PACIFIC RESEARCH INSTITUTE

How Can the U.S. Survive and Thrive in a Global Economy?

Remarks by John Rutledge
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Sally Pipes, CEO, Pacific Research Institute: We are delighted to have John Rutledge as our speaker this morning. He is going to focus his remarks on such important issues as the global economy, out-sourcing of jobs and the upcoming election in November.

John is a noted expert on political, economic, financial and regulatory issues. And he has advised several presidents as well as financial institutions and multi-national corporations over his career. Serving on President Reagan's transition team he was also one of the principal authors, or architects, of the "Reagan Economic Plan." He has been advising the current administration on both the dividend tax credit and the rebuilding efforts in Iraq.

He is most well-known, though, in the Bay Area for his insightful column in *Forbes* magazine, which he has been writing for over a decade now. He is also a regular contributor to forbes.com and thestreet.com, and he writes on economics for the newly re-born *American Spectator*. In addition to authoring two books he has been published many times in such important publications as *The Wall Street Journal*, *Fortune*, *Business Week*, and *The Financial Times*.

In his spare time Dr. Rutledge is chairman of Rutledge Capital, a private equity investment firm; Rutledge Research, an economic advisory firm; and the Rutledge Institute for Capital and Growth, an organization promoting economic growth through education and research. He is also the founder of the Claremont Economics Institute, based in Claremont, California. So on this beautiful morning please give a warm San Francisco welcome to Dr. John Rutledge.

Dr. Rutledge: Thank you. This is like coming home for me. I lived for 20 years in California, down south, where I was once upon a time a professor and got to enjoy all those happy faces every day.

It's great to be here. The main message I want to bring you today is that we have two choices in America. We can either learn how to compete for capital with businesses and people in other countries or we can learn to speak Mandarin, because one of the two is going to be required in the next 20 years.

The Chinese economy has been the largest and richest on the earth through most of recorded history. Only in the last hundred years have they fallen off the wagon.

They're back and they're coming very fast.

Last year they grew nine percent, this year they'll grow at nine percent again, and they will surpass the U.S. in size in the next 20 years. Not per capita, they have a lot of capitas, but in terms of total dollars, total wealth. But in foreign policy you measure wealth in different ways. You measure it in rocket ships, battleships, submarines, and other things.

My reading of history is big countries have big armies, big navies, and big air forces. And so there are a lot of dimensions that are going to happen in this story over the next 20 years. This is the biggest story of the rest of our lifetimes.

Right behind it is the resurgence of India, that's lived under terribly repressive corruption for a hundred years but is now reforming, privatizing, and changing the way it does business. In the last 12 months, India grew more than 10 percent. It has passed China as the fastest growing country in the world. India, China, and Vietnam are the first three. What are their secrets?

One secret is very simple. You've got a dot on your forehead. And that red dot is delivered with a secret weapon. And the weapon is, if you drew a list today of the countries in the world with the fastest, most reliable, most modern telecom networks and technology–if you made a top ten list–the U.S. is not on the list. The U.S. is number 11 today. We're behind Korea, we're behind Japan, we're behind Denmark, we're behind Switzerland, we're behind Canada. I know Sally likes the idea we're behind Canada but . . .

I grew up in the same post-war America you did. I don't like to be number 11 at anything. And I don't think we should be. We invented the technology in New Jersey, some of it here in the Bay area, and we need to be number one in this. We need a sort of man-to-Mars approach to this problem. It's called broadband.

Broadband is the hottest topic right now on the political scene. Last Friday the President announced that broadband *uber alles*, affordable broadband for every American, is number one in his economic policy for his second term. He announced that in New Mexico. About a half an hour later, by coincidence, John Kerry announced that broadband is number one in his economic plan, too. So, our communication network is not all that bad. But both of them have made broadband a priority. And yet most Americans are just learning what the word means.

First, I want to explain the word for you. And second, I want to discuss what we are doing wrong here and what we have to do to get it right. And then I'd be happy to talk about 14 other things, because I have the greatest job in the world. I wake up every day, I find out the coolest ideas happening in the world, I get on an airplane, and I go there. And it's like being Forest Gump with ADD. I fall into the most wonderful situations. I'll tell you about some of those, but first what's broadband?

Broadband is not what the newspapers are telling you it is. It is not a thing that you can define and put in the dictionary. Broadband just means that you can talk faster than anybody else. That you have the best technology in the world at communicating.

