

GOVERNMENT

Asia beacon of optimism amid politically-induced economic shortcomings in West

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Money

By FORREST CARDAMENIS

SAN FRANCISCO Economic recovery depends primarily upon functional elected governments, according to a former U.S. Treasury Secretary.

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At the Economic Outlook session at the Financial Times' Luxury Business Summit 2016 on May 24, Robert Rubin, co-chairman of the Council on Foreign Relations and former Treasury Secretary and Martin Wolf, chief economic commentator for the Financial Times, discussed the impact of Congressional gridlock, recent and impending elections, Brexit and interest rates on the economy. Despite considerable turmoil at present, history and numbers still provide a reason for optimism as the total of potential luxury consumers continues to grow.

"I think the massively important fundamental issue for the U.S. is, "with Congress, will there be the reestablishment of some moderate measure of willingness to govern?" Mr. Rubin said. "We have had now at least a decade in which there hasn't been a willingness to govern - that is to say the compromise and the making of deals.

"Conventional wisdom is the House will still be Republican so [presidential frontrunner Hillary Clinton] can only... make progress if there is some moderate measure of willingness to govern," he said. "And on the current facts, one would have to be concerned, especially since this has been an extremely negative campaign, and that's not going to build the sense to mandate, quite the contrary.

"Having said that, my view for whatever it may be worth, if you look at the history of the American political system, it's resilience, the rapidity with which it changes is quite remarkable. I think at some point, and it might take a while and it may be a difficult and complicated and messy process, but I think at some point we will establish sufficient functionality to do some reasonably good portion of what we need to do, but there is certainly no evidence of this in the facts right now and no guarantee."

Gridlocked

The gloom of today's world economy is hard not to see in the news. Japan has slowed to growth of half a percentage point, China has slowed to barely half of its recent growth, the once-promising Brazil has been swallowed by economic and political disasters and the Eurozone and U.S. have slowed.

Mr. Rubin notes that Japan has given up on reforming the structure of its economy, which he termed "the only reform that really mattered," and highlighted unemployment rates of at least 10 percent in France, Spain and Italy, with

growth projections of just 1.4 percent.

Likewise, the recovery from the financial crisis has been long, although Mr. Rubin suggests it will not lead to another recession, as long recoveries often do. Across the Pacific, other markets are unsure that China still has full control over its economy as it transitions from an export-driven economy to a consumer-driven economy.

Throughout the discussion, Mr. Rubin repeatedly underlined the failure of Congress to govern as a primary cause of and the only real solution to economic issues rooted in the U.S.

Asked about the significance of the Federal Reserve and interest rates, Mr. Rubin said the attention the issue has gotten is "absurd" and that relatively speaking it has "zero significance" substantially and that its psychological significance will wear out. Instead, he argued, reform across the criminal justice system, immigration, K-12 education and taxes are the real drivers of adverse economic effects.

Accordingly, media and analysts should be focusing on the failures of elected officials to compromise and work with another and spotlight Congressional gridlock rather than federal rates, as the power of the Federal Reserve is minimal given the politico-economical failings of the government.

As a result, the impending U.S. election is particularly significant. The unpredictability of Donald Trump, who may not operate within the broad framework of economic management, could cause further unrest. Hillary Clinton, meanwhile, would have to work with a Republican House of Representatives and a Republican- or very slight Democratic-majority in the Senate, meaning that the legislative reform needed to fix deep-seated economic issues may not come to pass.

The speakers say that similar issues have arisen in Europe, with the rise of Marine Le Pen France echoing the rise of Trump in the U.S. The possibility of Britain exiting the European Union could also cause serious short- and long-term economic issues.

However, both Mr. Rubin and Mr. Wolf argued that a Trump presidency is unlikely, and that British voters do not see their relative insecurities and wage stagnation as issues related to the European Union and will likely opt for the present familiarity.

"We are having all the bullets come at us and we hope that we will dodge them all, but you probably do not dodge them all," Mr. Wolf said. "You mentioned Madame Le Pen, and [in Austria] a really far right candidate lost by one percentage point.

