RECORD OF SOCIETY OF ACTUARIES
1991 VOL. 17 NO. 2

MAJOR ISSUES FACING THE ECONOMY, THE INSURANCE INDUSTRY AND ACTUARIES IN THE YEARS AHEAD

Leader: DAPHNE D. BARTLETT
Speaker: WILLIAM FREUND*

MS. DAPHNE D. BARTLETT: Our keynote speaker brings us a unique perspective on actuaries, on the economy, and on the insurance industry today. As the former chief economist and director of investment research for a very large life insurance company across the Hudson River, he certainly knows about our business. As chief economist emeritus of the New York Stock Exchange (NYSE), he certainly knows about the current environment in which most of us are working. Dr. William Freund has an endowed chair as the NYSE professor of economics at the Graduate School of Business of Pace University in New York. He's the chairman of the Department of Economics and International Business. He's widely recognized as an authority on the economy and business outlook, and, best of all, his biography tells me he has a well-developed sense of humor. He'll talk about major issues facing the economy, the insurance industry and actuaries in the years ahead.

DR. WILLIAM FREUND: You've given me a very big assignment, Daphne, and that is to talk about the issues facing the economy, your industry, and you as actuaries in the decade of the 1990s. You know, economists are inclined to say that this is the most difficult time to forecast. They say that all the time. But I think this time it's really true. Nonetheless, despite the hazards of forecasting, and I know all about the risks and how wrong economists can be, I believe it's better to stick your neck out and to make your forecast explicit and to leave your assumptions somehow hidden in the policy decisions that you take. I also have heard every joke that has ever been told about economic forecasters. Someone once defined an economist as a person who wonders if something works in practice whether it will also work in theory. Maybe you heard about the economist who was asked by his boss if he remembered a specific telephone number, and he said, "Well, actuaries have so many numbers to retain in our heads, I've forgotten the phone number, but," he said, "I can estimate it for you." What I'm trying to say is the motto of economists everywhere is, to err is human, to get paid for it is divine.

Let me turn serious now and say a few words about the shorter-term economic outlook, first the prospects for the next year and a half, say through the end of 1992, and then we can extend that out to the decade of the 1990s. Clearly, everybody knows we're in a recession. The unemployment rate is 6.6% of the labor force, but I must say that there are unprecedented regional variations, that is to say, the recession is much worse in some places than in others, and if you haven't noticed, the downturn is particularly severe in the mid-Atlantic states and in the Northeast. Actually, we now know that the recession started before the Persian Gulf War. According to the final arbiter of business cycles, the National Bureau of Economic Research, the recession started in July 1990, but what might have

* Dr. Freund, not a member of the sponsoring organizations, is Chief Economist Emeritus, New York Stock Exchange in New York, New York.

been a modest recession turned into a full-fledged downturn when the Persian Gulf War erupted.

The Persian Gulf War had its major effects on consumers. First of all, you will remember that crude oil prices jumped about 50% when the war broke out. That constituted a large tax on consumers and consumer spending and reduced purchasing power for other goods and services, and then I need hardly tell you that consumer confidence suffered. Consumers who were already heavily burdened with debt became anxious and uncertain and TV-ridden. I stress the consumer because consumer spending accounts for two-thirds of our gross national product, and if we are to emerge from the recession, it will have to come to a significant extent from the consumer. As usual, some economists predicted there would be some calamitous depression, but that was not allowed to happen and will not happen. The Federal Reserve, under its able chairman and my old friend Alan Greenspan, moved vigorously to increase the money supply and to bring interest rates down. Now, I know we read a good deal about controversy among members of the board of governors of the Federal Reserve, but I believe those differences are vastly overblown. The fact is that last year in the early months, M2, the money supply, grew by a mere 1.1%. This year money supply has been growing by 5.5%, and don't pay attention to weekly fluctuations. Furthermore, the Federal Reserve has cut the discount rate three times since November 1990.

What lies ahead now? Consumer spending, as I have said, is obviously an essential key, and there the numbers are beginning to indicate that consumer spending or the decline in consumer spending is bottoming out, witness the numbers that were released recently on retail sales, but the consumer purchases haven't turned up yet. Car sales are still anemic. In a way this recession is different from other recessions in the sense that it is a white collar recession and that many layoffs have been among that class of employees rather than the blue collar, and even some car buyers are now being turned down for credit which, is totally unheard of in our economy.