When I was young, broadband was an airmail stamp. I remember the first telephone that went into my small town in rural Illinois–that was broadband then. It replaced the airmail stamp. It was the fastest means of communication. Later on we had Fed Ex. I know it's heresy in this building to talk about Wells Fargo, but once upon a time the Pony Express was broadband. And in 19th century England they had five mail deliveries a day in London. That was broadband.

There's always been a fastest way to communicate. Everybody knows today that all of the wealth being created in the world is being created in service industries. My friend and former neighbor, Peter Drucker, calls them knowledge industries. It isn't the information, it's the knowledge of what to do with it that's the value-added proposition. Those knowledge industries are really working on an information network for swapping data, swapping information flows.

I'm a part owner of a group of MRI centers in Florida, in my day job, private equity. We do MRIs and somebody has to sit there, read them, and write a report about them, and then somebody has to talk to the customer. Putting the people in the MRI and taking their picture has to be done by a human being here. Talking to the customer has to be done by a human being here. But all that work in the middle doesn't. It can be done by a trained doctor anywhere in the world who can read scans.

Increasingly, it's happening in Bangalore in India. There are many reasons, not all because the price is lower. Some of it is because the education is better. It's an English-speaking place where people will work very hard and go through grueling educations to get things done.

But I'll tell you, the knowledge industries are really information network industries. Your ability to compete depends on your ability to squirt an image or a densely packed piece of information over a wire to somebody far away.

Now, when we talk broadband we're talking about a DSL line or a cable modem. I don't want to measure mips and bits for you but I'll tell you that the speed at which either one of those things works today is like watching a snail race compared to what they're doing in Korea. That is truly state-of-the-art broadband today. But what it means is in a small town, someplace in the hinterlands, if your business doesn't have high-speed communications and your customer is in San Francisco, the Korean firm can serve your customer better than you can–faster, more reliably, with richer information flows. They're going to steal your customer. So, what do you have to do? You have to match them and what that involves is capital flows.

Now I want to back up a minute and talk with you a little bit about competing for capital and about how the market is doing that today. Also about why we're so far behind in telecom. This is a situation where we really need a terminator because there are rules in telecom that are putting an incredible burden on U.S. capital trying to compete for telecom network space.

What I mean by that is there are rules in place, the most egregious of which is called the UNE-P. The UNE-P is a system that basically says that any owner of capital in the communication business in America must allow other people to have a ride on his or her capital. Not just your loop to your house but basically everything from your switchboard operator to your billing department. And the price for doing that is set by local officials in the various communities these companies serve. So as my 19-year-old would say, "Duh!" What do you expect those folks to do with those prices?

The prices are set below market rates, controlled by public utility commissioners all across the country. They're controlled, it turns out, at prices that are probably 30 to 40 percent of cost. The return on capital, therefore, is wiped out for owners of the capital. So if you were that owner of capital and you had the choice between putting capital in the ground here, so that someone else could use it, essentially, for free, or putting it in the ground some other place with a higher rate of return without those regulations, how would you play it? As a fiduciary, a board member, I have to make decisions for the shareholders. That's my job. And people are making these choices every day.

UNE-P is basically a corporate welfare system. It's a welfare system designed to keep a small number of companies alive. We used to call them long-distance companies but when I told my daughter about that she said, "What's long distance?" She doesn't do long distance, she says, she does minutes. And there is no longer a long-distance market in America, it's an anachronism. There's a minute market for talking to people and sending information and the cost of that is going down every day. Is there anyone here that would like to receive one more phone call from a phone company trying to sell you their products?

Regulations today are based on the idea that there's a monopoly still. The monopoly got blown out some time ago, first of all by the 1996 Telecom Act. I was in Oklahoma City recently and there were 22 numbers in the phone book to call for local phone service. And that trend has gone even farther because of the little thing I've got in my briefcase here. I've got a little box, as many of you do, that not only will make phone calls, it will take your picture, send your picture, do email, do instant-messaging, play music for me, and allow me to write notes. I can't find the scratch-my-back button on this thing but it can't be long before it gets here.

Wireless is fast overtaking wire lines. I got an email from my daughter last night because I haven't been able to find her. I said, "Your phone number doesn't work." She said, "It's disconnected." I thought to myself, "Children, they run out of money, they call Dad, right?" But my daughter said that actually they had just torched their land line and are only using the cell phone now. The land line only works when you're there, but the cell phone works wherever you are. So, it's actually a better phone service.

