Good afternoon! I'm pleased to have this opportunity to discuss the international economy with you people who are involved in keeping our own economy on the move. I know that with your academic and practical experience in business you are aware that the economies of the world's nations are becoming more interdependent on a daily basis. Within the past two months, the Wall Street Journal has moved its international news pages from the second to the first section—a symbol, I think, of the American business community's rising consciousness of the global market in which they compete. I like to refer to this shift in consciousness as the re-internationalization of our thinking, because through much of our history we Americans were traders, intent on keeping the doors of other countries open for our products. Over time, however, we found ourselves rich enough in labor and resources to be nearly self-sufficient, a blessing that also had the ill effect of making us somewhat self-centered. During the last decade or so events such as the rise and collapse of oil prices and the ballooning of the trade deficit reminded us that the rest of the world does not necessarily need us more than we need it. In the aftermath of this rude awakening, we have returned to the reality that events outside our own borders resonate increasingly within them.

What I would like to do today is sketch the major themes of the current international economic scene as I see them, beginning with the outlook for the United States in the year ahead and then turning to the other advanced industrialized countries as well as the developing nations. By way of conclusion, I'll discuss how these international developments will affect economic activity here in Georgia and leave you with some thoughts about the major issues that could alter this international outlook—and prospects here at home—if they're not resolved.
Economic Conditions and Prospects in the United States

In the year ahead, I look for a continuation of last year's performance as measured by the major economic indicators. Real GNP expanded at a rate of 2 1/2 percent in 1986 and should repeat that or even grow at a bit better rate this year. Given this expectation, it is difficult to project an unemployment rate for 1987 much better than the current 6.6 percent, since the number of new jobs will probably just keep pace with the number of people who want them. The third major indicator, and the one by which we did best in 1986, is inflation. The consumer price index rose just over 1 percent last year, primarily as a result of the sharp drop in oil prices. The benefits of that one-time occurrence have been for the most part absorbed by the economy, and this measure of inflation will probably return to a higher level, rising to 4 or even 4 1/2 percent in 1987.

The importance of international developments to our domestic economy is driven home in the outlook for 1987. The higher prices in my outlook—higher even than in 1985—are in large part due to international developments. These include not only the stabilization of OPEC but also the rise in import prices, which as of last year were up 8 percent when you exclude energy. The international sector is also critical to the outlook for GNP growth. I look to the foreign trade front for the stimulus that will maintain our moderate growth rate. The other major components of GNP—consumption, investment, and government purchases—don't look all that strong. I don't think consumption will be weak, but neither do I expect it to be the main source of growth in the economy as it has been in recent years. It is true that consumer assets are high in concert with gains in the stock market and home values. Debt-to-income levels are also very high, though, and the savings rate has fallen to quite low levels. Consumers may very well want to bolster their balance sheets, and this makes faster growth in consumption unlikely.
Sluggishness in the consumer component of GNP reflects the beginning of a trend we at the Fed have been predicting for some time, namely, smaller annual increases in per capita consumption. It's largely the inevitable "morning after" following the spending binge that we as a nation have been on—both publicly and privately—almost since the start of this decade. Now we must embark on what will be a rather long period of paying back some of the debt to the rest of the world that we amassed to finance that binge.

With consumption expected to slow, we must look elsewhere for economic stimulus. Investment, a second component of GNP, is unlikely to lead growth either. On the one hand, there is a temporary need for new investment to replace the considerable drawdown of inventories in the last quarter of 1987. This cleared stocks and set the stage for resumed production growth at least in the early part of this year as inventories are replenished. The positive impetus to production will probably be balanced, however, by the fact that business investment, particularly in structures like offices, along with multifamily residential construction, is hobbled by excess supplies and new tax provisions. As for government purchases, budget deficits are thankfully on a downward slope, but this means less fiscal stimulus than in the past.