But the recession will not last forever, and indeed, a turn is not far away. That's what the stock market's been saying. I don't mean last week or yesterday or the day before. But the stock market has been rising, and you know that stock prices do represent one of our best -- perhaps I should say one of our most reliable and consistent -- leading economic indicators. Surely you've heard that old story told, attributed to the Nobel laureate in economics, Paul Samuelson, who once said the stock market is our most reliable, leading economic indicator. He said it has correctly predicted nine out of the last five recessions. That's literally true; that is, the stock market often gives false signals. The stock market will go down, and nothing happens to the economy and vice versa, but it hasn't missed a turning point, and I don't think it is missing a turning point now. In the last six months investors, particularly individuals, have been rushing back into stocks. They have forgotten the collapse of 1987 when the world seemed to come to an end, when the stock market collapsed on huge volume and investors suffered and Wall Street suffered.

I think the stock market's been right. The fears of an economic collapse are vastly overblown. The banking system will not trigger a collapse. I know that banking problems are often cited as a reason for expecting a prolonged recession or even a major collapse. I think these fears are vastly exaggerated. True, the savings and loan

(S&L) industry is in deep trouble, but we are biting the bullet on that one. We are spending something like $150 billion to bail out the S&Ls -- now, in reading newspapers the number is $500 billion -- but here's a friendly audience who knows about present value and discounting, and the $500 billion includes the interest on bonds issued out 30 years. The present value of the bailout package is about $150 billion. That will not sink our economy. Bear in mind that our annual production of goods and services is now running in excess of $5.5 trillion, and we can even bear the burden of that bailout, but then the argument goes, commercial banks are next, and then, of course, the final step's always the insurance companies. But commercial banks are not in the same category. Last year, 90% of the banks were profitable. Their profits totaled $16.5 billion. Bank capital ratios in the aggregate are still going up and in excess of $200 billion. Now, there are a number of significant, large banks that are writing off bad debts and bad loans, adding to their loan loss reserve significant amounts, and there may be some failures but no collapse of the banking system. Do you remember not too many years ago when some Cassandras were predicting that the banking system would collapse under the weight of the Latin American loans and their defaults? You don't hear about that anymore. The banks did have a strategy. They wrote off a large fraction of the Latin American loans against profits, and they're doing so over a five- to ten-year period. Now, the Federal Deposit Insurance Corporation may have to borrow funds for some banks, but the amounts are minuscule compared to the S&Ls and will be paid back by assessments against the bank. I think that the problem loans at most banks are within a range the banks can absorb and, though troublesome, do not constitute a fundamental hazard to the stability and growth of the economy.

I expect consumer spending to rise by the third quarter of 1991. As I say, consumer spending is leveling out so that that negative drag is being removed from the economy. Consumers are benefiting from a moderate inflation which is now running at about 3% compared to about 6% a year ago. Also, U.S. exports are strong. U.S. industry has become more competitive. It has modernized. It's become more productive, and with the dollar down in international exchange markets, and again I'm talking about the last two years, not the last two months, foreigners are finding our prices attractive. U.S. manufacturing has been on a significant comeback trail and better than is widely appreciated. As Mark Twain once said on hearing Wagner's music, "It's better than it sounds." And I think manufacturing here is doing better than it seems.

In a quiet revolution the U.S., which was long derided as an industrial has-been, has become one of the world's lower-cost manufacturers. In fact, it has lower costs in many industries than those that prevail in Canada, in Europe and in Japan. It's simply untrue that we are becoming a nation where people earn a living flipping each other's hamburgers. Manufacturing is now a larger share of GNP than it was 10 years ago. I might note also that declining mortgage rates will help housing. There, too, the bottom is in sight.

If we have time, I want to tell you about a conversation I had with a friend recently about housing. "Y'know, housing," he said, "is an amazing industry. My grandfather lived in a run-down, old tenement. My father lived in an apartment. I live in a luxury condominium. The amazing thing is it's the same building." For those of you in New York, you'll appreciate that.

