

THE INTERNATIONAL ECONOMIC OUTLOOK
Remarks by Robert P. Forrestal, President
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Good afternoon! It is a pleasure and an honor to have this opportunity to meet with you members and guests of the Swedish-American Chamber. As most of you know, I have a strong interest in international economic relations. So when I was invited to speak to you about the international economic situation generally and the prospects for Swedish-American investments in particular, I was delighted to accept.

Although I pride myself and many of my colleagues in the southeastern business and political communities on having a strong international orientation, I must be honest in acknowledging that Americans generally have rather lately come to realize what Europeans have long recognized--that the world's economies have become a truly global marketplace. Unlike their counterparts on the continent and in the Pacific Basin, many American businesses were long content to serve our large domestic market rather than expend extra energy seeking opportunities to expand sales abroad. Our national awareness of the importance of international trade and investment certainly rose during the 1980s, when the dollar's appreciation on foreign exchange markets dealt a devastating blow to our manufacturing sector by opening the floodgates of import competition. More recently, the stock market crash amply demonstrated the high level of worldwide integration in money and capital markets. However, as a nation we are still coming to grips with all the implications of this trend.

For that reason we may be only vaguely cognizant of another, newer development that is taking place, namely, that this is a time of fundamental structural transition for most of the world's industrialized economies. And because we are only partially

conscious of this change and the problems that it entails, we are sometimes prone to call for solutions that are either impractical or, at worst, misguided.

In view of these all too widespread misunderstandings, I would like to spend most of my time today talking about this transition. For those of you in the audience from Sweden or other European countries my remarks should acquaint you with the American point of view and, I hope, give you a better appreciation of why we take the positions we sometimes do. For the Americans here, I shall endeavor to offer insights into why other countries do not always behave as we would like in this time of change and to suggest some better directions that we might take.

What does this have to do with investment prospects, particularly between Sweden and the United States--a topic in which I know you have a keen interest? Obviously the discussion I have just outlined seems to follow at best a circuitous path toward that topic. Rather than belabor my introduction further by trying to demonstrate that linkage, let me ask for your indulgence and trust that I will have something, indeed several very positive things, to say about that important matter. Without further ado at this point, though, I would like to start describing in more detail the nature of this important transition and then go on to consider several important policy initiatives that might be taken in response to the current international situation.

Outlook for the World's Economy

The transition to which I have referred several times is not entirely new. It really began last year. However, incipient changes are often hard to see. Now that its momentum is established, the change is veiled when we look only at macroeconomic indicators like gross national product or GNP, unemployment rates, and inflation because forecast for these barometers of economic performance do not point to dramatic change

relative to last year. In the United States, for example, real GNP growth averaged 2.9 percent in 1987. This rate of expansion helped lower the unemployment rate to 5.8 percent by December, the lowest in eight years. At year's end, prices as measured by the consumer price index were 4.4 percent higher than in December of last year, largely due to the fact that part of the 1986 decline in energy prices was reversed. Looking to 1988, I see a continuation of expansion, albeit at a slower pace of 2 percent or a little higher, unemployment remaining close to 6 percent, and no acceleration in inflation.

This forecast, which is good in itself, masks some even better news--namely, the U.S. economy is developing greater balance than it has had in several years. The United States is making the transition from a consumption-driven to an export-driven economy. Our manufacturing sector is experiencing healthy growth owing to the dollar's substantial decline over the last 3 years and the associated positive effects on those goods that are exported or are more sensitive to import competition. Also, farming prospects look reasonably good--a welcome change from a number of bleak years. Continued stability in oil prices should help the energy sector. In turn, those areas of the country that have been bypassed by the current expansion--the midwestern farmbelt, the oil patch of Texas, Louisiana, and Oklahoma, and the industrial heartland of the northeast and north-central states--should now see much more growth.

At the same time, though, consumption is likely to continue advancing by a much more modest margin than earlier in this expansion. More of our increases in output are being shipped abroad rather than consumed domestically. What's more, overall GNP growth will be slowing somewhat. I should emphasize, however, that I do not see a recession on the horizon.

When we look at the outlook for other advanced economies, we see a similar picture on the surface: generally, the outlook is for slower growth in the year ahead. Indeed, reflecting its uncertainty as to what effects the October stock market crash will ultimately have, the Organization for Economic Cooperation and Development (OECD) revised down its forecast for growth among its members by a half a percent. It now projects 2 percent growth for the 23 major industrialized countries.

Some of the main dynamics affecting the U.S. economy are influencing performance in other countries as well, but in the opposite direction. Both the price impact generated by the lower dollar and slower income growth will continue to dampen the important export sectors of Europe and Japan. This development may retard growth abroad. At the same time, though, the dollar's lower value will act as an anti-inflationary force in most other advanced economies.

