THE ECONOMIC OUTLOOK FOR THE NATION AND THE SOUTHEAST
Remarks by Robert P. Forrestal, President
Federal Reserve Bank of Atlanta
To the Conference on The Global Advantages of the South
in Forestry and Forest Products
August 23, 1988

Good morning! I am honored by your invitation to join in the proceedings of this conference. I am always pleased to be part of a discussion on the global advantages of our region, whether it is of a general nature or relates to a specific industry like forestry and forest products. My usual focus is the states of the Sixth Federal Reserve District—Alabama, Florida, Georgia, Louisiana, Mississippi, and Tennessee. Nonetheless, I believe that however one defines the South, several factors give us an edge that promises ongoing economic growth. Our transportation network by sea, land, and air affords quick, reliable shipment of goods to and from market. We have a large, relatively low-cost labor pool that is sought out by managers from outside the region for its strong work ethic. The southern climate is also a powerful attraction. Not only do our less severe winters attract businesses to locate here, but also they are a major reason that tourism has become an engine for consistent regional development.

These are some basic elements that should promote continuing competitiveness for this region in a marketplace that is increasingly global in scope. However, that market is evolving rapidly, and we must measure our steps now in order to stay in the running tomorrow. I would like to discuss several issues with which the Southeast must deal to keep abreast of worldwide trends. I think you will find that these ideas apply in the other states represented at this conference as well. Before I do that, though, let me provide some context by giving an overview of my outlook for the international, national, and regional economies for the coming 6 to 18 months.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

The National Economic Outlook

I look for the nation's economy to grow at a rate of about 3 1/2 percent in 1988 as expressed in real GNP figures. We will probably do better this year than next year. In fact, my outlook implies that growth will slow in the last two quarters of this year, since the first six months' growth has been above 3 percent. Inflation should be about the same as last year--that is, 4 1/2 or 5 percent--and persist in that range through 1989. I expect unemployment to fluctuate around 5 to 5 1/2 percent for the coming 18 months. Thus, we will be a relatively rapidly growing country. Japan, too, will grow faster after having experienced two years of growth that has been slow in terms of its potential. Most European economies, in contrast, are likely to expand at a modest rate of perhaps 2 percent over the course of the year.

Underlying these statistics are some important fundamental changes--in consumption and borrowing patterns, in price levels, and in foreign trade. From the beginning of the current expansion in 1982 through the first part of last year, economic growth in the United States was driven largely by growth in consumption. Both the federal government and individual consumers bought goods and services at a prodigious rate, and many of us borrowed heavily to do so. That tendency has slowed, in part because government purchases have embarked on a downward slope that I fervently hope will be maintained and even accelerated. Curbing the federal budget deficit is crucial to the continued health of this country's economy. In addition, a good portion of the baby boom has passed through its household-formation stage, when large, long-term credit purchases are made. This age cohort is entering a period when its members are likely to save more. This return to a higher rate of saving should help correct some of the imbalances that have led to record fiscal and trade deficits in recent years.

Another reason for the slowdown in consumption is the decline of the dollar from heights which kept the prices of foreign-made goods low and encouraged our national

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

spending binge. The dollar has returned to its levels of 1980 from a peak in 1985. Economic theory tells us that when such a depreciation occurs, it should lead to a corresponding adjustment in a country's trade balance. This happens as higher prices for foreign goods dampen imports even as domestically produced goods become relatively cheap overseas and improve exports. Research at the Atlanta Fed has shown that certain factors unique to the U.S. dollar--especially its role as a base currency in international transactions--delayed the onset of this effect longer than many analysts had expected. Starting in late 1986, however, the United States began to realize steady improvements in net exports in terms of the greater volumes of goods being exported and much slower growth in the volume of goods being imported.

Changing relative values of the dollar are now showing up in sticker prices here. While overall inflation has been in the annual average range of 4 to 5 percent over the past two years, the prices of foreign items, excluding oil, have jumped 8 to 9 percent. Meanwhile, as price shifts in favor of U.S. products boost our sales overseas, the resulting increase in exports is bolstering our manufacturing sector. After languishing during the high-dollar days of the mid-1980s, manufacturing has become the leading growth sector, stimulating increased investment in capital goods, too. We have also begun to notice some signs of strength in both residential and nonresidential construction of late, though I do not look for a major upturn any time soon.