Well, down on Wall Street they tell me, "Don't give us all the details. Give us the bottom line." The bottom line is that I think the end of the recession is in sight. In the first quarter the gross national product was down 2.6% per annum. In the second quarter, for which we do not yet have numbers, I think it'll be down about 1%. In the third quarter I think we'll be limping along the bottom with an insignificant rise of 1%. The fourth quarter will have a small rise, 2.5% of real growth per annum. And so I expect the recovery not to trace a V shape but to be rather unexciting. Bear in mind, too, that we get no fiscal policy help in emerging from the recession. Normally, in a recession the Congress votes higher expenditures and very often reduces taxes. With a federal budget deficit close to $300 billion, that's not feasible. Indeed, we are getting a perverse kind of fiscal policy because the state and local governments are raising their taxes and reducing their spending, and so our reliance on federal policy is mostly on monetary policy. But a slow recovery of the kind that I'm predicting isn't bad. We still have to work some excesses out of the economic systems that we accumulated in the 1980s, particularly reducing the burden of debt, but I think that a slow recovery will set the stage for more solid growth in the balance of the 1990s. I believe a subdued recovery is really much better in the interest of our economy, but we will emerge.

A word about the federal budget deficit. In 1990, as I'm sure you read, Congress changed the law and created what is often referred to as a pay-as-you-go regime. What it did is end at least some of the trickery, some of the numbers fudging, that used to go on with the budget, but it is also true that we will have this year a federal budget deficit of close to $300 billion. But in considering that budget deficit, I urge you to look at the components. Out of that $300 billion, about $100 billion is the bailout of the savings and loans. So, in terms of the fundamental federal budget deficit, we're down to about $200 billion, and then the recession itself, by depressing tax revenues and enhancing some forms of expenditures, probably counting for another $30 billion out of that deficit. So, we are down to about $170 billion. That's right on track with the congressional intent. The Persian Gulf War doesn't show in the budget. I looked at the GNP figures released just recently on the first quarter of this year, and if you were the man from the moon and looked at our GNP numbers, you could not find the Persian Gulf War. What happened was it was a war fought out of inventory, out of accumulated stocks, out of reserves, and it didn't show up in the economy at all. The estimated cost of replacement, the administration says, is $35-50 billion, and foreigners have agreed to pick up a tab of about $45 billion. So, there is no net cost to us at all. Contrast that with Vietnam which cost us $600 billion. What I'm trying to say is that the trend of the basic budget deficit is, indeed, down. As Winston Churchill once said, "In the end Americans always do the right things after they have exhausted all other alternatives."

Let me turn next to our longer-term economic growth. Once recovery begins I expect a period of prolonged and balanced growth. I tell my students that fundamentally economic growth longer run is determined by two factors. One is the growth of the labor force, and the other is productivity growth, that is, how many people are working and how efficiently are they hurting our goods and services? The labor force growth will diminish markedly, and already has, from about a 3%-per-annum rate to 1.5% and less because in the 1970s and 1980s, we saw this big bulge of baby boomers, and they are now followed by a baby bust generation, a small cohort coming along and joining the work force. The other factor in terms of the labor force is that we had in the past a huge increase of women in the labor force participation rate, and that obviously will diminish over time, and so we must learn to make better use of our human resources to improve our productivity growth. Much of our economic growth in the 1990s, indeed, will hinge on productivity growth.

When I talk to students and I mention productivity, sometimes their eyes glaze over with boredom because they think productivity is a kind of economist's abstraction, but you know it's real. Productivity growth measures our output per person. It measures our unit labor cost. It measures our efficiency of production. It determines much of our economic growth and in the end has a vital influence on our rising standard of living. In the 1960s and 1970s our productivity grew at an average annual rate of 3% a year – some years above, some years below. That was the average growth. And then in the 1970s and 1980s somehow we lost our way as productivity growth dwindled from 3% a year to 2%, to 1%, and in some years it was actually 0%.

I believe that better performance will be seen in the future. We will need new investment in plant and equipment and research and development and in education to bring that about. I coauthored a book on people and productivity some years ago. We cannot exaggerate the role of technology in productivity growth during the 1990s. Someone once said, it used to be, "If it works, don't fix it." Now, "If it works, it's obsolete." Major improvements in manufacturing productivity are already underway, and I have mentioned before the great strides we've made, the resurgence in our manufacturing base. The fear that America was deindustrializing are simply unfounded. Manufacturing was 23% of our GNP last year compared with 20% in 1982.

