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Peter Orszag
Chief Executive Officer and Chairman
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Moderator: Katie Kingsbury
Opinion Editor
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Introduction

President Barbara Van Allen

Good morning everyone. I know everybody's excited to be here. We like that. Welcome to the 864th meeting of The Economic Club of New York. I'm Barbara Van Allen, President and CEO of the Club and it's a pleasure to be here with all of you. I want to extend a warm welcome to students joining us virtually from William and Mary College and to recognize members of the 2026 Class of Fellows – a select group of diverse next-gen business leaders who are joining us virtually today.

The Economic Club of New York is proud to stand as the nation's leading platform for discussions on social, political, and economic issues. We are, of course, nonpartisan and take no position. We just enjoy intellectual rigor in our conversations. We've been doing this for more than a century and the Club has hosted over 1,000 preeminent guests during that period, contributing to our tradition of excellence which continues up to and includes today.

I'm delighted to welcome fellow member and our guest, Peter Orszag. He serves as CEO and Chairman of Lazard. He joined Lazard in 2016 and previously served as CEO of the firm's Financial Advisory Business. His career spans finance, public policy, and academia. Before joining Lazard, Peter served as Director of the Office of Management

and Budget in the Obama Administration and as Director of the Congressional Budget Office. Earlier in his career, he served in the Clinton Administration on the Council of Economic Advisers and as a Special Assistant to the President on Economic Policy.

In addition to being a member of the Club, he's also a member of the National Academy of Medicine, the Council on Foreign Relations, and the Aspen Economic Strategy Group. He also serves on the boards of the Institute for Advanced Study, the Peterson Institute for International Economics, and Mount Sinai Hospital.

Peter graduated summa cum laude from Princeton University and earned his PhD from the London School of Economics where he was a Marshall Scholar.

Today's program will feature a fireside chat moderated by Katie Kingsbury, the Opinion Editor at *The New York Times*, and we're honored to have her with us here today. The program will conclude promptly at 1:00 p.m. And as a reminder, the discussion is on the record and we do have media both in the room and online. There will be time for questions from the audience so please have those prepared. And without further ado, please join me in welcoming Peter and Katie. Thank you.

Conversation with Peter Orszag

KATIE KINGSBURY: Good afternoon everyone. Thank you so much for being here with us today. As Barbara said, I'm going to spend a few minutes asking, well, not a few minutes, about 40 minutes, asking Peter some questions and then I welcome you joining the conversation with whatever questions that you have.

I wanted to start, because I'm sure there are some people who have not had a chance to read your fascinating new paper yet, giving you a few minutes to just talk about the theory that you're putting forward. You've compared today's global economy to the Challenger disaster, a brilliantly engineered system undone by one cheap part, the O-ring. Richard Feynman's point wasn't really about the O-ring, though. It was that NASA's managers had talked themselves into, it leaked a little the last time and we were fine, so it's probably fine. Where in the economy right now, in the markets, in the companies, in Washington, do you see the same reasoning?

PETER ORSZAG: First of all, it's great to be with you. Let me just back up for a moment and explain why we put this forward and what the key point is. And the key point really is that we're living a new supply-side era, in which if you look empirically at the variation in both economic activity and business activity, it's disproportionately now coming from the supply side, not the demand side. And that is a different experience, a different set

of facts than for most of the post-World War II era, point one. And point two is that new supply-side era, this is not your grandfather's supply side. It's not about marginal tax rates and savings rates. It's about often geopolitically motivated things that happen in the global economy that then have really important consequences for the economy, for business, and for inflation.

So why does this happen, and why the different mix? The answer is that for decades we had expanding globalization, effectively infinitely elastic supply because the equivalent of the O-ring, if a component failed, or you had a problem sourcing it, really easy just to substitute out and get another one. Just wait for the next container ship and you're all set.

That has started to change because of the fracturing of the global economy. Globalization metrics have not declined, but they've kind of gone sideways, and there is this fracturing. So on the supply side, something's changed. And another big thing that's happened is, especially post-Covid, governments have stepped in dramatically, both fiscal and monetary policy, to cushion any demand-side imbalances. And so the demand side is not the primary source of variation anymore. It's the supply side. And because we're (audio issue) components really easily, we've built supply chains that have these multiple single sources of failure. And that's the issue, which is an expense that a global economy that has a wide series of O-rings, not just one, built into many

production processes fundamentally changing the nature of the economy.

And we could say, well, that's interesting, but so what? And just to give you, I'm sure we'll get to this, but let me give you one specific so-what, just to kind of ground the discussion in practicality. The due process, which is at the heart of what the Fed and other central banks have to account for, is a little different today than it was 20 or 30 years ago. At the beginning of this year, Adam Posen, who runs the Peterson Institute, and I suggested that inflation in the United States would not come down, it will stay high, stay elevated. And we were almost laughed at, at the time, because that was not the conventional wisdom. The overwhelming majority of forecasts were that inflation would come down. And we were right. And the point here is not to, you know, claim credit for being right, but instead to highlight why did we say that.