The stimulus from our export position that is driving manufacturing while consumption cools should bring more balance to our economy. Looking beyond the United States we find that the same dynamics are working in the opposite direction in other advanced economies. The lower dollar will continue to dampen the important export sectors of Europe and Japan. Consumption in these countries has begun to take up much of the slack left by waning exports. This is particularly true in Japan, but even in West Germany, where growth will be lower than in the United States, this shift is underway.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

This worldwide structural transition will not be without difficulty. Americans will find that our standard of living is rising by less than the additional amount we produce. That is because a greater portion of our products must be sold overseas to earn foreign exchange with which to pay down the foreign debts we have incurred in our consumption binge of recent years. Nevertheless, the turnaround in the export situation is a necessary correction that will help bring global markets into balance along with our own. Since market dynamics are working out this rebalancing here and abroad, it is crucial that we resist the temptation to get a quick fix of the American trade deficit by resorting to protectionism. Instead, we need to think of eliminating more barriers to trade so that international markets can do their jobs even more effectively.

Outlook for the Southeast

Having discussed the national outlook in terms of a significant shift from consumption to exports, let me turn to the Southeast and talk about how this transition will affect us at home. Because of the anticipated increase in exports, the likelihood of continued or even faster growth in manufacturing bodes well--at least for those regional factories that have been modernized. There is a slight hitch in the effects of the currency realignment as far as southeastern industry is concerned, however. It is true that last year the dollar finally began to depreciate against the currencies of Canada and developing countries in the Pacific basin--the chief competitors of many regional industries like forest products and apparel. Yet the amount of currency realignment is quite small compared to the dollar's fall against the yen, the deutsche mark, and currencies of other advanced economies. Moreover, cost structures in many developing countries are far more favorable to the kind of low-wage, labor-intensive production that became the staple in much of the South as the labor force shifted out of farming. Thus, for many of the region's industries the likelihood of substantial improvement is not high.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

In terms of specific states, those in the eastern portion of the region--Florida, Georgia, and Tennessee--can expect to see more of the good performance they have experienced of late, although their rates of growth will probably slow somewhat. These states enjoy diversified economies, in which more technologically advanced manufacturing and a vibrant service sector help offset weaknesses, whether in industries like apparel which have been battered by imports or the production of phosphates and other commodities whose prices remain depressed in world markets. Of course, rapid population growth is also a boon, especially to Florida. It has been a strong stimulant to Georgia as well, but since last year in-migration has dropped off considerably as vigorous economic growth in other parts of the nation have attracted some would-be Georgia residents away.

Louisiana and Mississippi will do better than last year, which appears to have been the trough. Mississippi's economy has been performing well recently as a result of the upturn in manufacturing that the country as a whole has been experiencing. However, in the longer run Mississippi's manufacturing faces downside risks because it remains heavily dependent on low-wage manufacturing and resource production areas, where developing countries have a decided advantage. Louisiana's situation is in some ways worse because its economy is so lacking in balance. Even its small manufacturing sector is heavily linked to energy, and oil prices have tailed off recently after a slight improvement earlier this year. As in Mississippi, however, some manufacturing gains will be experienced.

Alabama occupies the middle ground both in terms of geography and economics. Manufacturing gains should help this state further the advances begun last year, since its economy remains oriented toward industrial production despite growing health and educational services, especially in Birmingham. Steel production is currently rebounding thanks to the industry's improved competitive position. In addition, Alabama's still important natural resources sector should hold onto the gains made last year. Indeed, coal production began increasing last fall. On balance, the Southeast should do well again in

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

the year ahead.

Forestry Outlook

The national and regional outlook hold generally good news for forestry. This important industry--the fourth largest manufacturing employer in the Southeast--has already regained much ground since its low levels of the early 1980s. A weaker dollar and the accompanying surge in export-related manufacturing have increased the demand for both lumber and paper products--so much so that the pulp and paper industry is near capacity levels of operation. As the global economic transition goes on, we should see a continuation of this trend, aided by ongoing contribution from domestic markets.

Over the long run, the forest industry in the South must contend with a potential shortage of lumber that could be brought on to a great extent by land-tenure patterns here. The South possesses more commercial forest land than any other area in the country, but the majority of the land is held by private owners outside the industry. Even though the rate of planting on non-industrial private lands has increased recently, it is still far below the rate of harvest. In addition, some commercial timberland is being converted to urban development and to crop and pasture land. Policies now in place that encourage better forest management should help offset the projected shortage. Nonetheless, tighter supplies could have a substantial impact by the turn of the century.

