders.

Left to right: Gary Becker, Jim Heckman and Michael Milken agree; Lawrence Klein apparently doesn't.

By insiders, I mean those people who have good jobs. They do not want to free up their markets. They have good wages. They are already in a very good situation.

Who is being hurt? As usual, the people at the bottom. In most countries, they are low-skilled people, young people, women who try to move back into the labor force after moving out, and immigrants.

The political contest is between these relatively weak individuals and the people who are comfortable with their positions, who have good jobs in Europe, and who do not want to see radical change. Germany has been trying to overcome that and has basically failed to make a dent in the system.

NORTH: Let me go back to Japan again. Here is a country that has been stagnating for 10 years. And the problem is fundamentally a political problem – the point that Gary was making with respect to Germany. I am optimistic that the Japanese are going to solve it, but my optimism is not based on any neat body of political theory. Political scientists are even more primitive than economists with respect to being able to model what is going to happen.

MILKEN: European institutions like HSBC Holdings, Barclay's and Royal Bank of Scotland have come into the United States and bought our insurance companies and financial institutions. Deutsche Bank has made a whole slew of acquisitions, as has Commerzbank. Spain's leading financial institutions are here in the United States. Dutch banks – ABN Ambro, ING Group and others – have come in and acquired many of the brand names. And I think we are all familiar with Union Bank of Switzerland and Credit Suisse-First Boston's acquisitions of the major banking and Wall Street firms in the United States.

Do you see an opportunity that the knowledge and human capital that is now controlled by European financial institutions will change Europe in the near future?

HECKMAN: Well, the question is whether or not this amounts to an escape from Europe or whether or it is going to generate sort of an infusion back into Europe.

BECKER: We were ahead of the Europeans and the rest of the world in financial innovations. Low-grade bonds being one.

MILKEN: Securitized bonds.

BECKER: And securitized bonds. You know, options and all those things.

BECKER: So, we were ahead of them. I think there is no doubt that they are catching up with us in these techniques. You can see that not only from the companies they buy; in the last 15 years, the number of Europeans studying in U.S. institutions in business, economics and other subjects has grown tremendously.

So I do not think in the next 10 years there is going to be a major difference in knowledge between the Europeans and the Americans. The issue will arise whether the regulatory environment allows them to display that knowledge in as flexible and as productive a fashion as we do. I do not count London as Europe, because London is the United States, from my point of view, in terms of the way its economy functions.

MILKEN: Gary, some people in London think the United States is London.

BECKER: It is both. It is the so-called "Anglo-Saxons versus the Continent." And I think that is the basic difference.

MILKEN: I think it is time for some concluding comments. We have identified a number of destabilizing forces – demographics, income disparities, regulation. Are we going to move to solve these problems in the coming year?

NORTH: I am not as optimistic as many of my colleagues are.

MILKEN: So would you then say you are not optimistic?

NORTH: I am not *as* optimistic. That is a weasel word, Mike. We are entering a world we have never been in before, one that is novel with respect to so many dimensions. I am less optimistic, particularly in the political realm. And until you get a political system in place that guards economic and property rights, I think you will continue to have problems.

MILKEN: Lorrie, can you be a little bit more definite than Doug?

KLEIN: Well, I am generally optimistic. But I think we are going through a short-run adjustment now. I am not saying it will be over with next year, but it is short-run.

You cannot resist globalization; you cannot resist technical progress. But you have to learn to adjust to it.

MILKEN: Jim, what about you?

HECKMAN: I think everything we know from reforms around the world suggests that some of the problems plaguing Japan and Europe could be resolved by more flexible institutions. And I think they are being forced to become more flexible.

MILKEN: So we are going to put you in the more optimistic side of the ledger.

HECKMAN: Long run. Not a forecast for next year, but for next decade.

MILKEN: And Gary?

BECKER: Well, I am an optimist from a long-run perspective. I am not ignoring the issues that Doug is raising. But if we look at the last 50 years, we see two mega-developments. One, the great movement toward democracy, and two, the movement toward freer economies.

Of course, progress could be reversed. But I think there are powerful forces that have driven these trends. There are objective reasons why one should be pretty optimistic, although year to year, you can have a lot of difficulties.

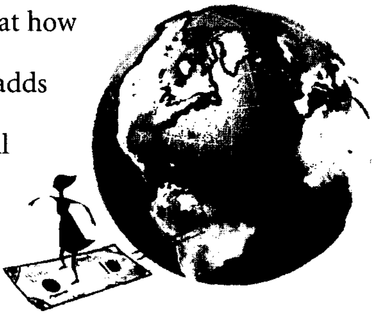
MILKEN: Okay, we got a little hedge there at the end. But we have at least two very optimistic long-term views, one viably optimistic long-term view, and one a little less optimistic long-term view.

Thank you all for joining us this year.

Money Makes the World Go Round

ILLUSTRATIONS BY
KEN ORVIDAS

For those who remember the Vietnam War as a defining political event, Barbara Garson's name probably comes to mind as the author of the deliciously nasty satire *MacBird*, a takeoff on *Macbeth* that gave Lyndon B. Johnson the very hard time he so richly deserved. Turns out there was a life after Vietnam for Garson, who has written a number of books examining, among other things, the sociology and economics of work from the perspective of the left. ¶ Her latest book is a smartly nuanced look at the consequences of globalism. Like Woodward and Bernstein (another blast from the past) she follows the money, in this case, her own money from a modest book advance that she invested relatively conservatively. ¶ This excerpt probably won't change your mind about the virtues and vices of global economic integration. But Garson's up-close-and-personal look at how her money is being invested in an oil refinery in Singapore adds flesh and bone to the bloodless tales that economists like to tell themselves about the triumphs of contemporary capitalism.



BY BARBARA GARSON

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