

**The International Economic Situation**  
**Remarks by Robert P. Forrestal**  
**To the German-American Chamber of Commerce**  
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**I. Introduction**

- A. Now that we are six weeks into 1988, most Americans have put away our lists of New Year's resolutions and, like people in other countries, we are caught up in the day-to-day routine.
- B. Most of us in business have filed way in the back of our minds the economic forecasts that capture so much attention in January, as we focus on keeping our daily operations functioning smoothly and, we hope, profitably.
- C. Despite this very human tendency to focus on our area of immediate responsibility, I think it is especially important for business leaders at this time to be aware of the economic environment in which we function.
  - 1. The reason that taking the "big picture" into consideration is particularly critical right now is that the big picture is changing in some fundamental ways.
    - a. The U.S. economy is undergoing a structural transformation--from one in which growth is led primarily by consumption, especially by households and the government, to one in which export sales are the engine driving growth in other sectors
    - b. Meanwhile most of the world's other advanced economies are experiencing the mirror image of this transformation. In other words, their international sectors are providing far less stimulus to overall economic growth, shifting the burden to what economists call "domestic demand" to take up the slack
  - 2. In view of the significance of this transition, I would like to devote my remarks tonight to discussing what is going on in the world's economy and what that implies, not only for the business community but also for policy makers around the globe

**II. Outlook for World Economy**

**A. Growth Prospects**

- 1. In the United States the transition that I referred to really began over a year ago--more precisely in the fall of 1986 when the gap between what we export and import, in price-adjusted terms, began to narrow.
  - a. This change was spurred, of course, by the decline in the value of the dollar on foreign exchange markets which began even earlier in March of 1985.
  - b. The shift entailed not only higher export sales but also slower growth in spending by consumers
  - c. This transition will take the U.S. economy through a period of slower growth in the coming twelve months at least, when the economy will probably advance by 2 percent.
  - d. However, on the whole, this transition is very good for the U.S. because it is bringing much better balance to our economy than we have seen for some years--manufacturing is rebounding after virtual recessionary conditions, the farming sector is looking up as foreign sales revive, and the energy sector is at least not exerting a drag as it was.
  - e. In turn areas of the country that had been faring very badly, like parts of the Southeast that are heavily dependent on manufacturing, farming, or energy, are starting to experience considerable relief

2. Japan best exemplifies the other side of the coin
  - a. As its current account surplus contracts, the stimulus package implemented by the government is fostering fairly strong spending by the domestic components of its economy--consumers and government especially
  - b. Growth there next year will probably be around 3 and 3/4 percent
3. Germany typifies the middle ground, which is shared, I might add, by many European economies largely because of their economic and monetary integration with Germany.
  - a. There the export sector is shrinking, but domestic demand has not picked up the slack, and the government has done less than Japan to modify this situation even though recently there has been some monetary relaxation
  - b. As a result, growth was quite sluggish last year--1 and 1/2 percent--and it likely to continue at this pace in 1988.

B. Implications for Businesses

1. The outlook for American firms, particularly those involved in manufacturing products that are sold abroad, is pretty good, compared with recent years; the same is true of farmers
2. However, those in the building trades as well as service providers, which had been enjoying booming growth, are facing decelerating or declining demand
3. Moreover, for those foreign firms seeking to sell to American consumers it will be tougher because of the higher prices of imports occasioned by the last three years' currency realignment
4. They may also have a somewhat harder time selling products to their own domestic consumers because the dollar's decline is making U.S. products more competitive and, as I have said, domestic demand is not all that strong in some European economies.
5. At the same time, with many of the advanced economies growing at less than potential, demand is slower in the world's developing economies and in turn their once growing markets for our exports have shrivelled.

III. Policy Implications

- A. In view of the rather mixed prospects for businesses during this transition, the question naturally arises--why don't we try to coordinate policies and thus achieve faster growth
  1. Such policy measures seem especially appropriate given the fact that the world's advanced economies seem to have plenty of slack
    - a. Unemployment rates are high, at least by American standards, in much of Europe--many are in or near the double-digit range and rising
    - b. Meanwhile, inflation is almost nonexistent in Germany although in countries like the U.S. and Italy prices are rising in the range of 5 percent.
  2. I, personally, believe Germany should take the lead in implementing such measures
- B. By the same token, I have to acknowledge that the world has changed since 1985 when the leaders of the industrialized nations sat down and agreed on a policy of bring the world's currency into better realignment--it has become harder to coordinate policies because conditions have changed
  1. That means that we cannot speed up business activity by doing more of the same as we did two and a half years ago
  2. the strategy of currency alignment is reaching the point of diminishing returns in my judgment