And the reason we said that was, well, if you want to know what's happening on inflation today, you have to look at the supply shocks that were happening a year or two ago. And you could clearly see that the full impact of the tariff shock had not played through, that there was the potential for additional geopolitical risk and so on. And so our prediction, if you will, was more a methodological change or a philosophical change than just a one-time thing. And now we all have to be armchair geopolitical analysts in order to evaluate what's happening in the business. I didn't really answer your question but that's...

KATIE KINGSBURY: That's okay. I think it's actually pretty important then to turn to this question. The paper argues that supply shocks behave differently, and they're slow to build, slow to unwind, with long lags through margins and inventories. But you also note that the economic damage from any single shock, like Hormuz or the chip shortage, has actually been smaller than their 1970s equivalents. So which is it? Are we more fragile? Or has the system actually gotten better at absorbing those hits, just more often? And why?

PETER ORSZAG: It's a great question and a hard one, but I would say a couple of things. The impact of any individual shock, I think, is smaller today than in the past. A great example is the energy shock coming out of the conflict in the Middle East. The U.S. economy, not only from a net production perspective, but also just from an energy use per unit of GDP, is less exposed to energy price shocks today than it was in the 1970s. So when something happens, the impact on the economy is smaller today.

But the thing is, so two things that, even though the impact of any given shock is smaller, the first thing is we are subject to an ongoing series of these things. So even if any individual one is smaller, the thought that, oh, we just need to get past this one thing and then we're good, is very likely to be wrong. We're going to have continued things happening that...(Audio Issue)...The U.S. economy has survived the incoming shocks that have been happening in no small part because of two things. The first is a

massive degree of fiscal support, so the fiscal deficit is around 7% of GDP. That is providing substantial underlying kind of, again, cushion or support to the economy. And the second is a really, really big AI buildout that is generating activity in the economy but that may have its own risks associated with it.

KATIE KINGSBURY: Yes, you've called the U.S. economy a levered bet on AI, you know, infrastructure mostly financed through debt, not equity. If that bet is wrong, however, isn't that a classic demand-side, Minsky-style financial fragility story, cutting against the thesis that demand shocks have tamed and supply is now the dominant risk?

PETER ORSZAG: So, first, I want to make it clear we're saying supply-side is the more important. It doesn't mean there's no demand-side impact. So it's not exclusive. But let me talk for a second about the levered bet on AI. And I think it's really important for us to distinguish the technology from the business model. I am a huge fan of the technology. The folks from Lazard that are here can tell you. I am a massive user myself, and we can go through all the various different ways in which I think it's an amazing time to be alive because of what you can do with the technology.

But separate that from the business model. And history is replete with episodes in which debt-financed processes run into trouble. And I think the risk that we face at this

moment in time has less to do with the technology, which is advancing rapidly, and has more to do with the fact that the investment levels are massive. A recent Brookings paper estimated the investment between now and 2032 at 3½% of GDP. And just to calibrate that, the buildout of highways was more like one. Railways, railroads might have been two. A lot of the old other examples, the electricity buildout was about a half a percent of GDP. So this is a massive, massive bet, and to your point, it is increasingly debt-financed.

And here's, I think, the business model concern, which is if it is debt-financed and token spend, instead of going like this, just goes like that, it's still increasing, but not as rapidly as the underwriting behind the debt financing, you can have severe financial distress open up at one of these firms. And so I think that is a real significant concern. Token spend is going to come under pressure not just from open-source models, but also from local and edge compute, which doesn't draw on the cloud architecture and tokens in the same way.

And again, the point is if it were equity-financed, going from this to this doesn't matter. But when it's debt-financed, it really does. And I think this is a pretty significant concern that we should be focused on because I think the odds that the debt financing plays out as expected, you know, is certainly far from 100%.

KATIE KINGSBURY: So I want to come back and talk a little bit about AI and China in a minute. But before that, I think actually you compare what's happening right now to the fiber-optic cable glut of the 1990s. Can you tell us a little bit about that example and the buildout there?

PETER ORSZAG: Yes, again, separate technology from the business model because there are lots of things where there's a significant amount of investment, and the people who have been making that investment don't reap the full benefits or even most of the benefits of it. But then there are long-term benefits to the economy as a whole, and I think that's what happened with the dark fiber period in the telecom buildup. By the way, the telecom buildout was also about a quarter or so of the projected AI spend. So just order of magnitude here, you know, dramatically different also.

But I think that's the point, which is there can be long-term benefits to the investments that we're making from a technology perspective, but it doesn't mean that the firms that are making the investment either benefit or even survive. And that's, I think, the distinction that is relevant to anything that is a new technology financed by debt.