This leaves us net exports as an engine for the expansion. It follows from both the two-year decline in the value of the dollar in the exchange markets as well as the need to start reducing our debt abroad. For some time now we have been spending more on consumption, investment, and government than we actually produced domestically. The substantial expansion of the government sector contributed to this. To meet our aggregate demands we imported far more than we exported and borrowed from abroad to finance this. Of course this cannot go on forever. Our creditors may become less willing to lend, and, just as any borrower eventually learns, the debt service inevitably rises with that debt and becomes a burden. So the time has come to start repaying. While GNP or
national output will grow at about the same rate in 1987 as it did last year, more of that increase in output will be exported and less of the growth will be available for use domestically.

I believe an improvement in the trade deficit will materialize because the dollar's depreciation relative to other currencies has made American goods cheaper and foreign goods more expensive. The extent to which the dollar has fallen already should be sufficient to provide U.S. manufacturers with stronger demand at home as well as overseas. In fact, exports began picking up in real terms in the last 3 months of 1986 while imports flattened. It is true that the latest figures for February seemed to show a reversal of this trend, as the merchandise trade deficit widened to $15 billion from $12 billion in January. Since imports cost much more in terms of dollars while export prices are pretty much the same, the trade deficit measured in current dollars may not start falling until some time after the real deficit turns around. I'll return to this subject in a moment, but first, since I pin so much of my forecast on an improvement in international trade balances, let's examine briefly the prospects for America's major trading partners.

**Conditions and Prospects for Other Major Industrialized Nations**

The overall picture for GNP growth in Canada, West Germany, Japan, Great Britain, and France is for a continuation of expansion in the 2 to 3 percent range. France, Germany, and Japan will probably be on the lower end of that spread—which is, by the way, a significant amount in terms of GNP. Their projected growth, then, is best described as sluggish. Canada's growth is likely to be moderate, with a rate of 2 1/2 percent and England's a bit better. By the standards of advanced industrial economies, unemployment is and will probably remain high in all these countries. England and France are in double-digits at 11 and 12 percent, respectively. Canada is just under 10 percent and Germany below 9, while Japan is at a post-war high of 3 percent. Inflation is
a mixed bag. Canada, France, and England face the likelihood of inflation at levels comparable to what I expect for the United States—4 to 4 1/2 percent. By contrast, West Germany and Japan are currently in the midst of a deflation—prices are actually falling, and whether or not that condition persists, their inflation rates will remain considerably below our own.

The low domestic inflation rates in Germany and Japan are the beneficial result of the rapid appreciation of those countries' currencies against the dollar and the drop in energy costs which are denominated in dollars. Goods that they import from the United States cost them far less now than they have in the past two years or more. However, the appreciation of a currency is a two-edged sword, particularly for countries whose growth has been linked to exports. Even as foreign goods become cheaper to consumers in Japan and Germany, their products become more expensive elsewhere. It is the reduction in demand for Japanese and German exports that leads to a forecast of slower overall growth in their economies. They need to start adjusting to less export-driven growth just as we need to start reducing our need to borrow from abroad.

Outlook for LDCs

The outlook for these advanced economies looks brighter when we compare it with the situation in the less developed countries, which are burdened by massive debts and repayment difficulties. The extent of these problems has been exemplified most dramatically by recent events in Brazil. A year ago Brazil was held up by many as a beacon of hope. Today it is in default. In preceding years, reduced imports had enabled Brazil to accumulate the foreign exchange necessary to meet its interest payments. Last year, in the face of internal political pressure to end this austerity regime, Brazil greatly stimulated domestic demand and was able to return to rapid real growth. However, higher demand engendered by that growth increased imports from the low level called for
by austerity measures. Higher imports in turn narrowed Brazil's trade surplus, which then forced the country to draw down its foreign exchange reserves sharply until most foreign interest payments had to be suspended.

More recently an earthquake disrupted Ecuador's oil shipments, two-thirds of its total exports, raising a similar foreign-exchange problem that affected debt service. The question raised by the actions of Brazil and Ecuador is whether other major debtors will follow their pattern of default. I think not; at least we have not as yet seen any evidence that they will. Despite its recent prominence in the news, the overall LDC debt situation has not really changed much. We still need to approach it on a case-by-case basis. The outlook is for not much change, insofar as we seem to be closer to neither a full resolution nor a systemic crisis, but this doesn't give hope for much growth in that part of the world.

