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Remarks by

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of the

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I am pleased to be back at Florida State again, and I am honored to find myself on this side of the podium this time.

A commencement is an occasion to celebrate. It is also an opportunity for graduates, their friends and family, to look both back on the changes wrought by these years of higher education and forward to a future that is "commencing" right now. If I may, I'd like to take this opportunity offered me to outline a similar retrospective-prospective look at the larger economic setting within which we live.

During the past four years--just the length of an average undergraduate career--we have seen an impressive expansion of economic activity in this country. When the freshman class entered college in the fall of 1982, the United States was still suffering from a severe recession. By Christmas break that year, however, the recession was history and the economy had embarked on what has turned out to be a period of sustained economic growth. Since fall 1982, real gross national product has risen about 15 percent and the economy has created 11 million new jobs. Notably, however, there has been no sign along the way of any reacceleration of inflation. During this period, households have benefited from renewed growth in real incomes while business profitability has also increased. Nurtured by deregulation and an easing of tax burdens, the spirit of entrepreneurship and healthy competition has been revitalized. And as a result, the groundwork has been laid for continued economic progress in which all will have an opportunity to share.

I must point out, however, that, while the economy has recorded a remarkable performance over the past several years and appears poised to extend that performance, we cannot become complacent, overconfident in the attitude that our economic problems are forever behind us. Much in fact remains to be done and events will likely provide challenges to government policymakers and private citizens for some time to come. We must consolidate our gains and follow through on the promise of the last several years.

Not everyone has shared in the greater prosperity. Major segments of industry and major sections of the country have lagged behind. And there is little comfort for depressed areas in the observation that this is an inevitable transitional period as the nation adjusts both to the fact that inflationary spirals are a thing of the past and to some drastic changes in specific important prices--such as that of oil or of agricultural products. Nevertheless, it is true that it is eventually in all of our interests to pursue a course consistent with noninflationary, and hence sustainable, economic growth.

The lagging recovery in some parts of the country--and in some other parts of the world--has had repercussions for financial institutions. At times, and in particular areas, these repercussions have produced substantial strains in our financial system. The depth and flexibility of our markets, along with assistance from the institutions we trust to safeguard our system, have thus far cushioned the economy from significant adverse consequences. But here, too, we continue to face challenges.

And though recent economic growth and increases in employment have been impressive, we have not yet achieved the kind of uptrend in productivity in the economy that we need in order to ensure greater long-term progress in the welfare of our people.

That said, where do we go from here? One thing is clear: if we ever could realistically hope to address our problems successfully from a narrow, insular perspective--what economists tend to call a "closed economy" view--those days are long gone. Our nation's economic fortunes have become inextricably linked with those of other countries as markets for goods and services, as well as for financial assets, have been increasingly integrated on an international scale. This is a development that has been brought home forcefully in recent years to a broad spectrum of this nation's economy, from wheat farmers on the plains of the Midwest, who have been financially strapped by the collapse of their export markets, to bond traders in the skyscrapers of the East Coast, who constantly try to gauge the ebb and flow of foreign funds into financial assets in this country.

In the long run, the increased interdependence is a healthy development, fostering a more efficient allocation of resources around the world and allowing countries to concentrate on producing what they produce best. In the short run, however, individual economies can be subjected to swings in trade flows resulting in important dislocations. Here I have in mind specifically the slow pace of U.S. exports and the rapid increase in U.S. imports in the 1980s against the backdrop of a sharply rising exchange rate for the dollar and strong growth of income in the United States relative to that in our trading partner nations. Despite a drop in our payments for imported oil, merchandise imports into the United States soared by about 35 percent from 1982 to 1985. Over the same period, however, our exports barely changed. The resultant huge deterioration in our net trade position meant that a significant part of the demand generated in the United States was satisfied by higher production abroad. That undoubtedly relieved some cost and price pressures that would have developed here otherwise, and contributed to additional growth abroad, but it also intensified some of the sectoral strains in our own economy. It is clear from this recent experience that it is important for us to maintain a deep interest in economic developments everywhere in the world.

One country, or group of countries, perhaps can temporarily achieve gains while others fall behind; the period encompassing the past few years when the United States experienced much stronger growth and sharper disinflation than some of our major industrial trading partners is an example. But that example also underscores the pressures associated with such a pattern--both economically and politically. The cost has been a marked disequilibrium in our balance of payments, and dangerous pressures at home for protectionism. These developments not only create economic strains, in the end they diminish the capacity for cooperative efforts among the allied nations of the free world.