Germany, once the dynamo of Europe, seems likely at best to repeat last year's sluggish 1 and 1/2 percent GNP growth. Prospects for France, and I might add Sweden, are similar. Italy's economy expanded faster in 1987--at about the same rate as the United States. Like the United States, their expansion will slow to around 2 percent in 1988.

The strongest growth among European nations next year should come in the United Kingdom, which is not as closely linked with the slow-growing countries on the continent. Last year's 3 and 3/4 percent rise in gross domestic product finally brought unemployment below the 10 percent mark in the last quarter. Such performance is probably unsustainable. Nonetheless, growth should remain faster than on the continent and even ahead of the U.S.

More rapid growth is also likely across the Pacific in Japan. That country has been more aggressive in making the transition from an export-led economy to one fueled more by domestic demand, whether by consumers, government, or business spending on capital goods and structures. Japan's emergency stimulus package and new tax laws, enacted last year, are starting to have a ripple effect and should spur noticeable growth in domestic demand. That increase is likely to lead the economy to repeat its 1987 growth rate of 3 and 1/2 percent, even though reducing its large current account surplus will exert a drag.

Of course, growth rates are not the only measure of economic well-being. Unemployment and inflation must also be weighed. When we do so, the difficulties Europe has been experiencing in making the transition stand out more clearly. Unemployment in much of Europe seems quite high by American standards. Great Britain's jobless rate just fell below 10 percent, and Germany's has been edging up to the 9 percent range.

Furthermore, price pressures are not abating in all countries, despite the dollar's decline and the attendant effects on dollar-denominated imports. Consumer prices were virtually flat last year in Germany, and inflation is quite low in Japan. Among the other advanced economies, however, prices are rising somewhat faster, though generally about on a par with the United States. In Italy and Great Britain, for example, countries that have been expanding pretty fast, price pressures are intensifying. Sweden is also facing wage demands which threaten to translate into higher costs and an inflation rate close to that of the United States.

Perhaps most importantly, the growth rates projected for most of the world's advanced economies are below their potential. When Americans hear that Japan will

likely expand at a pace almost double ours in 1988, we tend to regard that as quite fast. What we forget is that the structure of Japan's economy is such that it could be growing even faster without generating inflationary bottlenecks. Were they to do so, the higher income growth that would result could support more purchases of U.S. goods and thus stimulate our expansion.

Even more significant is the fact that faster growth in the industrialized nations would be a decided boon to the world's developing economies, or LDCs. Many are heavily indebted. Still more have had much slower growth in the eighties. With inflation less controlled, living standards in many have deteriorated. The implications of these seemingly far-away developments for the advanced economies are profound. No one wants to contemplate the terrible reverberations in the banking community of a flare-up in the ongoing LDC debt issue. All of us have lost earlier strong export markets because of the austerity programs launched in much of the Third World in response to this ongoing crisis. Finally, the potential for political upheaval is heightened when the promise of improved living standards is deferred for so long.

Summing up the current international outlook, I see many positive developments--better balance in the U.S. economy, continued though decelerating growth in other industrialized nations, and only moderate price pressures generally. Clearly, the American outlook is pretty positive. Furthermore, compared to a worldwide recession, slow growth in the rest of the "First World" does not look bad. However, there are negative aspects of this transition, as I have just noted. Indeed, the negative side of the transition currently taking place in the advanced economies seems to call for coordinated policy actions. In view of the apparent logic of this point of view, I would now like to consider what joint actions we might take to to render this transition less painful and bring growth up to potential.

Issues and Policy Challenges.

When we begin to think about international policy coordination, the human mind naturally tends to focus on specific problems and solutions peculiar to them. Discussions of LDC debt, for instance, often gravitate toward loan restructuring proposals and the like. Such stopgap measures are, of course, necessary for dealing with crises at hand and can sometimes set the stage for more improvement. The current Mexican debt proposal exemplifies this approach: I find it an innovative and encouraging approach, though it is not a solution for all LDCs.

Similarly, I strongly support economic summits and other regular meetings. When these gatherings result in policy coordination decisions, generally we are all better off. We need only think to the salubrious results of the September 1985 summit on currency realignment. Notwithstanding the success of this meeting in fostering better balance among the world's currencies, I feel that this narrow approach is reaching its limits. The current focus on targeting particular exchange rates will not be successful, in my view, unless the values for various rates are sustainable in financial markets. Money and capital exchanges are too interconnected, as we saw this past year, to enable governments to maintain artificial exchange rates. The comparative stability of exchange rates for much of the post-World War II period derived from agreement on policy objectives among nations that there was a need for worldwide expansion. In addition, there were no large differentials in inflation rates during that period. When the economic objectives of individual nations began to diverge in the 1970s, the system of pegged exchange rates no longer worked. By the same token, we cannot go back to imposing exchange rate targets or ranges unless we have agreement upon economic objectives.