Managements have been shocked into action by tough, new competition. They have cut fat. They have lowered break-even points. They are adapting to international competition. The managements have become more aggressive under the pressure of competition. Just a week ago the Bureau of Labor Statistics revised our productivity numbers and showed that in the past three years our manufacturing productivity rose 3.3% per annum. The U.S. has become more competitive. We have restructured. We have slimmed down. We have undergone industrial rejuvenation. Now taking place before our eyes is a slimming of the service industries. As happened in manufacturing over recent years, service productivity has clearly lagged – as best as we can measure it, and we don't measure it very well. Painful adjustments are now underway. Productivity is sweeping the service industries, from banking to brokerage, from insurance to legal, from food processing to health care, from airlines to retail trade, from accounting to advertising. In the brokerage business, from its peak, 70,000 people have lost their jobs, about half in the New York area, from 260,000 to 190,000. That is a reduction in human capacity of close to 30%, but actual capacity has hardly declined at all as productivity is beginning to improve.

I want to emphasize particularly for you as actuaries that in the long run, few things are as important to our productivity growth as education, and there is a new emphasis and a new awareness of the importance of education for productivity growth in the future. We have been shocked by the fact that we now know about the superiority of Japanese education. We know from standardized tests in math and in science that the typical Japanese high school student performs far better than his

American counterpart in math and science. We still do better in English. You laugh. Who knows for how long? There is an unprecedented need for skilled, qualified, literate workers. Indeed, there are no jobs in the U.S. anymore for the unskilled, unqualified and illiterate, and business must take an interest in education.

Daphne talked about involving actuaries in broader public policy issues. Here is one crying out for your attention. The latest studies show, for example, that the New York telephone company last year tested about 50,000 New York high school students in reading comprehension and arithmetic. Only 2,100 passed it. In Chicago, three out of four job applicants for entry level jobs could not fill out application forms. Twenty-five percent of our high school students drop out. Twenty-five percent can read no better than eighth grade level. I saw at McDonald's recently they have put symbols of hamburgers and French fries and cokes on the registers because the cashiers don't know how to handle dollars and cents. To survive in the 1990s, our companies need workers who can operate computers, who can analyze data, who can read and understand complicated instructions. Did you know that between 1973 and today people who didn't finish high school saw their real incomes decline by 29%? It's no wonder that businesses from American Express to IBM, to Xerox, to AT&T, to GM, to the NYSE, have been focusing on public education, and I believe that actuaries are uniquely qualified to play a role in upgrading computing and math skills. Some years ago the NYSE adopted a commercial high school in lower Manhattan called the Bergstrom School, and at that time senior stock exchange officials went to the school, and we lectured and had an active liaison with the school. We had seminars for teachers. We had summer internships for students, and provided them significant role models. We can remain a first-rate economy only with a first-rate educational system. The administration has put forward a five-part program that you've all read about which I applaud. The results will only be slow and gradual and need your help.

I want to say a word about the integration of economies in the 1990s and particularly talk about the integration of Western Europe in 1992, at least briefly. There's no doubt that that European market will be very large, 336 million people. There will be an integration of markets in the sense that there will be no tariffs in the movement of goods, no major impediments to the movement of people and capital. I have no doubt that there is a big potential for growth, but my question is how will outsiders fare? I'm afraid the answer is not all that well. The directives coming out of Brussels point to more, not less, protection against outsiders. You've probably read about the dispute over agricultural policies which have been very intense. There has been a dispute between Brussels and U.S. banks and Japanese banks after Brussels said, "We demand reciprocity, that is, if you want to conduct a business of both commercial and investment banking in Europe, you have to allow foreign firms to conduct the same business in the U.S. and change your laws accordingly." The world economic system has always run not on the basis of reciprocity but on national laws, that is, we do not treat foreign companies differently from domestic companies. Then there was a big brouhaha over TV programming. Brussels said, "You can't run more than 50% foreign programs on European television," and you know one of our most successful cultural exports has been "Dallas."