Recognizing that our fates are intertwined, policymakers in the major industrialized countries have taken positive steps in the past year to bring coherent effort to bear on the major problems confronting all of us. Progress is in sight with respect to the imbalances in foreign trade flows, the international debt overhang, and the inadequate growth of the world economy and widespread underemployment of human and physical resources.

At a meeting in New York City last September, finance ministers and central bank governors of the five largest industrial countries reiterated their intentions to pursue policies consistent with restoration of better balance internationally. They expressed their view that exchange rates did not yet reflect this convergence of policy or of economic performance. The dollar, which already had begun to adjust downward relative to other currencies after rising sharply over the previous four years, subsequently declined further to what is now widely viewed as a more appropriate level. On average against other major currencies the dollar exchange rate is about 30 percent below its peak a year ago.

This has been an important, salutary development, but it is time for further action, in another area affecting our trade imbalance. Specifically, U.S. exporters need strong and growing markets, particularly among our main trading parties. To sustain those markets, real incomes in other industrial countries should rise at a more acceptable rate. More robust income growth in Europe and Japan not only would help redress the imbalance that has built up in our external accounts, but also would provide markets for products from developing countries, helping to promote a vigorous, dynamic world economy.

Efforts to deal with the debt service problems of developing countries have been ongoing. At the annual IMF/World Bank meetings in Seoul last October, Secretary Baker put forth a strategy for addressing these problems and for enabling developing countries to improve the functioning of their economies and to resume growth. While only a framework, an invitation to a cooperative effort, the strategy nevertheless has provided a constructive basis for negotiation and planning in this area.

Both the G-5 initiative and the Baker debt initiative represent explicit recognition of the interdependence of national economies. They imply responsibilities not just for a few countries but for everyone. Industrial countries must act to ensure sustainable, noninflationary growth, leading to maintenance of lower interest rates, which foster investment and ease the debt servicing burdens of developing countries. Developing countries must continue to pursue responsible economic policies and must move further to make their economies behave more efficiently and flexibly. If these goals are met, private creditors and international organizations, such as the IMF and the World Bank, will support these efforts; the adjustments can occur smoothly if a moderate amount of additional net lending occurs. All countries must maintain--and work to enhance--the openness of their markets, to promote greater global economic efficiency and to allow developing countries to earn the funds to service their debts.

What specifically does this mean for the United States? Because the U.S. is the largest economy and the dollar is the world's most important currency, the effort to achieve sustained, noninflationary growth worldwide cannot reasonably be expected to succeed unless we play our role. And part of the role we must play involves strenuously resisting protectionist pressures. It is not hard to understand why calls for protection from foreign competition have mounted in the past few years--given the stresses that have been felt in many of our industries. But understanding does not imply agreement. Protectionism is a bad idea. It can temporarily aid certain groups in the economy, but only at great cost to everyone else. It raises costs and prices, to producers as well as consumers, and thereby jeopardizes the progress we have achieved in reducing inflation. It removes from protected firms some of the incentives to invest, to modernize, to become more efficient--thereby working to erode the the competitive position of U.S. industry. It hurts our trading partners, including our friends in Latin America who are struggling to put their economies on a sounder footing but who cannot solve their external financing problems if their exporters do not have fair access to markets in major industrial countries.

And it runs the serious risk of retaliation--threatening the world trading system and, more narrowly, our own exporters. From an international perspective, protection isn't a "zero-sum game"--it's a negative-sum game. It's bad economics, and it's bad politics.

In pursuing these global economic ideals, the United States is not acting completely out of altruism, for we stand to benefit from improvements elsewhere, and the effort to redress foreign trade imbalances should help us overcome the imbalances plaguing our domestic economy. A key step toward internal and external balance already has been taken, that is, the Balanced Budget and Emergency Deficit Control Act of 1985--better known as Gramm-Rudman-Hollings. One can raise questions, constitutional or otherwise, about the particular character of this law, but what is important and fundamental is, first, the recognition that heavy deficit spending cannot go on indefinitely without significant economic costs and, second, the commitment to make sure that it does not persist. Government deficit spending has absorbed much of our national savings and forced private investment to seek part of its financing from foreign sources. The only alternative to these foreign capital inflows would have been a harsh squeeze on domestic investment, at the cost of lost opportunities for productivity and growth.

Figures have been released in recent months, showing that the trajectory of the federal budget already has been significantly modified by actions taken in the past year. Where once the picture was one of deficits rising year after year, the projections now point to a downward tilt. However, it is clear that there still is more to be done if fiscal balance is to be restored, and Congress and the Administration must continue to wrestle with the basic questions of what the government can and should do.