KATIE KINGSBURY: So I think it's natural then to kind of turn to the question of Taiwan and TSMC's $265 billion Arizona buildout. You know, Taiwan now produces over 90% of the world's most advanced chips, and your own modeling of a blockade scenario puts

U.S. GDP down 3% in Year 1. Given that, does the Arizona build de-risk anything?

PETER ORSZAG: Barely.

KATIE KINGSBURY: At least on a timeline that matters.

PETER ORSZAG: Look, I think it's healthy for the U.S. to be building out domestic facilities, domestic capability, but even in the best case scenario, a very small share of overall chip production, and an even smaller share of the very frontier edge chips, will be produced in the United States. So it's good to do. It helps. You know, when you're facing a problem it's good to start creating workarounds. But this is not an easy or a short-term fix and it's not a panacea. So there still will be a significant amount of exposure to the production that happens on Taiwan itself. And from that perspective, Taiwan is effectively the O-ring Island at this point.

I mean it is such a key component, even away from the edge chips. So in the paper we go through an example of relatively inexpensive chips during Covid. Auto manufacturers thought that they didn't need them so they kind of said we don't need them. The chip production went elsewhere. And then when the auto manufacturers realized that demand was not declining as much as they thought and they wanted to ramp up production, they had a problem because they couldn't get back to the front of the queue.

And so these relatively cheap, dollar or two, chips actually caused auto manufacturing lines to shut down.

So the point about the O-ring is not actually a direct comparison to the space shuttle or what have you. It's instead that looking at something from a share-of-cost perspective is a much different perspective than consequence-of-failure perspective. And so we have lots of components from that era of ever-expanding supply that are relatively cheap and, from an accounting or cost perspective, look like they can't be that important, but whose failure causes the whole thing to shut down.

KATIE KINGSBURY: For those of you who are interested in today's realities of that, my colleague, Farah Stockman, wrote an excellent piece about a single bolt that has slowed down production of U.S. ammunition in recent years.

PETER ORSZAG: An expensive bolt at that.

KATIE KINGSBURY: Yes, they are expensive bolts.

PETER ORSZAG: Well, as bolts go, yes.

KATIE KINGSBURY: We've been talking about hardware but China has, you know, bet

large on the idea of cheap, open-weight models over frontier ones. If reasoning becomes a near-free commodity, that would be a pretty massive supply shock in the way that you're defining it. But it also kind of would mean that the U.S. would lose dominance in something it's currently paying trillions of dollars to build. What outcome do you actually think is more likely in the next three years?

PETER ORSZAG: So there's a horse race going on. One of the reasons why it's worth focusing on that kind of token-spend trajectory is the pressure from open source. And it doesn't necessarily mean, in fact, I think over the last couple of weeks what we've been seeing, it doesn't necessarily mean that the market share goes to those open-source models. It instead can mean that the pricing of frontier or U.S. closed models comes down to maintain some market share, but you're still, the origin of that competitive pressure, if you will, as at least in part, the open-source models.

Stepping back for a second, I do think across the board the Chinese are playing for foundational control of key parts of the global economy. For a long time, from the post-World War II era, the U.S. benefitted dramatically from being in control of the underground empire, controlling the infrastructure, controlling the financial stack, controlling the tech stack and what have you. It gave us an ability to exert a lot of influence, including through secondary and even tertiary sanctions, on what happened in the rest of the world.

And I think if you look at what's happening in digital financial stack, if you look at what's happening in AI, if you look at what's happening in lots of parts of the physical world, including in renewables and so on, the Chinese are manufacturing at scale, whether it's pure manufacturing or virtual, the infrastructure for the next several decades. And so you're seeing this battle play out in many other areas of the world, in Africa, in the Middle East and what have you between different models. And therefore, I think the near-term profitability is not necessarily the only objective, especially from the Chinese side.

KATIE KINGSBURY: And that doesn't even include kind of the rogue, unexpected choke points that may be part of the geopolitical system for years to come at this point. In writing about your LSE speech in *Bloomberg*, John Authers raised the Goodhart Law. I feel obligated – I'm sure there are a lot of people who studied economics here – to raise it. So the idea that a choke point stops working the moment it's weaponized because everyone exposed to it then has a reason to route around it.

You actually addressed Goodhart's Law in your paper and let's dig into that. Rare-earth feels like the obvious example with the one-year truce. The Nexperia standoff was just resolved in a few weeks. If choke points keep self-defeating that fast, is that a new permanent era, or is it just a bad couple of years?

PETER ORSZAG: Sure, so this is really a fascinating topic. So, first, just to clarify, Goodhart's Law or Rule is actually from monetary policy. And it basically says as soon as you start targeting something from a policy perspective, like let's say you define an inflation target or you're going to use some metric for policy, it immediately distorts it and becomes useless or, you know, its useful life diminishes immediately.