Then there was the controversy over domestic content. When does a domestically assembled product become a domestic product? The Europeans said, "We don't want any screwdriver plants here," and so more and more companies are investing overseas. Indeed, the *Sunday Times* of London itself commented on the new protectionism in Europe, and since perhaps not all of you read the *London Sunday Times,* let me quote, "The European community showed America the new face of a united Europe and an ugly face it proved to be. Any American who doubted they were fast constructing a fortress Europe will have to think again." And the *London Economist* dated May 4, 1991, a few days ago, carried an article stating, "Fortress Europe is being built brick by insane brick." Major American firms are learning that they must operate from within. They are taking European partners from Pepsi to DuPont, to Ford, to GM, to Pfizer and on. It could lead to trade blocks. You know that we have a free trade agreement with Canada that President Bush is trying to extend to Mexico. One reason is it would strengthen our bargaining power with the European community. Carla Hills, our trade representative, has said she needs a crowbar with the Western Europeans, and a free trade area here would give her more of a crowbar. We could well see other trade blocks in the Far East and Latin America.

I also want to say something about the cost of capital in the 1990s. I believe that the cost of capital in the next decade is going to be quite high, and you should include that fact in your planning. To make productivity rise will require substantial investment of savings in new plant and equipment and new capacity. In the U.S., we also need large amounts of capital for infrastructures: our roads and bridges. Business will need large amounts of capital. Now, one way, of course, would be for the U.S. Treasury to cut back its borrowing and make way for the private sector, but there will be worldwide competition for capital that will be quite keen. The integration, the combination of Eastern and Western Germany, was estimated originally to cost a few hundred billion dollars. It is now estimated to cost $1 trillion. I might say also that the Japanese are saving less. They're becoming more like the U.S. The young people have discovered credit cards, and that's the beginning of the end. And so I think relatively high costs of capital will prevail in the 1990s.

Let me now talk a bit about the insurance industry and your future role. On the whole I am told by experts like you that the insurance industry is in good financial condition. Profits are up. Capital's up. And the industry's productivity is improving. There is fierce, new competition not only among insurance companies but also from investment firms. In the past a lot of companies could afford to be sloppy in their management and still earn decent rates of return but not anymore, and so they, too, are cutting redundant staffs. The flight to safety, I would have thought two years ago and even a year ago, would benefit insurance companies enormously, but there are now problems of public confidence in the insurance industry, and often perception is reality, and your first order of business in my humble opinion is to restore public confidence in insurance companies, and you cannot do it by public relations or public information. That will only backfire. That fear about the solvency of insurance companies has been fed by politicians. Undoubtedly you saw John Dingell's recent statement about insurance companies, which I think is vastly exaggerated, indeed, inaccurate and unduly alarming. He said, "The parallels between the present situation and the early stages of the savings and loan debacle are both obvious and deeply disturbing." There are financial problems among insurance companies. They may be the exception and not the rule, but they exist. I saw a quiet report circulated within the insurance industry that was hardly noticed. It was a report of the American

Council on Life Insurance which said recently, "Despite the overall financial stability of the industry, there are undoubtedly individual companies which have taken and will continue to take unreasonable risks. Steps must be taken to address the potential problems posed by these conditions." And the report went on to recommend, "We believe that the lack of consistent solvency regulations among states must be addressed, coupled with adequate and appropriately targeted enforcement." We need action, and I think it should be spearheaded by actuaries, not by public relations people. First of all, I think you have to admit a problem exists.

Let me share a very personal experience. Two years ago, I had occasion to address a group of insurance salesmen, and I had become somewhat concerned about the higher risks assumed by insurance companies, particularly longer-term interest rate guarantees covered by junk bonds. I made the mistake or maybe the courageous statement that some insurance companies, if they continue, are likely to get themselves into trouble. I named a number of insurance companies, among them Executive Life and Presidential Life and others, as owners of a high percentage of junk bonds. After my presentation, I was deluged with objections by salespeople. How dare you undermine the image of our industry! The next morning I got a call from the president of one of the large insurance companies calling me to task, asking me to come in because he wanted to persuade me that all was well. I think you have to educate the public to recognize, first of all, that in our free economy some firms must be allowed to fail. That is an essential characteristic of our economy. If we don't allow some firms to fail, then we become like the Soviet Union where inept managements and unproductive enterprises hang on at the expense of the consumer.