It's a strange thought. I remember the first phone that came in with the party line and the dash-dot ringing system and all that, which is a shocking thing. And now land lines are on their way out and right behind them is not only the cable but also the wireless.

There are six national wireless networks in America. You can buy all six of them wherever you are. Not very long from now telephone service is going to come into your house through your electric wires in many cases. You stick a piece of fiber in the middle of the copper and the phone signal comes in with the electricity. I suppose you could still do pony express if you could find a horse but there are many, many ways of doing this now.

Let me talk a little bit about capital markets because this is where the action really is. The tug-of-war battle between capital and workers has radically changed in America and around the world. It's radically changed because of technology, because of communications speed.

Once upon a time, if you worked at a steel mill, the steel mill had a strike every three years. I remember those strikes as a boy in the mid-West. The strikes never lasted more than about 30 days because by then everybody had had their vacations, at the end of 30 days they all went back to work. Why did both people settle?

They both settled because the worker couldn't make a living and support his family without the steel mill, and the steel mill couldn't sell steel and make a profit without the worker. So, it was a forced marriage in a small town. Now that marriage has broken up. And the reason it has broken up is because the borders are so open today that capital can go anywhere it wants. In fact, the restrictions on labor are much more onerous than they are on capital.

Getting in and out of the United States, you have to be fingerprinted. Nobody fingerprints my money when I bring it in and out of different countries. What happened there? I could leave the room and move money from America to China with one call on my cell phone. No government would know I did it and they wouldn't be able to find out.

In a steel company, we rebuilt the MIS computer system. We did it by hiring an American firm down the street that did programming. It turned out they were only two guys and dog in that business because all the programming was done in India. They piped it in overnight on the modem, and they would bring it in and install it every day. So the question I want to ask you is what would you call the thing that came in on that modem from India every night? What would we have called it in the old days? Immigration!

Immigration happens electronically now. It isn't the Mexican border and the border patrol, it's the value of the labor flows that happen across the communications network with China, India, Sri Lanka, Taiwan, Vietnam, and many other places. It's professional services. And that's why outsourcing is such a hot issue.

Baby boomers were all reconciled to the idea that it was unfortunate but okay that your father lost his job because the factory first moved to North Carolina, then to Mexico, and now to Kuanchou. But it is shocking that you could lose your job because the programming that you went to school to learn how to do has moved to India. Congress is having hearings about out-sourcing of technology jobs right now, I think, because the political shock of this is so big to people that they can't accept it yet. But it is part of this new world.

Let me tell you why it works that way. If I were in a boardroom looking at an investment in New Jersey, California, or China, the managers would bring in the numbers. They really want the money, but as a director you're supposed to poke holes in the numbers. And in China, after you poke those holes, you will find out there's so little capital and so many people.

We would be building a factory, say to create air conditioners, for sale in China to local customers. We would be able to hire a mechanical engineer or an electrical engineer in that factory for $150 a month. That's six days a week of work and the $150 covers the dormitory where he sleeps, and his health care and pension system. Now that's a pretty good price but it's really an indication that labor is plentiful and capital is scarce there.

The return on capital for that factory, to me, as the owner would be about 100 percent a year. Pretty good. Return on equity here in the U.S. for building things like this is about 14 percent. So you make a lot more money there but, of course, they're also going to steal it because there's no rule of law, no securities law, and no intellectual property protection. The risks are huge.

So the way these things happen is you make an arrangement with the mayor of a town. The mayor puts up empty land on the edge of town, which is really worth nothing, of course, into a joint venture. You'll put in $20 million, he'll put in land that just happens to be worth $21 million. And so he's your joint-venture partner and he owns 51 percent of your business and his job is to make sure that all these bad things don't happen to you. This is the "Wild West" of investing.

There has been a tension between American and we'll call it Chinese, but it's true really for most of the world, returns for some time. You can make a 100 percent return with a huge risk in China or you can make a 14 percent return in the U.S. and, gee, we hardly steal any of it. We steal some of it legally, through the tax system. And every once in a while you get an ENRON story or something like that so we randomly steal a little bit of it, but mostly we don't. And so, low risk/low return here, high risk/high return there.

