

**THE ECONOMIC OUTLOOK AND ECONOMIC WELFARE:
WHY AMERICANS DON'T FEEL BETTER ABOUT THE ECONOMY**

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It seems clear to me--and I know most of you would agree--that the country is going through a very difficult adjustment period. Consequently, it would seem that we should be changing our expectations to deal with the new economic circumstances. Earlier this year, I spoke out on the need for Americans to change our attitudes about growth. My point was that, as our maturing economy slows down, we must not be tempted to resort to 'quick fixes' to spur growth. That is because rapid growth would tend to bring on imbalances that would have to be corrected later through yet another transition similar to the one many industries have been experiencing. Instead, it is time for us to shift our thinking from such short-term, unsustainably fast growth to long-term, sustainable growth.

This evening, I would like to take this argument a step further to discuss why we must also adjust our attitudes about the relationship between growth and economic welfare or well-being. One of the most common assumptions made by Americans is, if the economy is growing, we must be doing better. Until the 1980s when the huge government deficits began to affect the economy, this assumption may have been true, but as I will explain later, it no longer is. In fact, my thesis tonight is that Americans will feel better in the 1990s and be willing to support policies that focus on the long term only when we stop equating growth with economic welfare. Before I go into detail on this topic, let me first give a brief economic outlook for the nation.

Economic Outlook for 1992

Due to the slow start in the first quarter, I believe the economy will grow at a moderate pace of around 1 1/2 percent on average or perhaps slightly faster. Since employment lags behind output growth and many businesses continue to consolidate, I think the jobless rate will end up the year close to where it was last year in December at 6.9 percent--although the annual average may be somewhat higher than that due to the run-up in the unemployment rate in the first quarter. Price pressures look more moderate than they have in some time, and the consumer price index (CPI) should increase about 3 percent as an annual average in 1992.

Recent data suggest that a genuine and stable recovery is under way, although it is a mild one compared with previous recoveries. I am glad to say that anecdotal information suggests that business and consumer attitudes are also somewhat better. What differentiates the present situation from last year when an incipient recovery did not take hold? First, considerable progress has been made in alleviating imbalances and constraints to growth over the past 12 months. For instance, household and corporate debt have been worked down, and business inventories are even leaner than they were last year. Second, some mild pent-up demand has had a chance to develop over an additional year of weakness, and lower interest rates are now encouraging consumer spending, particularly purchases of automobiles and single-family housing.

Generally speaking, there has been a strengthening recently in housing, consumer spending, and manufacturing. Manufacturing is being boosted by export demand. The forces bolstering growth during the rest of 1992 should continue to be exports and consumer spending,

particularly on services and, to some extent, nondurable goods. Net exports should remain a source of support as our external position continues to improve, but the pace of expansion will be slower than in the last few years. Real export growth will continue to outpace overall gross domestic product (GDP) growth, despite the relatively sluggish economies in large industrial countries in Europe and in Japan. The Middle East and Latin America are strong sources of demand. For example, with Mexico undergoing an investment boom in anticipation of the eventual passage of the North American Free Trade Agreement, it has an increased need for capital equipment. Although the interest rate declines have spurred some consumer spending, growth in this area 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, such as health care, 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 for services such as health care in particular should lend modest support to the recovery. In addition, sales of durable goods have been climbing lately, thanks in part to improving conditions in the housing market.

Consumers have also been purchasing more nondurable goods, as seen by improving sales at department stores in the past few months.

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. However, as I just mentioned, single-family housing construction is on an upswing thanks to lower interest rates. 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. 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 to lead economic growth over the coming year. Housing should continue to 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.

Why Don't We Feel Better?

A modest recovery it may be, but a recovery nonetheless. However, even with encouraging signs in the economy, people seem to have been in the grips of a pervasive and lingering malaise. Compared to prior recoveries when consumers led us out of recession, this time around, consumers seem much more reluctant. Signs of this mind set have been very low responses to consumer confidence surveys and the persistent talk about a recession when many economists were saying we were no longer in one. Thus, a question remains: Why don't we feel better about ourselves and the economy?

I can offer three reasons. First, discretionary income is decreasing as the cost of certain necessities, such as health care, continue to climb. Having less money to spend on items other than necessities makes people feel less well off. Second, the de-leveraging and restructuring going on in the corporate world--while basically a good thing--feeds into consumer uncertainty. People may understand theoretically that certain industries in the service sector grew so rapidly in the 1980s, as I mentioned earlier, that they are being forced to trim their workforce now. However, it is another thing altogether to see people losing their jobs from such blue-chip companies as IBM and GM, not to mention the many bankers and other professionals who have

received pink slips.

But most important of all, we do not feel better because we have mortgaged our future, and we are just beginning to come to terms with this problem. Let me provide some history on this subject: 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.

Meanwhile, throughout the '80s, rather than investing as much as we should have in areas like education and infrastructure, 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 send abroad for others to use is growing faster than the growth in what we consume domestically. In a sense, we have begun to feel like Sisyphus, the ancient Greek whose special torment in Hades was to push a rock up a hill only to have it roll back down time after time. In much the same way, having to service our huge debt burden forces us to produce more while enjoying less for ourselves.

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.

Why Better Measures Will Not Help

As a nation, we have clung to the 'more growth equals greater well-being' notion, partly because growth in output is relatively easy to measure. But as our economy has shifted from a manufacturing base to a service industry base, it has become more difficult to measure the output. Ideas, quality, creative solutions, and inventions are not as easy to count as manufactured goods--cars or refrigerators or the proverbial widgets of economics classes. Antilock braking systems and airbags have contributed to safer cars, and the relatively clean air we breathe in the Southeast is far preferable to that of Los Angeles or Mexico City. Unfortunately, it is difficult to calculate just how much better off we are. Coming up with a dollar measure for quality has always been more difficult than simply measuring quantity--ask any manager filling out job evaluations for employees. In fact, it is not at all possible to do so for every situation. For instance, we can easily put a value on the hours we spend on the job--it is what we call wages and salary--but how would we value our leisure hours and the time we spend with our families? My point is that we cannot really measure many things that are important to us, such as the environment and our personal lives, but we know they add substantially to our sense of well-being.

Beyond the difficulty of actually measuring the intangible items that contribute to our economic welfare, I would like to point out that having more growth has not solved all of our problems. Many societal problems--poverty, for one--have persisted despite the rapid growth of the 1980s. An increase in overall GDP does not necessarily translate into growth in per capita GDP. That is, more people could be producing more products as a whole, but if economic growth lags behind population growth, people will feel poorer because, on average, they are poorer, much like what has happened in many developing countries. Further, neither growth nor per capita growth speaks to how the increased income is ultimately distributed among the population.

In addition, the desire for growth can also pervert the way our free markets work, making them less free. For example, if the stock market goes up, everybody is happy. When it starts to come down, though, the impetus is to try to fix it rather than letting it take its course. Growth for the sake of growth means that we have become intolerant of market failures. We always want things to go up, and we have not come to grips with how to deal with the downside of a free market.

Ideas vs. Output: The Importance of Changing our Attitudes

All of this may sound like I am against growth, which, of course, is not true. We still need growth in tangible goods as well as services to accommodate a growing population. However, I hope I have convinced you by now that growth in output alone is not an adequate measure of economic welfare. We must broaden our concept of growth to achieve a better sense

of our well-being. One way to do this is to focus more on the intangible aspects of growth, such as quality, inventions, and ideas. Our dependence on the growth of goods that we can see and count has made us less conscious of the importance of intellectual output that we cannot so readily count. In a sense, we have taken the easy route of deciding that if something is intangible, it has no value. Yet, in this more competitive and integrated world, the opposite is more and more the case--ideas are what drive true growth. This issue is more than an abstract debate. Our views about growth in output have led us, in some respects, to value low-skilled labor over highly skilled labor because we can measure the output of one much easier than the other. On trade issues, for example, we have become preoccupied with trying to save low-skilled jobs. What we should be concerned about is saving the highly skilled jobs for ourselves. These are the jobs that will help to make our country stronger and richer.

We should be seeing our comparative advantage in world trade less in terms of physical things like cars and more in terms of the products of our minds. We should not be putting the emphasis on producing the videotape, but rather on the movie or TV show that goes on the tape. We should not be so concerned with manufacturing the medicine bottles, but with inventing the new life-enhancing medicines that go into the bottles. We should not be so obsessed with building the computers, but with creating the software that runs them. Ideas and inventions should be recognized as more important than tangible goods, because they create new sources of economic welfare. As we have seen, given the right materials and a blueprint, the workers of any nation can do the repetitive and boring job of reproducing a computer chip. But without the original idea for a chip, we would not have the vast computer industry that exists today.

Ideas--not mere output--create the kind of growth that actually enhances economic welfare.

Many new ideas, however, do not come from the assembly line or the boardroom. They come from schools and colleges, research and development centers, laboratories, garages--and sometimes even from the government. If we are to encourage the growth of more new ideas and inventions, we must decide to spend more of our resources on education and research and development. As all of you know, we have begun to lag behind other industrialized nations in each of these areas. I am not speaking about enhancing education only for those students in colleges and universities. I believe it is equally necessary to rethink how we educate and train those who choose not to go to college. We must find ways to improve the technical training we give to these students, much as the Europeans and Japanese do, but still incorporating the breadth of curriculum--in English, history, and the like--that will give these students the flexibility to change and adapt to new careers as technologies evolve and even become obsolete.

Conclusion

In conclusion, U.S. leadership in the future depends on our being able to stop equating growth with economic welfare and on our looking past simply improving the data we use to measure that growth as a solution. We must change our attitudes about growth and welfare and learn to emphasize intangible, unmeasurable ideas over tangible, concrete products. New ideas to improve our health-care system, for example, will help more people in the United States than producing five more widgets per hour will. I believe that once we change our attitudes about the value of ideas compared with the value of things, we will also put a greater value on

education--a result that is long overdue.

Americans have for too long been entrenched in 19th century values introduced by the Industrial Revolution. But as we are on the verge of entering the 21st century, it is time that we update our outlook to recognize how we have shaped the 20th century. I do not believe it is too late to credit ourselves for the brilliance of our discoveries. I do hope it is not too late for us to transform our growth-based value system to one that better acknowledges the critical role of creativity and invention.