THE U.S. ECONOMIC OUTLOOK FOR 1992 AND BEYOND

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I am very pleased to be here to speak to this annual meeting of the Florida Council on Economic Education. My remarks today will focus on the outlook for the U.S. economy for the rest of the 1990s.

Focusing on the longer term is especially appropriate at this gathering today. As we all know, Americans are far too prone to take a short-run perspective. Fortunately, the Florida Council on Economic Education, along with other such organizations around the country, is an exception to this rule. By helping teachers and students to better understand the principles on which market economies operate, the council is fostering a greater appreciation of how short-run solutions to problems can actually make things worse in the long run. If American society is to overcome its fascination with the short run and quick fixes, it will be because each of us--as voters, policymakers, workers, employers, and stockholders--has a better understanding of economics. In turn, we should have a better grasp of what economic policy can and cannot accomplish. Thus, there is a natural synergy between the mission of the Florida Council and the longer-term issues I will be discussing this afternoon.

Long-term U.S. Outlook

Let me begin with an overview of the longer-term prospects for growth in the U.S. and the dynamics underlying this outlook. Although the Federal Reserve does not make formal forecasts over an extended time horizon, a variety of factors suggest that the United States will be growing more slowly in the 1990s than it has in recent decades. The longer-run potential for growth is now closer to 2 percent than to the 2 1/2 to 3 percent that we experienced on an annual average basis from 1950 to 1980.

The modest rate of the anticipated growth arises in part from demographics. We will have fewer people entering the work force in the 1990s than we did in the 1970s and '80s. In the late 1970s, for example, some 3 million people entered the labor market. In contrast, last year fewer than 1 million people sought jobs for the first time. The sharp drop in the growth of the U.S. labor force translates into less demand for housing, for automobiles, and for many other products. Aside from altering our immigration laws, there is very little public policy can do about the adverse impacts of this demographic change on aggregate demand. Even if we could make up the difference by selling more abroad, in a fundamental sense these demographic changes limit our capacity to grow by limiting our labor resources. We all know that labor is perhaps the single most important factor of production.

Of course, the number of workers is not the most critical dimension. Rather, it is their productivity that counts the most. However, prospects here are mixed. U.S. productivity in manufacturing has improved substantially, but such gains have not been forthcoming in the other sectors of the economy. One reason is that, as a society, we have not invested as much as we should have--particularly in education and infrastructure. We are simply letting too many people enter the working world ill-prepared, or unprepared, for the demands of the modern workplace.

Another closely related factor underlying the slow growth trajectory for the rest of this century is the huge debt that is burdening the nation. As a result of the debt buildup, businesses and households are being forced to make a painful transition. Of course, there is nothing wrong with debt per se. Borrowing is a standard means by which businesses expand, and there is no theoretical basis in finance or economics for selecting the optimal amount of debt versus equity. Unfortunately, rather than investing as much as we should have, Americans consumed more than we produced and went into debt. This penchant toward debt occurred in all sectors of the economy--households, businesses, and especially the federal government, which began to run massive budget deficits. 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, or more precisely, enjoying less of that increase.

Why did we take on so much debt as a society? In my opinion, many households and businesses had become used to the high inflation of the 1970s and early 1980s. In an inflationary environment, debtors are the biggest winners because they can pay back what they have borrowed in "cheaper" dollars. In fact, though, inflation has diminished. As this change became apparent in the late 1980s, businesses and consumers began scrambling to de-leverage in order to reposition themselves for a less inflationary economy.

More fundamentally, however, I believe that Americans trusted too much in growth for its own sake. In other words, there was a widespread view that we could simply outgrow many of the problems that were plaguing us--poverty, affordable housing, health care, and the like. It was thought that if such growth required a catalyst of debt, the resulting benefits would outweigh the costs. Moreover, solving these problems through growth would avoid having to make tough choices between competing causes. Unfortunately, the problems did not go away. Poverty, for one, has persisted and perhaps has become worse. At the same time, we have handicapped ourselves from dealing with these issues. The huge federal budget deficits have virtually eliminated fiscal policy as a countercyclical tool, and it is hard to see a significant change in this situation on the horizon.

Lessons to be Learned

Now all of this analysis sounds pretty bleak, but I do not want to draw an overly pessimistic picture. There are, to be sure, some positive developments in the offing. Balance sheets have been improved considerably as household and corporate debt have been worked down. No family or firm is likely to forget--or repeat--the painful memory of this adjustment process anytime soon. In addition, major sectors of the economy are making fundamental changes in the way they do business. In the service sector, for example, many firms are downsizing. This shift is particularly apparent in retailing, airlines, and banking. These firms are becoming more productive in the process.

