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THE ECONOMIC OUTLOOK FOR THE 1990s
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Good morning! I am pleased and honored to be a part of this successful annual event sponsored by the Georgia Society of CPAs. Since this is a financial planning symposium, I thought I would share my views on economic trends that might affect financial plans in the 1990s. Of course, anyone projecting an economic outlook ten years into the future must do so with some trepidation. It is difficult enough to foresee what might happen in the last three months of this year, let alone in the next decade.

In the absence of any unexpected shocks, however, I believe several major dynamics are likely to shape our economy in the 1990s. Three forces stand out: the globalization of world markets for goods and services, U.S. federal budget deficit pressures, and major demographic shifts. I would like to sketch the broad outlines of these themes for you this morning. I shall then summarize how they might in concert influence U.S. economic performance and conclude with a few remarks on challenges for policymakers in the coming decade.

The Globalizing Marketplace

Very simply, globalization entails the increased linkage of individual national markets into a more intertwined worldwide network. Such a network permits freer exchanges of capital and labor resources as well as goods and services. Globalization is occurring largely because of the success of post-World War II policies to encourage freer trade, but it is also being hastened by broader applications of technology. Computers and satellite linkages make it possible to compare prices for products or locate sources of funds anywhere in the world and then to consummate a deal by phone or fax. This shrinking of physical distances has made national boundaries less and less important as far as business is concerned. Moreover, as Federal Reserve Chairman Alan Greenspan has pointed out, technology has also made many products, like radios and computing devices, much smaller. The use of high-tech components and new materials reduces the physical dimensions and weight of many manufactured goods. This makes shipping easier and further contributes to the growth of international trade.

As we look ahead, globalization is taking giant steps forward in Europe. Members of the European Community will lower many barriers to international trade in 1992. This will create a new, unified market boasting a greater number of consumers than the United States. Communist countries may also show greater interest in engaging in trade with the rest of the world. The Soviet Union, its satellites, and--despite its recent setback--China, appear to be drawing closer toward market structures at home and abroad. Their increased international participation promises to expand sources for labor and outlets for goods. These economic prospects should also serve to moderate the military threats that for several decades have dominated our thinking in foreign relations.

I feel that by making a broader range of products available at competitive prices, globalization promises to raise living standards around the world. There are, unfortunately, several obstacles in the path of globalization. Protectionism is still a threat to greater merging of markets, particularly as trade imbalances persist in this country. We need to understand that attempting to assist uncompetitive industries through artificial trade restrictions gives them no incentive to improve. Protecting such industries also lowers our living standards by depriving consumers of lower priced imports or the full range of products available abroad. It also pushes our trading partners toward retaliating with protectionist barriers of their own--something that happened in the

1930s and helped push the world toward war.

The correct approach is not to protect our industries but to bolster their competitiveness. American businesses, particularly small- and medium-sized firms, are somewhat behind their foreign counterparts in their ability to market abroad. In addition, the global marketplace will require of us a better trained, more flexible workforce that can adapt to changing market conditions. Information-based businesses are replacing hands-on manufacturing here, and many of the low-wage, low-skill jobs Americans used to do are being exported. We will need to commit the resources necessary to provide rising generations of workers and those already on the job the skills relevant to the new world economy.

There is also the nagging problem of less developed countries (LDCs) that are being excluded from the global market due in large measure to their heavy debt burdens. These countries have the farthest to go in providing better lives for their people, and the gains the rest of us make from broader world trade will be hollow ones as long as they are left out. The efforts to relieve LDC debt currently being conducted by this country and others are moving us slowly in the right direction, but we must continue to make this issue a top priority if we are to achieve a truly global market.

Deficit Considerations

The second long-term economic trend I would like to consider is the impact of our continuing federal budget deficit. Since 1982 we have run federal budget deficits twice to four times as large in dollar terms as those incurred at the height of the second World War. Of course, such deficits are a smaller percentage of GNP now than in 1944, but they are, even in relative terms, much bigger than in any of the 35 years between 1946 and 1981. Today's budget deficits are also troubling for several other reasons. For one thing, the funds they represent have largely gone to consumption rather than investment that would increase the nation's future productive capacity and enhance our global competitiveness. What's more, the daunting size of our current obligations will inhibit our ability to undertake new investments in public programs for some time to come. Finally, unlike most of our recent experience with public debt, we owe a large portion of today's debt to foreigners.

Our need to service this debt guarantees that in the next decade, we will continue to experience budget shortfalls--especially when the Social Security surplus, which is added to the budget through some "creative accounting," is discounted. Deficit spending has led us to borrow at such a rate that net interest grew from 9 to 14 percent of outlays between 1980 and 1988. If we could deduct interest payments from the budget, we would be roughly in balance at present. Obviously we cannot do this. What's more, much of our spending requirements are locked into place. Entitlement programs account for about half of the budget, and discretionary programs have already been pared to minimal levels. Spending for education, for example, was only a small fraction higher in 1988 than in 1980.