Thus, the overall prospects for the world economy are for modest but continuing growth. This is a positive tendency to be sure, but one that will act as a constraint on sales of U.S. exports and so limit the impetus we can expect from the improvements in our own trade sector. Nonetheless, we will have some gains as a result of the substantial price changes occasioned by the dollar's two-year decline.

Implications for the Georgia Economy

What does all this imply for Georgia's economic outlook? Of course, along with the rest of the nation, we in Georgia would benefit from a turnaround in the trade deficit, but any improvement would probably not be dramatic in the short run. The dollar has only recently begun to decline against the currencies of international competitors for some Georgia products, such as apparel, and so improvement in those industries will probably be slow. In other cases, such as textiles, substantial improvement has already
occurred. Foreign auto prices have risen, and if sales of new cars maintain their recent strength, that sector of the state's economy could be a beneficiary of the trade shift. Georgia farmers won't be helped as much as farmers in other states because they don't raise an abundance of the grain crops that dominate international flows of farm goods.

Looking beyond these immediate effects, however, there are unmistakable signs that Georgia is positioning itself to play an active role in the international arena. We have our outlet to the sea in the ports of Savannah and Brunswick and a world-class gateway by air in Hartsfield Airport. We can be confident that our transportation advantages combined with the fact that Georgia is home to multinationals like Georgia-Pacific, Coca-Cola, and soon RJR Nabisco will continue to encourage urban expansion. The multinational presence will help generate a service infrastructure to support the international needs not only of those large companies but also of smaller businesses and local manufacturers who wish to export their products. Atlanta is already the seventh leading U.S. city in the number of foreign banks represented, and there are plans for two domestic banks designed specifically to handle international transactions. With this trend in motion, it is essential for Georgia's business leaders to incorporate into their planning a sense of the issues and problems that will shape international economic developments over the next several years.

**Issues and Problems**

There are several weighty issues that could, if unattended, arrest or reverse the anticipated modest rate of expansion. These issues include imbalances in global trade patterns, inappropriate fiscal policies, protectionism, and LDC debt. First, world trade patterns need to undergo a major correction. To begin with, the United States must increase its exports. I believe that in the short run, net exports are being pushed in this direction by the exchange rate realignment. In the long run, however, the American
business community's heightened awareness of international conditions must be translated into greater sensitivity to foreign markets. We must find ways to sell as aggressively in outside markets as we do at home, and this means becoming more familiar with other cultures, learning to speak the languages of foreign purchasers, and interpreting their unspoken signals. With Americans' experience in the psychology of marketing, it should be obvious that the product's appeal to overseas consumers is conditioned by subtleties of local taste and custom. Yet we persist in remaining international illiterates, paying much less attention to understanding foreign cultures than foreigners pay to investigating ours. It may be that the loss of our competitive edge that so many mention, is due more to our failure to understand others than it is to inefficient production and lack of quality.

Aside from the steps America might take to bring balance to trade flows, other advanced industrial economies need to rely less on exports and more on domestic demand. Japan and West Germany could stimulate their economies by accelerating tax cuts and implementing a generally more expansive fiscal policy. Both countries' economies could benefit from such policies. As I mentioned a moment ago, both have high unemployment rates. Not only would fiscal stimulus relieve joblessness, but it would make more money available for consumption of both imported and domestically manufactured goods. Greater Japanese and German purchases of imports would speed the reduction of America's trade deficit while helping to move the LDCs back on the track of faster economic growth by broadening markets for their exports.

Economic growth in the LDCs is essential for raising the living standards of their inhabitants, a concern that should be on the minds of the world's bankers as they weigh their loan policies for these countries. Many LDCs are at the point where the only returns likely from further austerity would be the negative ones of social and political
upheaval. It's therefore in the best interest of banks in advanced economies to work out creative solutions to the debt problem because improved living standards in LDCs make the option of revolution—which would probably mean repudiation of debt and a total loss of principal—less likely. A renewed ability on the part of the LDCs to import would also help the United States, since they could buy many of our manufactured goods if they weren't strapped with so much debt.