What has been happening is that other countries' governments have figured out that access to capital is the key to wealth and growing living standards. So, they've been doing things to institutionalize reducing the risk for a foreign investor. On March 15, the Chinese Congress ended with a new rule in the Constitution that says, "We now have private property rights." This is a very big deal!

That doesn't mean it's going to change over night. The mayor's still there and you still have your joint venture to deal with. But if you look in the *Wall Street Journal*, every day you'll find one, two, five, even 10 stories where somebody, someplace far away is doing something to lower the risk for an investor from here to do business there. And so as the risk recedes, the 100 percent starts to look pretty yummy and foreign investors (we) take advantage of it by moving capital.

Did anyone see the story a few months ago in the *Wall Street Journal* where a Chinese firm bought a shuttered U.S. steel plant, came in, sawed it into pieces, put the pieces in containers, and shipped them back to China? I want to give you this visual metaphor for capital flows because that's the most tactile example I've seen.

Usually capital flows take the form of money being transferred or wired across countries and building something new. But sometimes physical transfer of capital actually takes place. Now, why is that important? Because China is growing so fast today that they're driving the world markets in almost all commodities.

Why did the White House get rid of steel quotas a month ago? Because they're redundant. Steel prices have been driven up so much by Chinese buying that the quotas were irrelevant. We can't buy foreign steel here because there isn't any because everybody's shipping it there.

So, huge, huge buying. Same is true in all other industrial commodities, same is true in oil and gas. In China they're having to shut down sectors of cities because they don't have enough electricity, gas, or oil to keep the factories running. So what you're seeing today is happening in a world where they're constrained by a lack of energy. But eventually they won't be constrained, because there is drilling, there are pipelines being built, there are all sorts of things happening that are going to give them more supply.

Competition is going to intensify even more. So, what I wanted to give you was a view that there is a ferocious competition for capital across borders today. Ever since World War II America has ended up owning essentially all the capital in the world because, while there was capital in Japan and in Europe before, during World War II it got blown up.

We're the only place that didn't happen to, so for awhile we really owned the world. We rebuilt Europe with American money, the Marshall Plan. And, of course, there was private money, too. We provided the capital to re-build Japan and made a lot of money doing it.

Now it's happening in China and other places in Asia. And it's not going to stop. All this time it was not important for us to know how to compete for capital because we owned it, but increasingly the capital is going other places.

It doesn't just matter for returns, it matters for how competitive our businesses are. Remember that company I was talking about that is losing its customers to the Korean competitor? If we had the fastest telephone network in the world, that wouldn't be happening.

I often sit with business owners and did so recently in the Puget Sound area, Oklahoma, and in Hawaii. Fifty business owners in a room tell me the stories of their businesses and some of them break your heart. One 30-year-old construction company in Seattle is owned by a woman who is closing the doors because she paid $9 an hour for workers' compensation insurance. Each worker made $9 an hour and so it cost her $18 to give them $9. And the nine she gave them had to be FICAd and FUTAd and all those other things you do with pay checks. So the employee ended up with about $6 and, of course, she lost every bid for every job to a black market firm that doesn't pay workers' comp and doesn't pay benefits to its workers.

And so the black market here in California, which I am aware of because I've lived here for a long time, is the domestic parallel to the China story that I'm talking about. You can export capital from the legal market to the black market more easily than you can export capital from California to China. So we've got to do something to unburden capital of the load it's carrying today if we want to keep it here.

And what can we do? We can push for reforming the top marginal tax rate–that's going to be the hottest item in this campaign. Kerry wants to raise it, Bush wants to make the cuts permanent. The top marginal tax rate in America on ordinary income is the tax rate on capital. Why? Because most capital in America is not Bank of America, IBM, or GE–it's the mom-and-pop drug store. "Mom and Pop" is probably a proprietorship, they probably report all their money on their personal income, and it all goes down as ordinary income.

The top marginal tax rate is the first priority of competing for capital. The second priority is the dividend tax cut. Stock prices are up more than $2 trillion since last March and the dividend tax cut is very important. If Bush is elected he's going to go back after zero, if Kerry's elected it's going to go back to 40. So, if I'm a business owner today or a board member sitting looking at a capital spending plan, and let's say the election is really up for grabs right now, and I think it probably is, there's about an even chance that your dividend tax rate is going to be zero or 40 in 12 months.