"So what is happening is a very significant portion of the western population is very disgruntled now, that's obvious," he said. "But what worries me is we do not know how to make them less disgruntled."

In Europe, this is partially attributable to the incomplete promise of the European Union. The Maastricht Treaty, which led to the creation of the euro as a single European currency, was greeted with skepticism. Critics, including Mr. Rubin, were unsure that a group of countries with differing fiscal policies could share a currency.

While the euro was supposed to be the first in a series of unifying gestures, further changes did not come to pass, and as debt ratios have exceeded original terms, the single currency gesture has put undue economic pressure on Germany in particular to relieve other member states.

Likewise, countries will need to find better ways to react to immigration and the refugee crisis. Historically, immigration has had a positive force on economies, particularly in the U.S., but cooperation among elected officials is important for functional and effective immigration reform in all countries.

In China, both speakers expressed skepticism that China's reported growth rates are accurate and noted that China now sounds uncertain as to how to continue advancing its economy. While recently, markets and economists have adopted a similar attitude toward China as they did toward Japan 25 years ago a lack of understanding paired with a confidence in the country to succeed that faith has waned.

Nevertheless, a large foreign exchange reserve will help the country avoid a crash, and growth even at current levels will help prop up the rest of Asia.

Turning to the technology boom of the past decade or more, productivity has skyrocketed, but it has also displaced jobs and workers. While there are people with creative potential solutions and diagnoses, these voices have been drowned out by Congressional gridlock, and government will need to make substantial policy changes to manage the major changes tech poses to the economy.

In a particularly noteworthy irony, there is considerable agreement in the U.S. that tax reform is necessary, with particular emphasis on ensuring businesses cannot hide money offshore to avoid taxes. Nevertheless, such reform is far from imminent, further underlining the necessity of legislative advances.

"I do not think that is going to be fixed in isolation, and therefore only if we can do some kind of broader tax reform [will it be achieved]," Mr. Rubin said. "And that is going to require a Congress and a House of Representatives with a willingness to sit down and compromise."

Asked if the U.S. is entering a new era of protectionism, there was tacit agreement that such pressure will be strong over the next few years, but that the controversy over the Trans-Pacific Partnership echoes the controversy of the North American Free Trade Agreement. Mr. Rubin predicts that it will eventually pass, although it may take longer than was originally expected.

A better outlook

Nevertheless, the session concluded on a note of optimism. Mr. Wolf emphasized that cumulative annual growth of 2 percent in market power is significant, and that the expectations of the pre-recession are unreasonable given that the growth of that period was perhaps the greatest in history.

Likewise, growth across Asia is forecasted to be at least 4 percent and could stretch up to 6 percent. Over half the world's population lives on the continent, and that kind of growth means luxury brands will gain hundreds of millions of potential consumers.

Chinese residents will make 90 million outbound trips in 2020, with that number increasing by an additional 36 million over the following decade, according to a report by Euromonitor.

As reported in "[How to Target Chinese Shoppers Abroad](#)," outbound trips have increased on average by an impressive 13 percent since 2000, helping China overtake Japan as the second largest consumer market in 2011. With the significance and size of the Chinese tourist market only projected to swell, brands will need to develop a more nuanced understanding of the market in order to reach consumers ([see story](#)).

Lagos, Nigeria and Mumbai, India are also poised to become major players in the luxury world, according to a recent report by commercial real estate services adviser CBRE.

Although nobody should expect another China, the residents of the Nigerian and Indian cities are already beginning to make their presence known to luxury brands. Continuing globalization ensures that the economy will remain a major factor in the luxury market, so brands must be attuned to economic patterns and shifts to stay ahead ([see story](#)).

"I think people should be extremely probabilistic," Mr. Rubin said. "I think uncertainties are greater than any time in my adult lifetime - it sort of always feels that way; you don't want to overstate that, but it may actually be true.

"One should make allowance to all the uncertainties," he said. What we should be most focused on is what I have said now so many times, which is, 'will our political system regain some moderate degree of functionality, and a president who functions in some reasonable manner?'"