Unfortunately, consensus is hard to reach when a broader scope of problems is addressed, or when conditions and social values from one country to the next diverge sharply. Five years ago when most of the industrialized nations were underperforming as a group--with ample excess capacities--a simple strategy of applying expansionary policies in each country proved beneficial to them all. If their economies are all overly strong, then coordinated policies designed to slow them will be effective. However, when performance--or social values--vary, coordination may be complex.

This is the crux of our current problem. It is easy for Americans to point an accusing finger at Germany, blaming that country's slow growth on its failure to implement more stimulative fiscal and monetary policies. We seem to overlook the fact that Germany indeed has relaxed its tight policy stance, particularly on the monetary side. The reason we are not satisfied is that we fail to appreciate the different set of political, social, and economic values in Germany. Clearly, the German public will tolerate more unemployment and less inflation than we will in the United States. What's more, in a period of transition like the present, slower growth may be the most prudent course, lest adjustments turn into severe dislocations, throwing industry and commerce seriously out of balance. Germany is not alone in growing at less than potential, as I mentioned.

Aside from the fact that narrow policy agreements are not optimal in a complex situation and that agreement on broader fundamentals is often difficult to reach, another constraint on international policy coordination inheres in our policy tools. The macroeconomic policies that we have are of only two kinds--the monetary policy of central banks and government fiscal policies. Tax and spending policies in the industrialized nations are very slow, perhaps too slow to change, as all of us are well

aware. This places an undue burden on monetary policies, which are often put in the position of trying to attain more goals than they can possibly achieve.

Is there no hope, then, for global economic coordination? Yes, there is, and I believe that the focus on exchange rates has led policy makers to pay too little attention to other important issues in recent years. All countries have some protectionist policies. Almost every nation has certain agricultural policies, for example, that work to distort international trade flows. By working to lower trade barriers in all their forms, we can enhance the advantages of the "global marketplace." I hope that the recent free-trade agreement between Canada and the United States will be a harbinger of similar moves to reduce trade barriers elsewhere. Also, we need more coordination on agreements in the area of technology and creative patents. The recent round of talks in Uruguay were only a small step in this direction. This, then, is a fruitful area for policy coordination that is woefully underexploited.

That is not to say that some attempts to achieve this kind of meaningful coordination are not already underway. Unfortunately, their momentum has slowed because of protectionist pressures in this country and the misplaced focus on exchange rates. The failure of the U.S. trade balance to improve by a substantial amount has brought forth demands from some quarters for more trade barriers. I am hopeful that further improvement in the trade balance will contain these pressures and allow us to meet global policy challenges in a more rational and productive manner.

In addition, under the U.S. political system of checks and balances there are typically offsetting forces when public policy in one arm--or level--of government approaches the shoals of folly. Today, the state and local governments, particularly here in the Southeast, are well aware of the globalization of markets. More than many parts

of the United States, this region has learned first-hand the adverse effects of constraining trade with artificial barriers. This historical experience has been translated into today's positive attitudes toward foreign direct investment and foreign trade generally. Policymakers here actively and successfully recruit foreign firms.

In 1985, the latest year for which statistics are available, the Southeast had proportionately more workers employed at foreign-owned businesses than in the U.S. as a whole. Foreign-owned operations are especially prominent in retail trade, real estate, and machinery production. Eighteen percent of downtown office space in Atlanta is foreign-owned. I see no reason why this pattern of foreign direct investments should change. Indeed, the dynamics of the current transition that has been my theme today favors even more such activity, not just in the Southeast but nationwide. The dollar's depreciation may increase the lure of foreign direct investment in the United States. Many foreign firms are taking advantage of the current situation to increase their holdings here even as their exports to the U.S. decline. This condition holds just as much for Sweden as for most of the European countries since it has followed the general European pattern of appreciating against the dollar since February of 1985.

Conclusion

What I'm implying here is that the two topics you asked me to discuss--the international economic situation and foreign investments prospects--can be mutually reinforcing. Current economic conditions in various countries influence where investment will be directed. At the same time, as foreign firms set down roots in local economies they can, through their impact on the community, management styles, technological innovations and the like, foster a more positive orientation toward the importance of international economic linkages. If the world's industrialized nations work to further trade and investment flows by tearing down our many barriers, we will be able

to make some difficult changes in the structures of our economies more smoothly. At the same time we will move faster toward the one value which we all share--higher living standards for people in every country.