How do I make a decision about a dividend payout, a special dividend, or recapitalizing my business to sell shares to repay debt? The answer is I think I'll wait 12 months to do that, just like I will wait 12 months to see if we're in or out of Iraq. So there's a stark contrast in the selection in terms of competing for capital and also on foreign policy.

Your judgment there is up to you but I think the stock market is going to move all year long as the odds on the presidential election change because the tax rates will be determined by this election. I'm not a tribal Republican guy, I hang out with them sometimes because from time-to-time they like free-market policies. But it's only from time-to-time, and you're welcome to your own views on the politics. But I think the tax rates are very important coming into this.

The last thing I want to talk about is the way you can think about economics. Then we'll have time for Q&A, or complaints. We do complaints, too.

The way to think about economics is that there's only one law in the world that none of us has ever broken–the first law of thermal dynamics. If I took a cup of coffee and a glass of cold water and put them together, guess what? As everyone knows, one hour later they'll both be the same temperature. That's why the joke about the thermos bottle, keeping hot things hot and cold things cold, is funny because we know temperatures go together.

Temperatures go together for the same reasons that pressures go together in weather systems. And I like to think about these things we've been talking about as a weather map. Investors drive returns together because we all buy the high ones and sell the low ones so the normal state of that market is that returns are pretty much the same everywhere, adjusted for risk and taxes. But once in awhile some government changes a policy in a way that makes a big gap between the returns on one kind of asset and the other kind.

The dividend tax cut did that. It made dividend-paying assets much more attractive than non-dividend paying assets. So, as we then sell the bad one to buy the good one, we're driving the prices of those assets apart and we're driving the returns together. That's what creates capital gains in the asset markets, it's these return gaps or yield gaps created by policy changes.

The math is exactly the same for the weather. Weather systems, temperature differentials, pressure differentials that cause, God forbid, earthquakes–all are caused by the exact same thing, as are chemical reactions, biological processes, and so on.

That's the only law you need to know to understand change in the world. In economics, it's return differentials. And right now, we're looking at a return differential that's partly fundamental because markets are opening up and it's partly artificial because we're burdening capital in America with all sorts of costs.

I don't know if you know this but in many places in the U.S. if you look on your cell phone bill you'll find out that there's a 20-to 25-percent tax on top of whatever you're paying to whoever's providing the service. Why? It's because we're addicted to talking like we're addicted to smoking and drinking. Right? It's one of the few taxes they can stick on you that you will pay, because you have to talk.

That's causing a drop in return on capital and a decease in investment. There's $100 billion of capital spending in telecom between fiber and wireless that is teed up and ready to go when the regulations will allow it to happen. Until then it's going to just sit there and wait. And until then American companies are going to be uncompetitive with Asian and some European companies on not only broadband but also in other areas.

I'd like to stop there because I want to allow time for the things you would like to talk about. So, let's shift to some questions. I think I know some of what you're going to raise–we haven't said the word "deficit" yet, or health care, and so on. So over to the audience.

Audience: Could you talk about the education system, which, in my estimation, is our achilles heel. And it's critical to where we're going to be tomorrow.

Dr. Rutledge: Absolutely. I have five children and I know that's our real investment in the future. But reforms in this area have been slow. Essentially, we have a single-provider system of education in America controlled by a large labor union and change is not on the agenda. In particular, the high-cost education system that we have is not able to take advantage of new technology to provide low-cost education to people who can't afford it. That's because of restrictions that are imposed by various interest groups in the industry.

I've been in villages in Morocco where they have a satellite beam teaching them how to speak English. We don't have a lot of the technology working here except through our brick and mortar institutions. So there's a huge amount of work to do there.

I think PRI's work is right at the cusp of this issue so I would defer to Sally, Sonia, and others on the issue here. But it's very, very important and the good part is that the education system in China is really pretty lousy. So that's a comparative advantage we don't have to worry about, but the bad thing is the educational system in India is great. And is spitting out engineers like a fire hose and we're not going to win that unless there are radical changes made in the U.S.

Audience: We've always done well because we've had the competitive advantage of the high-value added market. Now that we are exporting some of our previous "advantages" overseas, where can we expect the next developments?

Dr. Rutledge: The reason we always end up with the good new stuff is because, first of all, we're really rich and so we're the customer. And second, we have had educated resources here to invent stuff, and we've got this sort of attitude here that I think is part of our history. Our culture is less cohesive than many countries but more creative than many countries. So we invent a lot of stuff here and that's a very good thing.