3. there are limits to how far we can go toward targeting particular exchange rates unless the values chosen are sustainable in financial markets--money and capital markets are simply too interconnected, as we saw during the October stock market crash, for governments to maintain artificial exchange rates
4. Those who point to the era of fixed exchange rates as a model tend to forget that
  - a. there were no significant differences in inflation rates, a factor that now exists and does confound attempts even in the Common Market countries, to maintain some sort of constancy among their currencies
  - b. moreover, there was more widespread international agreement on policy objectives at that time
  - c. when that consensus diminished in the 1970s, the system of pegged exchange rates no longer worked
5. This is the crux of our current problem--the German public will tolerate far more unemployment and far less inflation than will Americans
  - a. That disparity tends to move our exchange rates continuously out of line
  - b. it also makes it more complex for the leaders of Germany, America, and other advanced economies to agree on a course of action like domestic stimulus in Germany as a catalyst to faster growth there, in the rest of Europe, and ultimately the entire world
- C. Another current limit on increased policy coordination is that we have only two tools--the fiscal measures of taxes and government spending, on one hand, and the monetary measures of central banks
  1. The problem is that tax and spending policies tend to be slow to change
  2. As a result, monetary policy often is given an undue burden--central bankers are often put in the position of trying to attain more goals than we can possibly achieve
- D. All this seems very pessimistic, and I do not want to underestimate the current complexities of policy coordination. Still, I think there are avenues where we could achieve more cooperation and, in so doing, promote faster growth for everyone--in particular tearing down the walls of protectionism that virtually all countries have
  1. A most obvious example is agriculture, where all kinds of subsidies distort trade flows and cost governments, taxpayers, and consumers considerable amounts of money.
  2. We have given too little attention to the recent round of Gatt talks begun in Uruguay
  3. On the surface it might seem that this avenue of negotiation will prove no more fruitful than the other forms of policy coordination whose complexities I have just outlined
  4. However, I am optimistic that as the world's economies become more closely entwined, not only through trade flows but also through the proliferation of direct investments in places like the Southeast, people will become more aware of the advantages of free and open economic transactions among nations
    - a. in this region many localities have benefited in terms of employment and income from the establishment of a foreign-owned manufacturing facility
    - b. such operations often introduce new technologies and management styles that can be adopted by other local businesses, with beneficial effects on their productivity and profitability

- c. state and local leaders in the Southeast have recognized this benefit, and actively recruit foreign firms to locate here
  - 5. Since the dollar's decline is making foreign direct investment in the United States relatively more attractive than exporting to this country, I expect to see more of this activity here. This leads me to hope that popular attitudes will change, not just here but in other countries too, and thereby lay the groundwork for more policy coordination at the national level
- IV. Conclusion--I would like to wrap up and close on this positive note
- A. Let me remind you that the world's advanced economies are likely to grow by two percent on average this year--certainly a respectable rate and much better than a recession
  - B. Similarly, inflation, while uneven from one country to the next, remains well below what we were experiencing a decade or so ago.
  - C. It is true that we are all undergoing a transition--in the U.S. from a consumption-driven economy and in Europe and Japan, from export-led growth.
    - 1. The slowdown associated with this transition means that most industrialized nations, as well as the developing economies, are expanding at less than our potential
    - 2. that will make it hard on some businesses because their markets are diminishing or growing more slowly than they have become used to
  - D. This situation seems intrinsically to call for some concerted action on the part of the world's leading economies to speed up growth, but unfortunately, past efforts at policy coordination like currency targeting probably cannot do much to overcome this situation when inflation rates and domestic policy objectives from country to country vary as much as they do now
  - E. Nonetheless, we could promote faster growth by agreeing to dismantle some of the many trade barriers
  - F. I think that popular support of these and other forms of policy coordination will gradually grow because the increasing trade and investment flows of recent years are making more people aware of what economists have long know--that such activities benefit everyone
  - G. As these shifts in popular attitudes gain momentum and are communicated to national leaders, I am hopeful that we will overcome the complexities and make further progress toward policy coordination, in turn nourishing the kind of macroeconomic environment in which more businesses can prosper and people everywhere enjoy a higher standard of living.