Failures in our economic system perform the essential function of weeding out uncompetitive enterprises, but insurance is, in a way, like banking. We have to make sure that only the stockholders and not the policyholders and not the annuitants lose. Insurance, like banking, is affected with a public interest. And so I want to make a proposal to you. I would like you to consider a regime of self-regulation. You know John Dingell proposes to give regulatory powers over the insurance industry to the federal government. As *The Wall Street Journal* noted in its editorial on the May 16, 1991, "Congress has done such a wonderful job regulating the savings and loan industry that some members now want the federal government to take charge of regulating the insurance industry as well." Now, I recognize the existence of state regulation, but these regulations are uneven and inconsistent. I make my proposal of self-regulation having spent 18 years at the NYSE and having observed a regime of self-regulation, and I believe it has been a good thing.

Self-regulation by the NYSE and the National Association of Security Dealers (NASD) has worked reasonably well, not perfectly. It has not prevented all fraud nor prevented unprofitable companies from failing, but there have been few losses to customers. Without self-regulation the federal insurance scheme, called the Securities Industry Protection Corporation (SIPC), as you know, would surely have run out of money long ago. The NYSE enforces stringent rules on assets, on liabilities, on capital and capital ratios. It performs audits. It penalizes offending companies. It has put companies out of business, and it has been reasonably tough. It costs money, it costs staff, but I think it is essential to public confidence, and that's why the NYSE is doing it.

I believe that would be an alternative for the insurance industry to government regulation. Who is better to carry that out than actuaries? You might also consider an industry guarantee fund financed by the companies in lieu of the state funds that are rather scattered and unpredictable. In short, I recommend that you act pretty soon because if you don't, it'll be too late to take over this pressing problem of public confidence in the insurance industry without which prosperity in the decade of the 1990s cannot be achieved. I recommend also in line with what Daphne was saying here that actuaries play a broader role in promoting stable, long-term economic growth. Actuaries are uniquely qualified to contribute to the public interest particularly as it is affected by two things, by education and by health. You can contribute to upgrading our math literacy in this country in a variety of ways. Adopt-a-School is only one. Then I think there is the other pressing problem, and that is health care, which is the subject for another day because I am by no means, by no stretch of the imagination, an expert, but nonetheless recognize it is perhaps our most pressing long-run problem. These are issues that actuaries should not merely study but do something about, and you can make an important contribution to intelligent public debate on the issues and to public policies.

In conclusion, I'm optimistic about America's economic future. The world is not coming to an end. You know what Will Rogers said about the world coming to an end. He said, "If the world comes to an end, I want to be in Cincinnati. Everything happens there 10 years later." We do have problems. A recession's underway, although I think it will give way to a gradual, subdued recovery later this year. I know also we have very great strengths. We have a resilient society with great personal energy and initiative. I believe that productivity growth is making a comeback, although I also recognize that productivity doesn't happen by itself. It's people like you who make it happen in your own backyard. Above all, I urge you, as actuaries, to play a broader role in our society than functioning as mathematicians for the insurance industry. You are the brain trust that can safeguard the solvency and the reputation of the industry if you are but willing, and solvency and reputation will determine the future of your industry, make no mistake about it. I recommend that you consider a tough, new industry selfregulatory agency to reassure the public that its money is safe, that you audit companies to ensure compliance with tough, new rules and that you take enforcement actions against those who flaunt them. Time is running out. You can't debate the issue too long or others will do it for you. To end on a positive note, in the 1990s, by and large, I expect a decade of growth with new opportunities for success in a highly competitive, global market.

MS. BARTLETT: Dr. Freund has agreed to answer a few questions. So, if anybody would like to challenge him on some of his challenges, feel free.

FROM THE FLOOR: I will ask this question as a Canadian and a member of the Society of Actuaries. You mentioned the impending trilateral North American trade agreement. What impact do you think that will have on the relative economies of the three countries? I know labor costs are roughly inversely proportional to mean country temperature. That will presumably mean some reshuffling of the relative economies of the three countries. Could you comment on that?

DR. FREUND: I think implicit in your question are really two things. One is the low wage argument, and the other is, is it a good idea to have a trilateral system only?

Let me address the second part first. There is no doubt, and I think most economists would agree that a multilateral system of free trade would be preferable because it might still lead to some distortions in trade because we have some tariff preferences here that are not applied to the rest of the world. In other words, a system based on the General Agreement on Tariffs and Trade (GATT), would most favor treatment that reduces tariffs to all countries, but on the other hand, I think that it is a natural alliance in the North American continent even though there are substantial differences in wage scales. The fact is that unit costs of production are not determined by wages alone. You know, some congressmen have protested saying, we should not allow the cheap labor goods of Mexico to come to the United States, but if you go to Mexico, they will get the same kind of opposition, we should not allow the highly efficient, highly productive, highly capitalized American firms to dump their goods on our market. It is still true that we must, in our international trade, specialize in high capital, high productive goods and services, not people intensive goods and services. That is the division of labor that would benefit us all. On the whole, particularly given the rising protectionism of the European community, the trilateral approach is better than no approach.