What jobs can you protect from people overseas? If you produce something really heavy like a brick, you're safe. Because bricks cost a lot to put on a boat and ship to San Francisco. If you produce strawberries, no problem, because strawberries rot on the way here. So, strawberries from the central valley are safe. If you produce something you have to hand-deliver to your customer, like a neck massage business, you're okay. Because to get a neck massage in China will cost you $2,000. You have to buy a plane ticket and at least one night in a hotel. Otherwise we have some serious trouble because the borders are gone.

The borders that are meaningful are completely gone. So we have to think about this in a different way–whether we need to have that competitive advantage. We always talk about competing for jobs here and I think that's the wrong way of looking at this.

Cave men all had jobs. There was zero unemployment for cave men–50 percent of them hunted dinosaurs, 50 percent of them tended the fire and cooked things. No unemployment. We could erase unemployment tomorrow if we got all the unemployed people to scratch each other's backs and say they were delivering tension relief services. No unemployment there. We aren't creating any wealth, but we've created jobs.

So the real issue is how do you create value or wealth? And you create value by giving people the ability to produce something. The job is going to be standing right next to wherever the machine is. If the machine's in Pittsburgh, the job's in Pittsburgh. If the machine is in Shanghai, the job is in Shanghai. And so what we need to do is focus on how to get workers the tools they need and the capital they need to do their work including education as a form of capital–human capital.

And so these comparative advantages are changing very rapidly as we go along. If you have children, think of it that way. There are several critical things to teach your children. First, an awareness of these other markets because they're going to have to deal with them every day. Second, make sure they're not allergic to language skills, although English is becoming the language of the business world through the Internet. And third, they have to be prepared to change their job, their business, and their skills about every three years.

You know, my dad had a job in the mid-West in a factory that he thought was his life and fortunately that factory died just before he was ready to retire, so he was okay. But the guy who was 42 when that happened wasn't okay. That's how Appalachia stories come about. We have to be very flexible which means we have to have education that is flexible, not single-skill education. And California has often been a leader in that kind of thinking.

Audience: Question inaudible.

Dr. Rutledge: There's a terrible old joke about what happens when you're in an airplane and the airplane goes down, and the answer is you bend over and kiss your behind goodbye. Privacy is gone. Intellectual property is unenforceable. Period.

If you get spammed, for example, you don't have an idea of where that came from. Once it gets into the Internet it's just streams of molecules, right? Or particles. So, likewise with intellectual property. I've had businesses in China where we opened up and then six months later the foreman resigned, and I'll be darned but the same business opens across the street with the same technology and the same machines, and he's the president of the darned thing. As long as there's one place in the world that doesn't enforce intellectual property or privacy laws, then there is none.

All you need is a portal to get into the information flow anywhere. I think the only protection you have for privacy is not to do anything interesting to anybody, so they don't care and they don't want to know. Basically I think the cow's out of the barn on that one. And intellectual property I know is a big issue in California, as it is in many places.

A lot of the loss of intellectual property is because customers have decided that the sellers are piggy, and so they really don't feel too badly about unbundling and taking things over the network. And for a certain amount of that we can thank the media for showing us just what wonderful lifestyles some of the performers have.

What we're going to see in the music business and many other information businesses is that the means of distribution are going to change radically. They're going to go over the wire, digitally, and they're not going to be packaged or bundled anymore. You're going to buy one song at a time or one drug at a time, and you're not going to be able to control flows of drugs across borders because of the same information flow issues.

And while intellectual property is important because you have to have a return to justify investment, that doesn't mean the perimeters of intellectual property have to remain frozen forever. I expect you're going to end up with a battle here that's going to change the useful lives, the protectable lives, of intellectual property assets, especially in the course of the debate going on in the music industry. I think we're not protected and we're not going to be protected.

Audience: How about competition from European countries?

Dr. Rutledge: They're dead. Europe died some time ago and we're just getting around to burying it. I'm referring here to non-English speaking Europe. The exception to that is Ireland, which is the fastest growing country in the Western world in the last 10 years.

Ireland has fiber optics wired up to every hut and barn in the country. It's easy to do since they've only got three million people, but they did it. They lowered taxes, they lowered taxes on capital, they created financial markets that work, they're one hour closer to New York than London so it's a good place to have a conference, and they've got a great Prime Minister, Bertie Ahern.