In spite of these constraints, however, we are sure to experience greater demands for social investments to enhance our quality of life in years to come--environmental and medical concerns come immediately to mind. Public opinion polls show that the environment ranks at or near the top of voter concern in this country. In addition, it seems certain that our medical costs will grow. The aging of the population is just one force straining our medical system and pushing up costs. Price pressures in health care continue to outstrip other components of the consumer price index even though consumers are now bearing more of the direct costs in higher insurance policy deductibles, copayments, and the like.

In addition, we have had to go increasingly to foreign sources for funds. During the past decade, the United States has had an historically low savings rate, and on our own we have been unable to meet our investment and financing needs, including those of the federal government. Thus we have had to rely on foreigners with higher savings rates to finance our spending. In order to repay this foreign portion of our debt, we will have to export more of our products, and this means that living standards may not increase as rapidly here as in the past. For this reason, we owe it to our children and grandchildren to take steps to bring the deficit under control.

Demographic Changes

A third continuing development, demographic changes, will have a considerable impact on our efforts to deal with the budget deficit and other aspects of our economy in the next decade. There are three major demographic strata to consider: the growing ranks of senior citizens; the maturing baby-boom generation; and the "baby bust" generation that follows. Among these three groups, the numbers of senior citizens are expanding most rapidly. The continued growth of this segment of society has several implications. For one thing, it guarantees that entitlements will continue to contribute to fiscal budget deficits. Military and government pensions will have to be paid out to increasing numbers of recipients for longer periods. The Social Security fund is capable of handling these greater demands at present, but over the longer run may experience difficulties. Social Security is now in surplus because of the contributions of the large baby boom generation. The fund is likely to be drawn down as baby boomers retire in the second decade of the next century, though. As demand increases and techniques become more sophisticated, health care costs, particularly those related to long-term nursing home care, will probably continue to be affected.

The baby boomers, the large cohort born between the mid-1940s and the early

1960s, are passing from their years of household formation into their peak productive years. They will probably begin saving more for their retirement. I look for their added savings to lead to an increase in the saving rate. This in turn will improve Americans' ability to finance our own investment and government financing needs. It should also allow greater investment in productivity-enhancing projects, which in combination with the cohort's maturing job skills should improve U.S. competitiveness.

Following the baby boom, however, is the smaller cohort called by some the baby bust. Over the longer term, there could be economic shortfalls associated with their life cycles. Already businesses are feeling the pinch in attempting to find workers for the entry-level positions this age group traditionally filled, especially in the service sector. This change could create wage pressures throughout American industry. In addition, further down the road, it will be more difficult for a smaller number of active workers to support the larger baby-boom generation through its retirement. We may well need to liberalize our immigration policies over the next ten years to open new sources of labor for American industries.

Potential Economic Preformance in the 1990s

Having described these three major dynamics--globalization, fiscal deficits, and demographic changes--let me summarize how they might together affect economic performance in the 1990s. I feel all the signs point to respectable growth in the U.S. economy but also to the continuing threat of inflation in the coming decade.

In my view, the United States is generally well positioned to benefit from the movement toward greater integration in world markets. Two great and undiminished strengths that we still bring to the international market are the creativity that drives our research and development and our marketing expertise. In spite of the concern many feel in regard to our trade deficit, I don't think we have lost the creativity that led to inventions like the personal computer and the VCR, for example. Nor do I think that foreign managers are outstripping our own in methods for getting production out. What's more, we have a good deal of experience in selling to a large, integrated market--our own. Thus as Europeans unify their markets in the 1990s, U.S. businesses should have an edge in marketing products and selling marketing skills as well.

In addition, a significant number of U.S. businesses have been undergoing structural changes that may leave them more competitive over time. I refer to the wave of leveraged buyouts (LBOs) that has transformed some of our large publicly held corporations into private firms. While some LBOs, especially those driven primarily by tax considerations, raise legitimate concerns over the extent of corporate America's debt burden, the better constructed deals have already led to the streamlining of organizations that had accumulated unnecessary layers of fat. Such buyouts also have the effect of bringing ownership and managment together. In this way, LBOs are making U.S. corporations more like their competitors in foreign countries like Japan, where ownership tends to be shared by company management and financial institutions. In our case, the LBO replaces equity with debt that must be serviced in a disciplined way. This forces management to weigh each decision carefully and gives them the right incentives to be efficient and maximize the value of the firm. Thus I feel that market forces in the 1980s have been pushing U.S. industry toward adopting forms that could prove more effective in the global market of the future.