MR. GREGORY S. STRONG: I'd like to challenge one of the statements that you made about failures of insurance companies. I think not only the stockholders should pay a price but also some of the policyholders. If policyholders had to give up some of the interest that they sought from companies like Executive Life, we might change consumer behavior. How would you react to that position?

DR. FREUND: I react very badly to that position. You might say the same thing for bank depositors, that is, you might --

MR. STRONG: I would.

DR. FREUND: You would.

MR. STRONG: I would.

DR. FREUND: Yes. I should have known better than to debate an actuary. I think the problem is that when people buy insurance or annuities they're given the impression that that is an ironclad guarantee that you can't lose. Maybe the interest rate will fluctuate depending on the contract, but you're not going to lose any principal. Now, if you were going to sell a different kind of product, say over a certain amount, you get a higher return if you take the risk of our going belly-up, and you notify the policyholder accordingly, then it may be fine. Similarly, if the banks say, over $100,000 you have no protection, you're on your own, and we'll pay you a higher rate of interest on a jumbo CD, for example, I think that's fine, too. I think it is a question of confidence and perception, and you have given no indication to your policyholders, to your annuitants, that they are at risk in any way.

MS. BARTLETT: I think we have time for one more question over there.

MR. GENE ECKSTUT: I have a comment and then a question. The comment is the last time I heard you talk was in 1982 at a luncheon at the Society of Actuaries and you predicted that the 1980s would be very good as far as growth, and that was right in the middle of a recession, and that turned out to be a good prediction, and I hope that your 1990s prediction turns out as well.

My question relates to several articles I've read lately and also the way the Social Security assumptions of economic growth in the twenty-first century are structured. It seems like productivity in the 1970s and early 1980s was low. I interpret that because there was a lot of influx of workers, and the economy catered to the influx of workers instead of capital accumulation. There seems to be a few articles that take that low productivity and then project it into the twenty-first century when it's projected that there won't be a lot of new workers, and the low productivity increase on the low number of workers turns out to give a growth rate of the economy of less than 2%. It seems to me that in a period of low growth of workers, you would have higher productivity of capital. That was my question. Would you comment on that?

DR. FREUND: You did a dreadful thing. You reminded me of predictions I made in 1982, but I don't apologize. The fact is that in many ways the 1980s were an extraordinary period. You, yourself, refer to the fact that we absorbed a huge increase in the work force which is no mean achievement and at the end of that period had reasonably high levels of employment, around 5.5%. Some economists would say that's even full employment. We absorbed this labor force both of young people and of women as no other country in the world managed to do, not in Europe, not even in the United Kingdom or Germany.

Now, it's true that on the way we accumulated some problems. I think those were largely unpredictable, that is, the major problem we accumulated was a high level of debt -- public, consumer and corporate debt -- for which we are now paying the price, admittedly. That was unpredictable, but I think it is also incontestable that the 1980s represented in our economic history a period of substantial economic growth. Indeed, it was the longest period of peacetime expansion we have had. We have an upswing uninterrupted by recession between 1982 and 1990, an eight-year period of expansion, and I don't apologize for what I said then. Please do come in the year 2002, and we'll talk about my present prediction then. Will you reinvite me then?

The other question was on Social Security, and really what the gentleman said, as I understood him, was how can we have more than a 2% real growth in the 1990s with the labor force growth petering-out and maybe only a 2% productivity gain? My arithmetic is a little different, and if you're going to nail me down and judge me on this, I'll give it to you, nonetheless. I expect that productivity will grow close to 3%-per-annum, the labor force will grow 1%, and we will have real growth in the neighborhood of near 4%, but then let me finish off by reminding you about an experience I had a long time ago when I was a student at Columbia and I took a course in forecasting, and at the end of the semester the final words of the professor were, "I want you to remember these two principles if you go into forecasting." He said, "One is forecast frequently." And two is, "You can give them a number, and you can give them a date, but never give them both."