They've done it right. Ireland is importing people now. They exported people for a thousand years now they're recruiting people in Germany and other places.

Germany, France, and the rest of continental Europe are frozen in political paralysis and I don't see anything that's going to unfreeze them. What's going to make their lives more interesting, however, is that there are new members coming into the EU from eastern Europe that are very competitive, energetic, and willing to work for a living.

They're going to put huge pressures on the German and French economies. So, everybody I know in Germany who has a large pool of money is moving it here or Asia. No one is investing there that I know.

Every big investor I know in the Gulf is doing one of two things with their money: either taking advantage of the new investments in Malaysia, China, and other places, or getting ready for a huge investment spree in Iraq. There's going to be an Oklahoma land rush in Iraq that will make a big noise as soon as property rights are established.

The local investors know the people and the businesses, and their risk for building businesses in Iraq is much lower than for American firms. And they have huge bundles of money that are earning 2 percent money-market rates right now. They're going to buy Iraq in the next 24 months and the rebuilding of Iraq will actually be done by Arab investors from neighboring countries. The only issue is who's going to own it afterwards.

Audience: What's the situation of the euro versus the dollar?

Dr. Rutledge: I think the euro is too expensive, is the short answer. The euro is really a bet on a central bank. The European Central Bank, in spite of Trushay, is actually a German institution, and German central bankers are even more pig-headed than others around the world. And so I think you're buying austerity when you buy the European Central Bank.

They're talking about lowering the rates because they're even acknowledging how stinky the economy is there. But I think that the dollar is up against the euro over the next year. Our economy is growing, theirs is not, our rates are flat to up, theirs are flat to down. Investment's moving out of there and the only counter to that is that Germany is twice as big an exporter of capital goods as America. Their exports are going to Asia and you have to buy the euro to buy the German capital goods, so they've got some interest from Asia. But I think the euro is over-bought and not something to own right now.

Audience: Question inaudible.

Dr. Rutledge: Kerry, for example, wants to adopt incentives that will keep firms here from out-sourcing and the like. Out-sourcing is just another transaction to me, an international transaction, no different than exports or an insurance sale. So the best world would be one where you didn't have try and defend yourself from that because these transactions are just part of doing business.

The interesting thing you'd like to be able to measure is whether by out-sourcing you alter the cost of American businesses and make them more competitive. You're creating all sorts of opportunities for business that you can't even see or identify as being part of the out-sourcing game.

The biggest worry I have aside from the economics is that, from my reading of history, every time bad things happen and people get very frightened, they are willing to trade away their wealth and freedom for a little bit of protection. And I think if we go back to 2000 and the tech bust, 9/11, anthrax, ENRON, Tyco, Martha Stewart, Iraq, Afghanistan - people are scared to death and willing to make trade offs.

If you take what's happening in Cuba and Guantanamo in terms of "no rule of law," it is a very bad thing. It's just like the Spanish Inquisition, which was a reaction to the plague. There have been many similar reactions to perceived threats throughout history.

We are at great risk of having regulatory and control reactions from the political market harm us in all sorts of ways. Some of them very personal, some of them in terms of business. I think this is a very dangerous time. Which means it's not a good time to have your head up and very visible because there are people that would very much like to take it off.

Sally Pipes: That's our final question. Thank you so much, John.

Dr. Rutledge: You are welcome and it was great to be here.

Sally Pipes: I agree with you that the election is in the balance at the moment. And your message is one that Bush needs to articulate to the American people if he wants to be re-elected. Tax rates, dividend cuts, and the other things you have mentioned are the way to make our economy stronger and more competitive.

Thank you for an excellent presentation. We hope you'll come back and join us again sometime.

Before you leave, please fill out one of the cards we've left on the tables if you would like to be added to our mailing list. This is PRI's 25th anniversary, our silver jubilee, and we are holding our gala dinner on September 23rd with George Will. We'll be honoring Milton and Rose Friedman and we have invited the governor to speak as well.

We have several more immediate events coming up. On June 15, we'll welcome David Brooks, author and *New York Times* columnist. And in May we are hosting an event with Bill Simon, who will speak about the biography of his father.

Thank you all for coming. We appreciate your support and we look forward to seeing you soon. And again, thank you very much, John, for an excellent program.