My optimism does not blind me to weaknesses that could ultimately undermine economic growth in the years ahead, however. For one thing, we must address our clear shortfall in the basics of education. How can we expect to compete successfully in a global marketplace when students in our schools cannot find our major foreign competitors on a globe, let alone demonstrate necessary skills in math and communication? We are also lagging badly in making needed investments in our roads, bridges, and harbors--the infrastructure that moves our goods to market.

Our chief weakness, however, is the federal budget deficits that prevent us from taking progressive action on education, infrastructure, and other programs we will need to pursue in the 1990s. As long as we continue to run our federal government on excessive red ink, we can be assured that meeting accumulating interest payments will take precedence over investments in the nation's productivity. Moreover, these deficits ultimately weaken our external trade position. A soaring dollar in the middle years of this decade, reflecting expectations that U.S. interest rates would need to remain relatively high, helped cause our ballooning merchandise trade deficits. These trade woes brought on the demise of numerous U.S. businesses. Although manufacturing and exports have revived with the dollar's decline since 1985, this experience has left us with nagging concerns about our longer-run competitiveness. It is unlikely that we would see ourselves in such a negative light, however, were it not for the economic drag of those twin deficits.

Fiscal imbalances are also one reason that I believe inflationary pressures will continue through much of the 1990s. Even though deficits are on a gradual downward slope--largely due to the temporary surplus in Social Security funds--shortfalls appear certain to persist into the foreseeable future. In the absence of higher savings or continued strong foreign investment, we will find our investment and financing needs difficult to meet, and this would tend to constrain growth in productive capacity. Such capacity constraints, in combination with labor shortages expected with the baby bust can impart an inflationary bias to the economy. Action to resist such pressures, let alone reduce inflation from current levels, may end up keeping economic growth slower than we would like for an extended period.

Implications for Policymakers in the 1990s

It should be clear from what I have just said that policymakers have at least two well defined tasks laid out for them in the coming decade. Those are to reduce budget deficits and contain inflation. In the interest of enhancing our global competitiveness and ensuring continued improvement in living standards for coming generations, Congress needs to take steps now to trim spending and, if that cannot be done, to raise more revenues. It is also essential that lawmakers not divert their attention from budgetary shortfalls and pass protectionist legislation in the vain hope of correcting our perceived trade deficiencies. Not only would this fail to cure the symptoms of trade imbalances, it would bring on a new disease that could spread around the world as other governments retaliate with barriers of their own. All the economic promise of the movement toward globalization of markets would be dashed should this occur.

Reducing the deficit will also ease the inflationary pressures stemming from excessive consumption in the government sector. Such pressures complicate the Federal Reserve's effort to keep inflation in line and give rise to misplaced criticism of the Fed's monetary policy decisions. Today's critics have suggested reducing the independence of the Fed in a variety of ways. One proposal, which has now been withdrawn, would have placed the Secretary of the Treasury on the Federal Open Market Committee. It is argued that such changes would make the Fed more responsive to the political process.

I would point out to these critics that the Fed is not at all unresponsive to the political process. Our chairman reports to Congress twice a year on our objectives for monetary policy, for example, and there is ample opportunity for healthy debate at those times. Moreover, the wisdom of the U.S. central banking structure, in my opinion, is its relative distance from partisan politics. This frees the monetary authority to take a long-term perspective on achieving optimal economic growth while minimizing inflationary tendencies. By contrast, politicians often face strong pressures to stimulate economic growth in the short term, even at the expense of higher prices in the future. I have noted that the coming decade holds the prospect of price pressures from demographic changes as well as fiscal imbalances. Therefore, this is no time to jeopardize monetary discipline by politicizing the Federal Reserve System.

Conclusion

In conclusion, it is my opinion that the globalization of markets, continuing fiscal deficits, and demographic shifts will combine to influence the economic environment of the 1990s. I believe the United States can succeed in that environment as long as we keep our sights on our long-run comparative advantages. U.S. industry still has the resilience and creativity that brought a dazzling array of products to consumers around the world. And financial innovations like leveraged buyouts--another American invention--are perhaps helping U.S. industry evolve an ownership structure that should serve us well in the global market. As we work through this evolution, it will be important to retain discipline, however, and it is therefore necessary that policymakers come to grips with our most serious long-term competitive disadvantage--the federal budget defict. At the same time, we must also avoid spurious quick fixes that would undermine the global market and our ability to compete in it. This means in particular resisting the temptation to protect uncompetitive industries from outside competition. Likewise, we must not compromise the battle against inflation by restricting the Federal Reserve's ability to exercise its long-term economic vision. Let us instead reaffirm our commitments to defending free markets and the purchasing power of the dollar--two essential conditions for economic growth in the 1990s and beyond.