And so there is an analogy, as soon as you start or even threaten to exert pressure on one of these single sources of failure, you're creating an incentive for people to have a work-around. We're seeing this play out on the Strait, where there's lots of discussion of not only the East-West pipeline, but building new pipelines, finding new ways of working around the Strait itself, etc. etc. etc.

So the question then becomes – how easy is that to do? How cautious should you be in exerting any pressure on the choke point? And the only thing I'd say about rare-earth, the chips, and what have you, is to say there's a temporary peace is not to say that the vulnerability has been addressed. We are still extremely vulnerable to a cutoff of rare-earth supply from the Chinese, despite the fact that there's kind of a bit of a detente. And I think the way to actually interpret the stability in the U.S.-Chinese relationship right now, which is something that we should welcome is that both sides are playing for time. The U.S. is playing for time to build out more rare-earth capability, especially on the processing side. The rare earth materials themselves are more easily obtainable

than building the facilities to process them. And then on the Chinese side, to build more domestic, both lithography and other parts of the chip production ecosystem. And so both sides have an incentive to kind of play nice for a while, while there's this kind of, effectively, mutual assured destruction.

KATIE KINGSBURY: Your paper is pretty candid about reorganizing supply changes around the geopolitical blocks that you're describing. Of course, that will cost trillions of dollars. Who pays that bill? Is it the consumers, the shareholders, the taxpayers, and has anyone really been honest with the public about that?

PETER ORSZAG: Well, look, this is the inevitable consequence of ever-expanding globalization period ending. That worked really well from a cost perspective. It didn't work so well from a resilience perspective. But it will be more expensive to create redundancy, to create more resilience, to have this fracturing in the global economy. How much more expensive depends on the sector and what have you.

And we don't necessarily need that redundancy and resilience in every area. And so the extra cost may not be that substantial depending on the...but it will be more expensive. And that's the inevitable, buying insurance costs money. And it's very rare to be able to have a more resilient, a more resilient structure that doesn't also have some additional expense associated with it. So I don't know whether we've been fully honest, – you

know, I think you're really meaning policymakers — with the public, but there is a cost to moving away from that ever-expanding globalization era.

KATIE KINGSBURY: I mean what you're actually talking about in the paper gets into this as well, it's kind of a shift from a rules-based to discretionary state capitalism. You know, you raised the question of golden shares and government equity stakes in companies like Intel, you know, firm-specific deals replacing kind of the predictable regulation that we're used to. Can you talk a little bit about whether or not you actually think that's good for American capitalism ultimately?

PETER ORSZAG: So two things, first a little backdrop, and then I'll answer the question directly. One of the things that's happened over the past 30 years that has gotten far too little attention is if you look at corporate performance, the spread in performance has exploded. I think a lot of people are used to the inequality chart. So you look at, like the 90th percentile and the median and the 10th percentile, and it looks like that. If you rank companies by one common metric of performance, which is return on invested capital, the 90th or the 95th percentile has gone like this. It's the same chart. It's gone like this. The median is basically flat. And the 10th percentile is actually down a little bit. So the spread has widened dramatically. And so I think the question is, as we enter this new supply-side era, is that likely to continue?

And we think the answer is yes, for two reasons. One is if you're at the frontier, if you're the top firm, you want to make sure that your entire supply chain is very high quality because the cost to you from an O-ring moment, from having one component that's not quite as good, is actually larger than it is for the laggard firm, because you're otherwise at the frontier and one thing messing up really collapses your whole thing.

KATIE KINGSBURY: Your excellence depends on...

PETER ORSZAG ...on every part being excellent. So that's an important consequence. The second thing that's happening kind of at the same time is because these choke points or single sources of failure are more geopolitical in nature, it's changing the interaction between business and government. And this is where you get to the discretionary state capitalism point. That can happen in one of two ways. It can happen in the, here are the rules of the road, we're going to define them, and there is a different relationship between business and government, but it's a bit less anecdotal and a little bit less discretionary. Or it can be, we're trying new things. Come see me if you want to. We'll reach some special deals.

We are doing a lot of that, and I think what I would say is the evidence suggests that over time, that that tends not to produce economic outcomes or business outcomes that are as beneficial as a rules-based system because it creates a lot of variation across

firms that is unwarranted or that doesn't have to do with their underlying performance, and that kind of creates an inefficiency. And then it does also tend to almost inevitably lead to either the appearance or reality of corruption because the payoff to being one of those favored firms is so high.

Two years ago the Nobel Prize in economics was actually awarded to a set of three economists who basically made the argument that a rules-based system and that kind of governance leads to better outcomes. The thing is, it's not immediate. It takes time for those effects to play through.

KATIE KINGSBURY: I promise this question is not related to his last answer. Lazard advises governments and companies on exactly these kinds of choke points and geopolitical risks, what you call "contextual alpha." Is your own business a direct benefit of these changes in the world that you're describing?

PETER ORSZAG: I would say our business is about, on the advisory side, is about advising clients, helping them, it's not that one environment is better for us than another environment. But rather, our business is dependent on helping our clients understand the environment they're operating in. And so Lazard has always, back to the contextual alpha point, has always said, or had, I think, a comparative advantage in going beyond the narrow business question to a broader frame of, here are all the things that could

affect whether this is a good decision or not. And that goes back to Felix Rohatyn and the heyday of Lazard's history, past. But I would say in today's world that's more important than ever because whatever the operating environment is, this operating environment has a larger impact on narrow business questions than the one from 20 or 30 years ago.

KATIE KINGSBURY: You've talked about monetary policy a couple of times. You have written elsewhere that the AI CapEx is funded through cash flow and private credit rather than bank lending. But if monetary policy has weaker traction now, as you're arguing, what actually stops an inflation surprise once it starts, if not the Fed?

PETER ORSZAG: I think it does have to be the Fed, but maybe I could talk about the consequences of this new paradigm, the new supply-side era we're in for monetary policy. Because historically if you go back to your Econ-101 kind of Intro Econ, the argument was a supply shock like the 1970 oil shock hits, that the central bank shouldn't respond to it.

And you often hear some administration officials making this kind of argument. It's a one-time price level change. It doesn't affect ongoing inflation. It just raises the price level, and therefore, since the Fed is focused on ongoing inflation and not one-time changes in the price level, they should just kind of not do anything about it and let it kind

of play through.

Okay, but if what you're doing is you're seeing a series of these things and they're hitting one after another after another, then that sure looks a lot like ongoing inflation, because it's not just one thing. But back to my point earlier, you know, we've had six of these shocks in six years. And so I think the argument that the Fed or the ECB or any other central bank should just passively say, oh, that supply shock, don't worry about it, is much weaker today, given this new environment that we're in, than it was 20 or 30 years ago. Which is to say, I think the Fed needs to get pretty good at, the point I was making, which is if you're looking at inflation today, look at the supply shocks that were hitting a year or two ago and make sure you're playing through the consequences.

Let me give you one specific example. The Fed targets core inflation, which excludes energy and food, but those things do seep into underlying inflation. I think it's very likely that we're going to see significantly higher food prices next summer in an almost predictable way because of the constraints on fertilizer and other inputs into the agricultural cycle that we already know are happening. And you can kind of almost inevitably see that impact. And that's the point, which is if you want to be evaluating monetary policy and inflation, you have to get really granular at a sectoral level on all these shocks hitting the economy, because they have lags in terms of when they show up in prices, and you've got to be playing that game even as a central bank.

KATIE KINGSBURY: Do you think that the current Fed is acting aggressively enough right now?

PETER ORSZAG: As I said, inflation has remained elevated in the way that we expected, and I think it was appropriate for the Fed to respond to that by raising rates at the last meeting.

KATIE KINGSBURY: Do you think they should raise rates again?

PETER ORSZAG: I think from here, a lot will depend on the degree to which these ongoing supply shocks hit, but that the weight of the evidence or the risk balance tilts towards probably needing higher rates in the future also.

KATIE KINGSBURY: I guess I'm asking these questions because we are also experiencing a Fed that has had more pressure from the White House and other legislative bodies than probably perhaps ever before. So I actually think what I'm asking is more of step-back question. Your prescription for all of these questions is kind of a diversified abundance – which Ezra Klein will be accepting any fees for that use – more capacity spread across more suppliers and geographies rather than self-reliance. But you also talk about how long it took for Germany to adapt after Russian gas was cut off, you know, permitting reform is stuck in the U.S. Senate right now until a vote after the

midterms. Is that actually achievable, the idea of building in more redundancy everywhere in kind of the current political environment? Or is it just simply something that today's politics can't act on?

PETER ORSZAG: Okay, so let me do a little bit on the Fed because you started there and then I'll answer that question too. So, look, I would say I may be an outlier here. I think Kevin Warsh is going to surprise to the upside in terms of the degree of independence that he exerts on behalf of the Fed.

This is a position that he has long wanted. This is a dream job kind of thing. And I'm reminded, when I became Head of the Congressional Budget Office, Bob Reischauer, who was one of the icons of former CBO directors, pulled me to the side and said, "Peter, just remember, don't leave the dance with the people who brought you." In other words, you're in the job now. You have a series of responsibilities to fulfill that job, and whoever appointed you is no longer really that relevant because you're in the job.

And once you're in the seat of being the Federal Reserve Chair, you have these two icons in internal mythology – Paul Volcker and Arthur Burns. Paul Volcker, who withstood political pressure, brought inflation down, and Arthur Burns, who caved to political pressure and is seen as not the best Fed Chair in history. So internally, it's very clear which model you want to be reaching for, and we'll see how this plays out, but I

think Kevin may surprise people in terms of the degree to which he's more independent than anticipated.

Then secondly, on the German experience, I think the lesson actually is, don't prematurely cut off sources of resilience that could benefit you. So I think history is correctly judging the move away from nuclear, in particular, under the German government a decade in the past, is exactly what you don't want to do. And if I were then to bring that to the United States, I would say if I had a concern about our energy policy, it's actually not that we've moved toward, at least relative to the prior administration, being, you know, at least in symbolism more pro-fossil fuel, because Dan Yergin and I have written about how the transition was never going to be immaculate. It was going to take time.

Fossil fuels are embedded in all parts of modern society, and that's fine. It's instead being anti-renewables because I think the right approach is actually the one the Chinese have, which is you need a kind of all-sources approach, and the mix can vary over time. But to be adamantly for or against different sources of energy almost to the point of exclusion is a problem. And what's interesting about that in turn is despite policy shifting away from renewables, actually capacity buildout remains very heavily tilted towards renewables, including in states that people may find surprising, in Texas and elsewhere. Because fundamentally from a cost and business perspective, it's still

attractive.

KATIE KINGSBURY: What you're describing is a long-term vision, but I am wondering, having served in the Obama White House in 2008, what you see as the best supply-side crisis playbook, and who in the government today do you think you would trust to run that playbook?

PETER ORSZAG: The thing about crises is they're very hard to know how they kind of play out until you're in them, and so it depends what we're talking about.

KATIE KINGSBURY: Give us a hypothetical.

PETER ORSZAG: I mean, look, let's go back to the question of whether, and this is quite hypothetical, and so I will take your bait even though I'm sure the people in the back of the room are saying don't do that, but I'll take your bait.

Let's hypothetically say that we do face some financial distress around the AI buildout business model. I think the interesting question is what happens then. There's a lot of opacity in where the ultimate liabilities rest. Does someone in the federal government decide that the AI labs are too big to fail? The politics of that, I think, would be really challenging. Do one of the major players try to play JP Morgan from the early 20th

century and step in with a private-sector solution? I mean, there's lots of different ways you can see that play through, but it also depends on where the shock initially hits and lots of contours of it that are really hard to game out ahead of time.

KATIE KINGSBURY: That's fair. I want to turn to questions in a minute so please have them ready. But I want to ask one last question myself, which is, if you're right, and we are now geopolitical supply-siders, what is the one assumption that investors in this room more broadly are still making that you think is wrong?

PETER ORSZAG: That these are one-off events. In fact, I read an analyst report from yesterday afternoon from one of the well-known financial firms in New York that basically made the argument, don't worry, these are all one-time effects on inflation, and so it'll fade. And that may be right with regard to the shocks that were happening a year ago, but our point is there are going to be new shocks. There will be new things that come up because there are so many O-rings or single sources of failure that governments or businesses or others are going to try to exploit, that you shouldn't be shocked that this keeps happening. And therefore, you need to have a world view in which you can continue to operate despite the fact that these things happen.

The second thing is to not become, when they keep happening, not become overly negative, because it's easy to look at all these risks and kind of go to the Eeyore side of

the spectrum and think that everything is dismal. And I'm always reminded, when people get too apocalyptic, of David Ben-Gurion saying that anyone who doesn't believe in miracles is not a realist. Because it's just not the right kind of operating model but also empirically the fact of the matter is things have worked out, despite the fact that at any point in time in the past, you can look at all these risks and do the hair-on-fire thing. So I think we just need to also be cognizant of those risks, operate within them, but have some underlying sense of optimism because it's easy to kind of get stultified otherwise.

KATIE KINGSBURY: All right.

QUESTION: Bal Das from BGD Holdings. Thank you. That was an excellent conversation. Peter, I did want you to elaborate, if you could please, on, as you pointed out, on the levered basis we are investing in the greatest investment cycle in history in AI. Underlying that, as you said, it's debt, not equity. Underlying that debt has been this entire panoply of private debt, private credit. And I wanted to get your thoughts on that collective tissue as to the origins of its linkages to insurance, annuities, which affects the day-to-day person. So you talked about when a shock hits, who takes the liability? Do you think sufficient thought is being given to the systemic nature of the debt financing that undergirds this investment cycle, which prudent people like you are concerned could have broader implications if things don't pan out the way they are expected to?

Thank you.

PETER ORSZAG: Yes, what I would say is it's very difficult to make macro broad comments about a particular source of capital without going into really detailed, a lot of detail about how the individual contracts are working, the specific projects, all of that. That having been said, I would say the combination of a lot of debt and opacity around where those liabilities reside and an uncertain return, historically has not always played out well. And so that was the only point I'm making which is, and to go beyond that, you can identify now reasons why the trajectory of token spend may not turn out as optimistically as, you know, some may believe because we're already seeing the pressure on even closed-model pricing. That was kind of the point.