Given the fact that, until recently, I was at the Treasury Department and actively involved in work on tax reform, you will not be surprised if I include tax reform prominently in my list of important steps for us to take. As I have studied the tax code carefully over the past few years, I have become increasingly persuaded that it falls well short of what would be desirable--not simply in terms of its perceived equity, but also in terms of its effects on incentives to work, to save, and to invest. It greatly distorts decisions that determine the allocation of resources in the economy, and in the process imposes substantial costs in the form of lost efficiency and growth potential. I hope that, despite all of the contending interests that are so apparent in the current debate, we can put together a tax restructuring that makes sense and that will contribute over time to the achievement of improved economic performance.

Monetary policy, too, has a crucial role to play in shaping the economic environment. But that role is often misunderstood and overestimated. There is a temptation whenever there are weaknesses or tensions in the economy to seek relief through the provision of greater liquidity. This may for a time ease the problems, but the longer-range costs can be substantial. Certainly, we don't want to repeat the inflationary experience of the seventies, when--as we can see now, with the benefit of hindsight--monetary discipline was not maintained with adequate consistency. It is essential that we have a stable monetary policy, one that aims consistently at achieving sustainable, noninflationary growth.

A monetary policy that is perceived as stable can yield great benefits through its positive effects on expectations. Inflationary psychology can be minimized and people can have a greater sense of certainty about the future, making them more willing to make longer-range saving and investment commitments.

Implementing such a policy is not necessarily an easy task, unfortunately. In a rapidly changing financial environment, the meaning of many of our traditional policy guides has become more ambiguous. Individuals and businesses have an ever-growing assortment of financial instruments in which they can place their funds. And, as inflation and market interest rates fall, even the humble checking account becomes more attractive. There simply is no single measure of the money supply to which we can look today and judge policy to be loose or tight. The Federal Reserve has responded to the uncertainties inherent in a changing environment by adopting a flexible approach to policy. I believe that it will be necessary for my colleagues and me to continue to pursue a strategy that places a good deal of emphasis on a broader range of information--rather than simple rules--in feeling our way toward the basic objective of sustainable, noninflationary economic growth.

The private sector, as well, faces challenges in the current environment. Labor markets in the United States have demonstrated a good deal of flexibility in recent years--much more than in some other industrial countries. Wage structures have shown an ability to adjust to market realities and our labor force has continued to exhibit a high degree of mobility--not just geographically, but across trades and industries. Partly as a consequence--and in marked contrast to experience in Europe--employment has increased dramatically and the great majority of the workers displaced in the turmoil of the early Eighties have found their way back into the active workforce. More needs to be done to reduce chronic joblessness, but the solution to this painful social problem is not to be found in methods that introduce rigidities or distortions into the labor markets. As the economy continues toward greater prosperity, it is essential that the movement toward more flexible compensation schemes and more flexible work rules not be reversed.

Employers have benefited in general from the reduction of labor market rigidities, but they cannot now simply sit back, reaping those benefits while perhaps hoping for tariff barriers or a declining dollar to create further profits for them. Better balance in the economy will improve the economic environment in which firms operate, but firms still must respond vigorously, imaginatively, and efficiently to the competition they will continue to face in the domestic and international marketplace.

Ultimately, I don't think that there can be any doubt that the achievement of economic stability and growth is essential if there is to be political and social stability. This connection is quite obvious in the case of some of the severely strained debtor countries in the Third World, and it underlies the approach of the Baker plan. The ability of moderate, democratic governments to survive may well depend on the ability of those countries to achieve reasonable economic progress.

Even in the industrialized economies, we cannot comfortably live with sustained high levels of unemployment and with segments of the population that are permanently dependent and disadvantaged. It's a terrible waste of human potential, and it will lead inevitably to stresses in the social and political fabric--not to mention greater pressures for protection and other measures that will in the end only exacerbate economic problems at home and abroad.

The challenges we face are great, but so have been our accomplishments. The trends in many facets of our national economy are very favorable, and the groundwork has been laid for constructive and cooperative effort among many key players on the international economic scene. All it takes is one look at stock and bond prices to see that I am not alone in my optimism. The financial market rallies are an implicit vote of confidence in our economic future, a collective statement that, yes, working together we will succeed in setting the world economy on a path of sustained growth.

It would be regrettable indeed if we didn't rise to the challenges of the moment, following through now on the initiatives that have been taken. By doing the right things now, we can go a long way toward ensuring a better future for ourselves and those who follow us.

As I have suggested, there is no way any of us can avoid participating in the process that will determine our future course. What we do in our work, and in our decisions as voters, will play a role in determining the direction our economy will take. I feel confident that the graduates of this great institution of higher learning have been endowed with the tools for understanding and responding wisely to the challenges they will face. We are looking to you to make significant contributions in the years ahead.