Issues in the Region's Economy

From what I have said to this point, it should be clear that I feel international developments will continue to play an important economic role in the nation and our region in the immediate future. I would like to use my last few minutes to bring together several other themes I touched on earlier. I also will try to define several issues that must enter into our thinking here in the Southeast as we look toward future development.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

One of these issues is the need for diversification into alternative industries in states like Louisiana that are overly dependent on farming, forestry, mining, and other primary industries. Disproportionate reliance on natural resources in Louisiana and to a lesser extent in Mississippi and Alabama makes their entire economies extremely vulnerable to world-market price fluctuations. Thus, when the prices of commodities like oil or farm products fall, the whole economy around them suffers. Right now, because prices for some of these commodities have gone up on world markets, I expect the economies in these states to improve a little. For the future, though, state economic development efforts in the western states of our region should focus more on data processing, finance, health care, tourism, and other services, as well as the types of manufacturing that employ more advanced technologies rather than seeking to recruit low-cost producers.

A similar problem is the split between urban and rural economies in some of our states. We hear a good deal about the "two Georgias"--the rubric we use to compare the brisk growth of metropolitan Atlanta with slower expansion outside the city. A similar breach has been widening for the past decade between the urban and rural areas of Mississippi. It will be hard to close gaps like these because growth in cities tends to build upon itself, generating more expansion and economic strength. At the same time, workers in the rural areas frequently do not have the education and training to adapt to new jobs. Thus, in today's global economy with less developed countries offering even cheaper resources, industries that have been the staple of southeastern recruiters for decades are more likely to leave the rural areas than move there.

The main way we can encourage improvement in our rural areas and also the diversification into more high-tech manufacturing that some of our states require is to improve our region's educational systems. Education is probably the Southeast's greatest weakness. In the past, many of our workers have been employed in jobs like agriculture, natural resource extraction, and low-skill manufacturing that did not require much

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

training. Therefore, our states have not invested as much in education as states where workers with better skills were needed. Except for Florida, we still end up at the bottom of the list in terms of amount spent per pupil on education. Not surprisingly, high school drop-out rates are higher here. All of these facts mean our labor force is not keeping up with the rest of the nation's. Eventually, and probably soon, this weakness in education resources will hurt our chances in the competition with other regions for new industries.

As my comments on the globalization of markets imply, in the future our region increasingly will be in competition for jobs with workers in the rest of the world as well as with those in other parts of the United States. We have already lost many of our low-paying jobs to other countries. There is no guarantee that we will maintain our current dominance in services either. We have already begun experiencing keen competition from outside our borders in financial and insurance services, for example. The only way to prepare for this competition is to make sure that graduates of our schools have a variety of skills and do not become locked in to one kind of work. In this way, our labor force can adjust to changes in technology and move to new jobs when old ones become obsolete. Therefore, improvement of education is a need that extends across all state boundary lines and should be the number one priority in the region.

One other problem that stands out involves the areas that are growing fastest--Florida and the Atlanta area. Ironically, their problem is to find ways to manage the very growth that has made them prosperous. Their schools, highways, sewage and water systems, and other types of public-use infrastructure are already overburdened. More people are adding to the demands on that infrastructure every day. This pressure creates a threat to the environment, the quality of life, and the economy. People go to Florida because of its natural beauty and good climate. If they have to sit for hours in traffic, breathe polluted air, and worry about their drinking water, they'll start going somewhere else. The same is true for the businesses that have been locating in Atlanta.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Many of these are services like accounting and advertising, communications, and overall corporate management that economists call "footloose." Such businesses moved here voluntarily--not because of any necessary resource linkage. Hence, they can always move to a location they perceive to be more hospitable. So we have to be careful to keep up with the demands that growth places on our various types of infrastructure. We also must be willing to pay with our tax dollars to keep those systems in top shape.

Our efforts to invest in diversifying the region's economy and providing adequate education for our labor force face an obstacle of larger proportions, however--one that everyone in this country needs to be concerned about. That is a federal budget deficit that soaks up a disproportionate amount of our national savings. We must continue to urge government policy makers to bring spending into line in order to free up the funds needed for priorities like those I have outlined for you this morning. Such discipline is crucial to the global competitiveness of our region and our nation.

Conclusion

I have covered considerable ground this morning, going from the structural transition under way in the world's economy to regional issues that call for careful thought from each of us here today. In between I have said that the outlook for the national and regional economies is good in the year ahead. I have no doubt that we will continue to prosper in the globalized marketplace both as a nation and as a region because we have always risen to meet competitive challenges. Our will to win has not diminished. We must be certain, however, that we are adequately prepared to win. To be prepared for competition in an increasingly sophisticated arena we must educate and train and then reeducate and retrain as quickly as conditions change. If we are strong in preparation, none of us--manufacturers, farmers, or service providers--will have to resort to the losing tactic of hiding from competition behind protectionist barriers.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis