THE STATE OF THE ECONOMY AND ECONOMIC OUTLOOK FOR 1992

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As always, it is a pleasure to be in North Georgia at Berry College. It has been three years since I spoke at this annual conference, but how much our views about the economy have changed! At that time, we had just completed a year of 4 percent growth, and I was concerned mainly about the deficit, inflation, and leveraged buy-outs. The situation is considerably different today. Of course, the deficit is still with us, but 4 percent growth is not. While the need to worry about inflation and LBOs has abated, we have been dealing with a lingering recession after almost a decade of heady growth.

Before I begin discussing my assigned topic--the economic outlook for 1992 and beyond--let me first acknowledge what all of us know. Namely, 1991 was a tough year for the U.S. economy. Even though the recession was mild by historical standards and some economic signs suggest that recovery is under way, many businesses, consumers, and lawmakers seem unwilling to believe this. Confidence has been quite low, and there is a widespread sense of disappointment. Many people, especially after the Gulf War, had high expectations for a strong recovery based on memories of rebounds in the early 1980s and the 1970s. Unfortunately, in my view, the U.S. economy will not be able to return to the more rapid growth to which we have become accustomed, at least for the foreseeable future.

In my remarks today, I would like to focus attention on the change in growth prospects.

I am not going to dwell on the reasons we are undergoing a transition from rapid growth to slower growth. Rather, I want to concentrate on the need for Americans to change their attitudes about growth in a fundamental way. I am not just talking about adjusting our expectations to less rapid growth, but more basically, about learning to stop supporting schemes that spur growth only in the short term. Instead, as a society, we must learn to evaluate alternative patterns of growth in terms of their ability to sustain expansion over the long term.

Economic Outlook

In regard to the economic outlook for this year, I believe that, due to the slow start in this first quarter, the economy will grow at a moderate pace of around 1 1/2 percent on average. Since employment lags behind gross domestic product (GDP) and many businesses are consolidating, I think the jobless rate will remain pretty much unchanged from the average last year of 6.7 percent. Price pressures look more moderate than they have in some time, and the consumer price index (CPI) should increase 3 percent or a bit more as an annual average in 1992.

Generally speaking, the pace of business activity will accelerate gradually as current problems are worked through and more household and corporate income becomes available for spending. Of course, progress will not be even across the economy. The forces bolstering growth should be exports and consumer spending,

particularly on services and, to some extent, nondurable goods. In addition, later in the year, we should begin to see some improvement in capital spending by businesses. Net exports should continue to provide support as our external position continues to improve, but the pace of expansion will be slower than in the last few years. The interest rate declines that have taken place should provide a boost to consumer spending through both lower rates for new credit purchases and increased discretionary income resulting from refinanced mortgages. Nonetheless, spending growth will be quite modest compared to previous recovery and expansion periods. Even with lower interest rates, consumer spending is still constrained by high levels of household debt and the weak appreciation of housing--the principal asset of consumers.

Consumption of services began to pick up last year and should continue to grow. It is easy to lose sight of the strength in demand for services because we read so much about consolidation in industries like banking, airlines, and retailing. However, we have to bear in mind that these developments are occurring on the supply side. The rapid growth in the service sector during the last several decades was accompanied by even more rapid employment growth. The resulting disparity has left a number of service industries with fat to be trimmed. Many have been going through a period of consolidation, resulting in furloughs and other cost-cutting measures. Nonetheless, consumer spending, especially for services, should lend modest support to the recovery.

I am sure that you are all familiar with the weaknesses in the economy. The construction industry suffers from lingering excess supplies due to past overbuilding as well as appropriate hesitancy among many lenders to finance new projects. Demographics are also contributing to the sluggish housing market. The aging of the population means that there are not as many first-time home buyers as there were when we came out of the last recession in 1982. Besides the adverse demographics, we had eight years of expansion in which housing demand was very well met. That means very little pent-up demand developed during the recession. However, residential construction did pick up last spring and may show further improvement in the months ahead. Apartments and condominiums are quite overbuilt, but the rate of decline should narrow markedly. While there is no reason to expect that a housing rebound will contribute as much to the recovery as typically has occurred in the past, overall construction will be less of a drag on growth in 1992. Office building and other commercial construction will probably continue to decline for another year or more, though the rate of decline should diminish next year.

In addition to lingering weaknesses in construction, consumer demand for durable goods remains poor. Aside from the slow pace of income growth, demographics are again a major factor. Fewer new households translate into fewer purchases of new household appliances, for example. Weakness in construction exacerbates this pattern, since expenditures for furniture and other durable goods tend to rise with growth in family formation and home sales. In addition, the driving-age population is growing less rapidly. This trend, along with the fact that cars are better built and last longer, has caused auto demand to level off well below that of the 1980s.

In sum, I look for exports and consumption of services and nondurable goods to lead economic growth over the coming year. Housing should show growth in coming quarters, but it will be below average for recent recoveries. Commercial real estate construction will remain weak, as will personal consumption of durable goods.

Outlook for the Southeast

In the Southeast and Georgia, in particular, the story of the recession and recovery I have to tell is similar to the one I have outlined for the nation. That in itself is a new story because during downturns and recoveries over the past 15 years, this region has tended to do better than the United States as a whole. The two biggest states in terms of population, Georgia and Florida, were the worst performers in the 1990-91 recession after having barely noticed the 1981-82 downturn. The unemployment rate in Florida has remained well above the national average for some time. In contrast, the unemployment rate for Georgia is well below the national average, but this figure is not indicative of economic conditions in the state. In large measure, this lower jobless rate actually reflects a substantial increase in the number of "discouraged workers"--those who have simply stopped looking for work and therefore are not included in the official calculations of the unemployment rate. Generally, employment has declined in the Southeast by about the same margin as in the nation, with a slight lag.

One factor that stalled the performance of the region in this recession is its industrial composition. Except for paper and chemicals, exports represent a relatively small share of the manufacturing base. Exports have been critical in dampening the recession nationally, and they will be a major source of support in 1992. Instead of exports, many of the major industries in the region, which benefit from low labor costs, are fighting a battle against developing countries that can offer even lower wages and other costs. In addition to the industry mix, the faster-than-average growth in recent years in the Southeast actually is working against prospects for robust recovery. This rapid growth attracted a good deal of real estate speculation. Consequently, there are daunting construction-related imbalances yet to be resolved. In this region, the service sector, likewise fueled by very brisk growth in the '80s, is undergoing the same kind of consolidation that is occurring nationwide. Thus, the region has many of the same weaknesses as the U.S. economy but fewer strengths.

Longer-term, the region will remain a more attractive place to do business than other areas like California that have become very expensive. We continue to see consolidating firms relocating to the Southeast. In 1992, however, the imbalances may dominate. As the U.S. economy recovers and expands, the Southeast should see slow improvement--paralleling the nation, but at a more moderate rate than the region experienced in the 1970s and 1980s. Tennessee will probably track the nation quite closely. Florida and Georgia may lag behind in 1992 because the imbalances in these two states are greater. Traditionally slower-growing states like Alabama and Mississippi will reap a benefit from not having had excessive growth in recent years. Louisiana, which had been suffering from its own oil-related recession in the mid- to late-1980s, did not have far to fall. The recoveries in these three states will, therefore, start earlier and perhaps be a bit stronger--at least in the early stages--because there are fewer imbalances to overcome.

Looking Ahead to Our Long-Term Future

Having reviewed the outlook for the nation and the region, I would like to concentrate on the issue I mentioned at the beginning of my remarks, namely, the importance of changing our attitudes about growth. As I noted, there is widespread disappointment with the slow pace of recovery and a growing sense of urgency that something be done to quicken this pace or to "jump start" the economy. The danger is, of course, that policymakers will be pressured into a "quick fix"--one that will spur the economy for a year or two only to create new imbalances that will have to be corrected through yet another transition similar to the one banking, real estate, and many service industries have been experiencing.

Why is it that Americans have such impatience in this recovery when the last recession was so much more severe in terms of the contraction in GNP and the toll on employment? (You may recall that the jobless rate was 10.8 percent in November 1982 compared with the current 7.1 percent. Moreover, the unemployment rate remained high well into the expansion. As late as 1986, 7 percent of the work force was still unemployed, on an annual average basis.) As I see it, the main reason for the current disappointment is that many people have confused cyclical economic problems with imbalances that require more basic, longer-term adjustments. These include consolidation in much of the service sector and paying off excessive debt incurred by consumers, businesses, and the government. Those who are disappointed with the economy now also ignore fundamental demographic changes that alter demand for many products in a profound way. Having confused the problem, they seek the wrong solutions.

The current slow pace of the recovery arises largely from the complex transition businesses and households are being forced to make in response to past public and private decisions that led to an increase in debt and an overly expansive economy in the 1980s. Fiscal policy, for example, produced unsustainably fast growth in several ways: a large defense build-up, tax policies that encouraged excessive real estate development, and, more generally, the ongoing stimulus of large federal budget deficits. In enacting the 1986 Tax Reform Act, Congress recognized that earlier tax provisions were fostering too much real estate development and that federal budget deficits were growing out of control. Of course, removing the tax advantages from real estate generated considerable dislocations. Nonetheless, the artificial stimulus had to be removed. Otherwise, the ultimate imbalance between supply and demand would have been much larger and the resulting adjustment even more painful and attenuated. Although there was much talk in the 1980s about investment-led growth and there was a lot of capital spending in real estate, the nation neglected other kinds of investment, more public in nature, that are equally important. There were many initiatives in education, for example, but, as a society, we lacked the staying power to see them through. We are now seeing alarming cuts in educational expenditures, affecting the very basics of the curriculum, in some states. Likewise, we failed to come to terms with health care, another primary form of human capital investment, instead transferring this issue around, like the proverbial 'hot potato,' from the federal government to state governments and to those privately insured.

Throughout the '80s, rather than investing as much as we should have, Americans consumed more than we produced and went into debt. Now we must service that debt. Moreover, much of that debt is owed to foreigners since, as a nation, we lacked the domestic savings to meet all our demand for financing. To support the debt service, we are exporting a large share of our output; that is, what we are sending abroad for others to use is growing faster than the growth in what we are consuming domestically. We are producing more, so to speak, but enjoying it less.

This important insight, I believe, goes to the heart of the current malaise regarding the economy. Economic statistics like GDP reflect only what we produce, not what economists call "welfare," that is, our sense of well-being. In the past, growth in output was generally translated into growth in domestic consumption and therefore into domestic well-being, but that is not happening as much now because of the debt service burden. This burden is also limiting our ability to add capital for growth at the same time slower population growth is limiting our ability to add workers.

Clearly, long-term dynamics are constraining U.S. prospects for expansion relative to the fiscally induced growth of the 1980s and to the 1970s when the baby-boom generation was entering the work force in huge numbers. What, if anything, should be done to address popular dissatisfaction? First, I think we must cultivate some patience with cyclical policy measures. Countercyclical fiscal policy was not implemented in the recent recession, and rightly so, because of the huge federal budget deficits that must be contained and reduced. However, monetary policy has been at work. Credit growth at banks is weak, but interest rates have come down substantially and corporate bond issuance is up, largely as a result of the easing moves by the Federal Reserve over the past year or so. This accommodative monetary policy will continue to yield effects for some time in the future. The Fed will certainly be attentive to the economic situation. However, we must be careful not to squander the hard-won gains against inflation by pushing the economy onto a growth path that is too rapid to be sustained.

Second, as Americans look for policy measures that promote growth, we must be careful to select those that do not just yield a payoff in the next year or two but rather measures that foster sustainable growth. The corollary to this shift in thinking from short-term to long-term growth is that we must become more willing as a nation to grapple head-on with difficult challenges. We must start making hard choices about devoting resources to solve problems that in the past we tried to solve largely through growth itself. For example, we must begin to deal directly with difficult socio-economic issues such as affordable housing, health care, and education. We have simply not addressed these issues on the societal level, but rather have relied on growth itself to make the problems go away. However, many problems--poverty, for one--persisted despite the rapid growth of the 1980s. Moreover, in recent years, as fiscal policy has lost all latitude, government began to privatize social issues such as medical care. These costs have been increasingly passed on to employers. While I have no specific comments on the health care proposals of the administration or Congress, I am glad that we are beginning to debate these problems as a society. The past strategy of avoidance has the effect of making U.S. businesses less competitive in the global marketplace.

Other countries are showing considerable discipline in hewing to a longer-term growth strategy. West Germany has decided to accept slower growth in the short term in order to integrate the economy of East Germany. European countries are looking to raise their performance in a sustained way by integrating economically through the EC 1992 agenda, even though economic integration on such a large scale involves a good deal of sacrifice on the parts of the governments and the people of the various EC countries. For one thing, by integrating their economies and eventually using one currency, the different national governments are giving up a certain degree of autonomy in their monetary policies.

We need not look only at industrial countries to find examples of such future-oriented leadership. Developing countries in Latin America and Africa are making basic changes in their economies. More recently, leaders in Poland and other eastern bloc countries have also been won over to the precepts of a market economy. They are now working to stabilize their currencies, privatize their industries, and revamp their infrastructure of intermediaries--finance, transportation, distribution, and so on--in order to reap the benefits of a market system. Sometimes, such actions can lead to protests, as we are seeing in Russia, or attempted coups, as we saw recently in Venezuela, one of the oldest democracies in South America. Nonetheless, these countries are proceeding with measures that should lay the groundwork for a better tomorrow.

In view of what is going on elsewhere in the world, the United States may be falling behind in global competition. Unless we, too, make some tough decisions soon, we would be less prepared than many other nations to compete in the global marketplace. To get tough with ourselves, we must be willing to reorder our priorities, realizing that whatever we target for investment--be it education, health, or infrastructure--will not yield as quick a payoff as building another high-rise office building did in the '80s, for example. Yet, we can be secure in the knowledge that we will have improved the prospects of our nation for the future.

Conclusion

The kind of transition in thinking that Americans--including business executives, consumers, taxpayers, voters, and lawmakers--must undertake is certainly not easy. Nor is it easy for those who are unemployed or facing difficult business problems to be patient and work through the present transition, allowing the policy medicine that has already been administered to work its way into the bloodstream. Nonetheless, my fervent hope is that we can transmute this time of questioning and change into a serious discussion of our long-term goals and how we should achieve them.

It is becoming more critical every day for Americans to change their expectations, bringing them more in line with a mature economy that may grow more slowly yet steadily over time. I believe we have the sense to know that something must change in the way we view our situation. I only hope that we also have the willpower to encourage our elected leaders and policymakers to translate our desires into economic policies more truly in line with the needs of the future.