QUESTION: Thank you, Peter, for your comments. I actually run the CBO research during financial crisis and then I also run private credit research at one of the major banks. So, a similar question to that, but going deeper. As your experience being the CEO of a financial advisory firm prior to this current role, what do you see that needs to happen to make sure that individuals or institutions that are taking on this risk understand what they're getting and if there is a timeline of the needed steps to make sure the music continues, regardless if an open source model takes over, the market share or revenue of the open model, or the frontier model or not.

PETER ORSZAG: Look, I think, I'll say two things. One is for fixed income or debt

investors, it's like anything, which is you need to make sure you understand where the liabilities actually reside, what your protections actually are, how significant force majeure or other carve-outs could be that could interrupt the flow of your return. And then for the equity investors that would sit, you know, as the first line of defense before that, I mean that's a different set of calculations. But I think, there's nothing fundamentally different about this set of questions than any other levered or debt investment that people make or that institutions make, which is obviously you need to do your homework.

QUESTION: There's lack of transparency, to your point, right? The structure is not standardized. The data is not public.

PETER ORSZAG: That's more of the macro concern. I mean from an individual investor perspective or the institutional investor perspective, if you're the one investing in that instrument, hopefully you have clarity about the provisions that may not be public.

QUESTION: Fiscal policy, you've had a great perspective, both from the Washington side, OMB, CBO, and now a number of years in the financial markets here, we've hit $40 trillion of national debt, interest rates are rising, Social Security insolvency is now just six years ago. I guess two questions. How, particularly given all the shocks you've talked about today, how vulnerable do you think the United States is given where we

are and we continue to head? And two, do you see any near-term prospects for bringing down deficits as a share of GDP in the coming years?

PETER ORSZAG: So a couple of comments. I mean, first, on the bringing down deficits, it's not through policy. I think, outside of a crisis, policymakers will talk about wanting to bring down deficits but not do very much. There is the possibility, which I think we should not completely rule out, again we've been talking a lot about the business model associated with AI, you know, that we could see a boom in productivity, including from the technology. That could have a very significant effect on at least the debt ratios because productivity is the way out of an otherwise not so pretty fiscal picture.

With regard to potential for crisis, room for maneuver, I think less of the, you know, you wake up one morning and you have a fiscal crisis, and more that if there is a crisis that hits from some other dimension, our ability to step in with yet another massive fiscal package is going to be more constrained. The bond vigilantes are definitely coming back and that means that the era that we've just been living in for the past 10, 15 years of very low interest rates with the thought that we can kind of do whatever we want from a fiscal perspective is probably more constrained going forward than the past. And in that environment, you know, let's hope that one of these things doesn't hit, because we just have less maneuvering.

KATIE KINGSBURY: In a moment where there is record inequality from a wealth standpoint, you don't think that there could possibly be political pressure for policymakers to figure out reforming the tax code or offering some other sort of policy solution?

PETER ORSZAG: Here's where I get really cynical because, yes, maybe, but my experience, I mean I'll just tell you an anecdote since I mentioned the Congressional Budget Office before, from my CBO days, which is at the time we didn't have, the IT wasn't as good so I had this big binder of options to reduce the deficit. It was a printout, a big binder. And I'd get all excited, I was like Charlie Brown. I'd get all excited if Senator So-and-So would call me up and say I really want to talk about how to bring the deficit down. This is existential. The future of the country depends on it. This is why I came to Washington.

So I'd trudge up to the Senate building. I'd sit down with the Senator. I had my big book. Go through the first page, can't do any of that. Go to the second page, can't do any of that. Third page, fourth page, fifth page, it'd be like the 40th page, we finally got to, I might be able to do that. And that was like $200 million, which, you know, is something, but on the scale of these things...

And so the bumper sticker of we need to do something, great. But when you start to get

to the actual pros and cons of the specific thing, unless there's a real forcing pressure like the U.S. had in the early 90s because the bond market was effectively saying you have to do something, it's just really hard to do politically.

It reminds me a little of someone that I worked with in government, Gene Sperling. He called it the M&M problem, which is if you go on a diet, you can look at an M&M and say that's only, whatever it is, 2 calories. So I can eat one of those because what's 2 calories, it doesn't matter. And then you can apply the same logic to the next one and the next one and the next one. So in these environments it's very easy to say we can just keep going because it's too painful to take the steps. Ultimately, we will have eaten the whole bag of M&Ms and then you've got a problem. But I think the political economy of taking action before you hit that moment is just really, really hard to do.

KATIE KINGSBURY: What do you think of proposals like the AI tax or the wealth tax in California in terms of policy solutions?

PETER ORSZAG: I think, first of all, let's see what happens with regard to the point I was just making about the politics of it, or the implementation of it, or the legislative optionality. But then there's the, what's the actual effect? And it is, I think, very hard to do things at the sub-national level because you do, you know, people can be mobile. And it's got different effects at the local and state level than at the federal level. So we'll

see what the actual effects would be, but I would say, you know, to put my Econ hat back on, the elasticity of response to state or local tax is going to be significantly different than the national one.