Looking beyond the borders of the United States, I am particularly optimistic about developments in Latin America. The policy reforms that were implemented in the latter part of the 1980s are beginning to yield returns. Growth rates are up and inflation is down. Moreover, healthy demand for a variety of U.S. exports by countries south of the border is already helping to offset the effects of the relatively weak economies of our major trading partners. Since these changes in the Latin American countries reach to the very structure of their economic and political systems, their effects should be long lived.

In addition, the United States, Mexico, and Canada are likely to enter a North American Free Trade Agreement, which will enhance commerce and other interchange significantly among these three neighbors. Likewise, Europe 1992 holds very auspicious long-term implications, not just for Europeans but for all countries. The substantial lowering of trade barriers that will begin at the end of this year will certainly cause some adjustments and even dislocations for inefficient producers, but overall output should expand more rapidly than it would have. At the broadest level of trade liberalization, the news has been less positive. The General Agreement on Tariffs and Trade, or the GATT, has undergone a frustrating period of negotiations over some important aspects of trade in the future. Fortunately, Europe has finally made some concessions on agricultural subsidies. Other areas like intellectual property rights are still in the process of negotiations. However, these are very difficult aspects of international trade, and I take heart that any progress at all is being made. On balance, then, all of these developments, along with continued stellar performance among the newly industrialized countries of Asia, suggest that American businesses that take the initiative to export will find good market opportunities abroad.

However, these positive developments are merely opportunities, not a forecast of business activity. Certainly the United States has come to export more as a percentage of GDP. In fact, the share has risen from 4 percent in 1960 to 8 percent in 1991. Imports have gone from 3 percent to 9 percent over this period. However, small and medium-sized U.S. firms are not as export-oriented as are their counterparts in Europe. Moreover, we have seen a troubling rise in protectionist sentiments that, if successful, could negate these hard-won gains. Americans must do a better job of taking advantage of these opportunities just as we must do a better job of dealing with the federal budget deficit and related macroeconomic problems.

It is in this area that the work of organizations like the Florida Council on Economic Education is so vital. I believe that those who are teaching economics to our elementary and secondary students are perhaps in the best position to help Americans make the most of our long-run economic opportunities and do the best we can in grappling with complex problems. Economic education does far more than help students learn how to balance a checkbook and manage their personal finances, although these basic skills are sadly lacking in too many adults. More basically, economics training helps students think clearly and critically about practical problems.

The study of economics promotes clear thinking first and foremost by crediting people with being rational. That is, it assumes that people do things for a reason. It credits taxpayers with recognizing gimmicks for what they are--very often simply transfers of spending and taxes from one period to another.

Following from this first step in logical and analytical thinking, the study of economics takes students farther along the path of rational thought by encouraging them to ask "Why?" and perhaps more importantly, "Why not?" The study of economics creates a desire to find out why things happen the way they do and to try to figure out what will result in the future from certain actions taken now. It will not take long for a student entrepreneur who has gone into business selling cookies at school to realize that raising the price of a cookie could cause a number of results: most likely, fewer students will buy cookies or the same number of students will buy fewer than they would have at the lower price. Perhaps, however, students will buy the same amount because the cookies are so good. This entrepreneur can test these hypotheses by raising the cookie price and finding out what happens.

Laying the Groundwork for More Informed Voters

By helping students develop a concept of dynamic, rather than of static, equilibrium we are preparing the voters of tomorrow to see how actions taken today will affect the long term. As I have emphasized, many of our current problems are the result of unwise policy choices made in the past. It is easy to blame Congress, the Fed, or the President for these decisions. However, in a democracy, we get exactly the economic policy we deserve. Whether we end up with good or bad policy ultimately reflects the views of voters. For example, people want better schools, strong defense, and social programs such as Medicare, but they do not want to pay for them in the form of higher taxes. This popular attitude of wanting to have it both ways has helped to create overwhelming budget deficits in this country. Until each person in the United States better understands the basic principles of economics, we are likely to repeat the same mistakes.

It is also critical to pique students' interest in the global economy. As I mentioned, the international arena is probably the most promising area of growth in the next decade. Awareness of this potential can be fostered not just in formal economics classes but in a variety of courses--geography, history, languages, civics, and government. If it is possible to get these two points across to students--that long-term thinking must replace the current obsession with the short-term and that the United States must play an even more active role in the global economy--then I think we have a good chance of creating more informed voters and, in turn, better-informed economic policy.

Conclusion

In conclusion, the U.S. economy is not likely to grow as fast on average during the 1990s as it has in recent decades. Changes in demographics and the adverse effects of large federal budget deficits are constraining our capacity to grow. There are bright spots, however, particularly in the realm of international trade. In addition, we will begin to see a new generation coming of age. As these students take their place in society as workers and voters, many will be better equipped to participate in the economy and contribute to the long-term prosperity of the United States. These students will do so because they have a firmer understanding of economics, thanks in no small degree to the work of the Florida Council on Economic Education.