I am concerned that if the world's industrialized economies don't act soon to bring about this shift in trade patterns, the forces of gloom could undermine our economy along with the rest of the world's by burdening American trade policy with protectionist baggage. While I sympathize with the agony of industries, some of them here in Georgia, which are losing ground to foreign competition, I look with dismay upon the many calls for protection. Tariffs, subsidies, and other trade barriers cannot guarantee that protected industries will become more viable—a fact which the experience of agriculture, one of the most heavily insulated industries, illustrates all too well. Rather it weakens them further by shielding them from competition. It almost certainly guarantees retaliation from our trading partners, and erosion of our purchasing power and free choice as consumers.

Rather than overreacting to short-term imbalances, it is critical for us to continue expanding our vision to include all the possibilities held out by the evolving international order. Our recent positive experience with Canada convinces me that through negotiation rather than confrontation we can convince our trading partners to assume more of their own responsibility for keeping the exchange of goods and services as well as labor and capital as unrestricted as possible. We should continue to call on Taiwan and Japan in particular, two nations with extraordinarily high trade surpluses and substantial import barriers, to lower the protective walls which make it impossible for many of our
goods and services to penetrate their markets. Raising protectionist barriers is an attempt to beggar your neighbor and get a larger share of the output pie. Instead it only reduces the size of the pie and ends up hurting everybody. Our experience in the 1930's amply demonstrates this.

If Congress truly wants to alleviate the trade deficit, there are methods at its disposal that would prove far more effective than protectionism. If I have been somewhat critical of Japan and Germany for dragging their feet on easing their fiscal policies, I must also emphasize that we have been far too slow ourselves in correcting the intemperate fiscal policy that has contributed in no small measure to our trade deficit. Government borrowing to finance the deficits of the early eighties pressed beyond the ability of American citizens, with their relatively low rate of savings, to carry the debt. This pushed interest rates to a level that made government securities attractive to foreign investors. The subsequent scramble for dollars to buy our dollar-denominated assets eventually made our currency so expensive relative to others that our goods lost price competitiveness on foreign markets. In order to maintain the momentum I see building toward a turnaround in international trade, we in the United States need to sustain the attack on federal budget deficits.

Solutions to the final problem—LDC debt—are less clear cut. For Ecuador, the problems are related more to a natural disaster than to economic ills, and fairly routine measures like loaned oil from Venezuela, along with some loan restructuring and postponements of scheduled debt service, could bring relief. For Brazil more funding seems to be necessary, at least as a transition mechanism. From a broader perspective, we must ensure that the LDCs are brought back into partnership with the United States and other advanced countries for the reasons I outlined earlier. Higher domestic living standards would provide growth markets for advanced economies like the U.S. We all
agree on the long-term goal of boosting living standards, since the alternative seems to be impoverishment of these countries and the possibility of political turmoil and debt repudiation. The problem is how to get there. The U.S. policy debate pivots on the ideas advanced by Secretary Baker, who focuses on additional funding and a variable payment schedule, and Senator Bradley, whose program involves some forgiveness of current loans. There's also the idea of converting some of the debt to equity, a move the Japanese seem to be taking the lead in experimenting with. Personally, I favor the Baker plan, which is being tested in Mexico. However, I admit the complexity of the situation will require flexibility and compromises.

Conclusion

In sum, I am worried about the LDC debt situation. I think we have in place the mechanisms to deal with it, but it is likely to take a very long time. Meanwhile, I am concerned that protectionist sentiment might spill over into actual policy measures. Ultimately this would adversely affect Georgians—not only by raising prices we as consumers must pay and through retaliatory measures hurting some of our industries but also by foreclosing future export growth opportunities for business not even born yet.

Fortunately, the moderate rate of growth I have projected for the world's advanced economies and the turnaround in the U.S. trade deficit which I foresee should allow us a breathing space in which we can work to resolve the debt situation and defuse protectionist sentiment. In these ways we can keep on course to a re-internationalization of American business, a process that holds great potential for us and our fellow citizens of the world.