QUESTION: Hi, I'm Sarah Hammer. I'm the Head of AI Governance at UBS. I'm curious what you think of the safety incidents at the frontier model firms and the collaboration model that large firms think about when they think about building together with someone like Anthropic and Open AI. Because now we're really looking at the security and testing environment of those firms on top of commercial terms, on top of data protection, non-exclusivity for example, and then the recent signing of the Safety Accord last week.

PETER ORSZAG: So, I think there's some cynicism around why there's been so much call for regulation, but my view of this is things can have two causes or two explanations. One doesn't necessarily need to exclude the other. It could be simultaneously true that, for example, if you're worried about financial distress from the levered bet on AI, that it would convenient to have intervention that kind of slows that down a bit and protects everyone to some degree, but also that you're worried about the safety component. So I think the cynicism may be a little bit misplaced because things could be motivated by more than one factor.

And then on the pure safety question, I do think that there are reasons to be cautious

about things that are hard to understand and that are escaping the boundaries that have been ostensibly placed on them. And so usually it's very hard to have the benefits of a new technology without taking some risks, and I think the hard question is how to get that balance right between the massive potential here of making lives in science and healthcare and lots of other things significantly better against the risk of losing control. And that is art, not science, and I don't have an easy answer to it.

QUESTION: Hi. I'm Jason Wetzel from NORD/LB. I just had a question about contextual alpha and how you deploy that in your decision-making process in, you know, advising clients in an environment where geopolitics and policy uncertainty is high? If you can just provide any examples or just kind of general guidance, that would be appreciated.

PETER ORSZAG: Yes, look, I mean, I don't mean to turn this into a Lazard advertisement, but I'll do 30 seconds of it at least. I'll give you a couple of examples. We have a great geopolitical advisory team. It includes people like Bill McRaven and Jami Miscik, but also Erik Kurilla, who has recently served as CENTCOM Commander. Their ability to help clients read, not just what's in the news, but kind of interpret in a sophisticated way the risk of what's likely to happen and kind of read between the lines, which then has direct impact on your business operations. And so I won't do the full advertisement because it seems inappropriate, but we're always happy to talk.

KATIE KINGSBURY: Any other questions from the audience?

QUESTION: Thank you. Michal Katz from Mizuho. Just curious as to what impact, if any, do you foresee on the economy or business broadly with the anticipated flip of the House and the Senate in the midterms?

PETER ORSZAG: I don't think it's going to have dramatic effects on the business environment in the U.S. Certainly not, you know, a lot of things like the antitrust environment, that's regulatory and not directly influenced by the legislative side of things. But I think there probably are two consequences. One is there will probably be more government shutdowns. The flip of even, it doesn't have to be two houses, just the House, let alone the Senate, means that there's a choke point, if you will, on the appropriations process. And it's very likely that you're going to see some showdowns around things that the House Democrats don't like that the Administration is doing, that the Administration wants to continue doing.

And so shutdown, and then one side or the other loses that political battle and the government reopens, but this is likely to recur. In addition, we'll have the debt limit binding probably late '27 or early '28. So that will be the kind of, you know, much more muscular version of the skirmishes that may happen in the meanwhile around continuing appropriations, continuing resolutions, etc. But that's one set of

consequences.

The other set of consequences for the corporate community is there will be a lot of Oversight Committee hearings in the investigations. And I think they will often target CEOs and not government officials because the government officials are going to invoke executive privilege. And as I like to say to a lot of our clients, unfortunately executive privilege does not apply to the Chief Executive Officer. So it is likely that corporate officials will be caught, I think the Democrats are already kind of signaling this, that that's likely going to be an area of focus for them.

KATIE KINGSBURY: I could ask you about a thousand more questions about that. But on that note, thank you very much. Thank you all for being here.

PRESIDENT BARBARA VAN ALLEN: Well, thank you both. That was terrific. I think we could have kept going, but then there's a hot lunch in the kitchen there waiting. I do want to just mention, if you turn over your programs, that we have a lot ahead of us, including Monday, we have David Axelrod and Karl Rove in a webinar looking at the midterm election. Charlie Cook will be joining us on the 22nd, next Thursday, from the Cook Political Report. That is in-person. And then Tarek Mansour, Kalshi, will be joining us October 27. And, of course, we just added Henry Paulson. He will receive the Peter G. Peterson Award, and so we're excited about that, on October 29th. Also in October,

it’s not in your program yet, for those that are baseball fans, David Winfield has a book, and he will be joining us as well. So be sure to continue checking the website for updates. We have a lot planned way past October as well through the end of the year.

As always, I just want to take a moment to thank members of the Centennial Society as their donations enable us to do the work that we do at the Club. So for everyone joining us virtually, we’re going to say goodbye. And for everyone in the room, please enjoy your lunch. Thank you.