The question I have been asked to address this morning is how health-care reform might affect the economy of the nation. Here are two possible answers: if not handled wisely, it could add to the deficit and still not provide basic health care for all Americans; if handled wisely, it could put a brake on health-care inflation by containing health-care costs while providing a decent level of care for all Americans. Notice that in both of these answers, I have gone beyond the economic result, for indeed I believe to frame health-care reform as merely an economic need is to deny the deeper reason for reforming health care in this nation. It is the hallmark of a civilized society that it provide some degree of care for those in need. In our current wealthy society, we have discovered that many people are medically needy. That is, they do not have access to routine care until their condition reaches emergency or crisis proportions. Furthermore, providing health care the way we do now results in ever higher costs.

Since I have a captive audience of business leaders, I would like to take the opportunity to outline some of the larger macroeconomic principles that I believe should be weighed as we begin to come to terms with this long-term national issue. As a monetary policymaker, I look at the country as a whole, although I am not indifferent to the plight of businesses in dealing with health-care costs. Case in point: The Atlanta Fed employs more than 2,300 people throughout the Southeast. As its chief executive, I am keenly aware of the day-to-day business concerns of
providing reasonable, cost-effective health care for our staff. However, I believe there are larger issues to be debated than microeconomic issues such as whether an employer mandate is the best way to implement health-care reform. Two that I would like to discuss today are the issue of health-care costs and the issue of equity in health-care coverage.

Before discussing these health-care issues, I shall provide you with an economic outlook for the United States and the state of Georgia. Indeed, any economic outlook is affected by the way health care is handled. Taking Georgia as an example, we have failed to invest in certain areas, such as pre-natal care. As a result, the state and families pay dearly in the form of high infant mortality—one of the highest rates in the nation, I might add. Also, many babies are born seriously underweight, and they then require extensive hospital care before they can be taken home, another added cost for lack of investment in decent health care. Situations such as these make it all the more important that we reform the health-care system.

The U.S. Economy

Turning first to the economic outlook for the United States, my discussion begins with three key measures of economic performance—output, inflation, and employment. For the nation as a whole, I believe the economy could grow at a pace of around 3-1/2 percent for the year as measured by gross domestic product (GDP). Inflation, as measured by the consumer price index (CPI), should increase by around 3 percent this year. Earlier declines in oil prices, productivity gains, and ongoing import competition are keeping prices well behaved in the near term. Unemployment should move down from 6.7 percent in January to a little more than 6 percent
toward year end. This improvement is better than it sounds because the U.S. Labor Department changed its methodology at the start of this year, with the result that measured unemployment is about half a percentage point higher, on average, than the one obtained by using the old method.

The main strength supporting this outlook lies in consumer spending, especially on durable goods like autos and household appliances, but there are other strengths. Residential construction will also make a solid contribution to growth, leading to continuing strength in related areas, such as home furnishings. The purchases of consumer goods should support continued growth in manufacturing. Finally, capital spending by businesses, especially on computers and industrial equipment, should remain vigorous. The lagged impacts of the relatively low interest rates of the last few years—even though rates have moved up recently—are a factor in all of these areas. Recent employment gains should also provide support for further increases in personal income and consumer spending. On another promising note, imbalances have been worked down substantially on corporate balance sheets, due largely to the earlier declines in interest rates, the lengthening of debt maturities, and equity issuance. Banks and real estate firms are also stronger.

To be sure, there are also specific areas of weakness in the economy: commercial construction, government spending, and international trade. Office construction still suffers from overbuilding in previous years, but I believe that we are beginning to see a modest upturn. While state and local purchases will grow, government spending overall will be weak because
expenditures at the federal level are being affected by defense cutbacks and deficit reduction. Of course, I do not view this "weakness" negatively because deficit reduction is long overdue.

The third negative factor is the outlook for net exports, which remains poor due mainly to the weak economic conditions of many of our largest trading partners. This situation abroad, however, has begun to show signs of reversing. (Indeed, the International Monetary Fund [IMF] has revised its forecast higher for world economic growth.) I expect the western European economies to round the corner this year. Whatever growth in exports the United States does have will come from Latin American countries, Canada--our largest trading partner--and Asia, excluding Japan. Computers, telecommunications, and other capital equipment, as well as services, should remain the leading exports. In fact, our leadership in technology bodes well for the future. At the same time, imports will continue to grow faster than exports as the increase in U.S. spending still outstrips that of many of our trading partners.

Current Direction of U.S. Monetary Policy

These weaknesses notwithstanding, it does not seem appropriate to be concerned about whether the U.S. economy can expand. If anything, it would be wiser to worry about the possibility that too rapid and thus unsustainable growth will ultimately contribute to rising inflation--an outcome the Federal Reserve most assuredly wants to avoid. Therefore, the Fed began in February to shift away from the accommodative monetary policy stance we had had for some time.
Certainly, we recognize that the globalization of the U.S. economy helps to dampen domestic price pressures. However, the economy has been growing at a rate in excess of its long-run potential, thereby running the risk of constraints on capacity. This situation often leads to inflation. In general, as the gap between actual and potential output narrows, central banks begin to become concerned that the momentum will push an economy through its capacity constraints. Although there have not yet been any signs of accelerating inflation at the retail or output level in the United States, the pressures that can lead to it are there. With the current course of monetary policy, the Fed wants to make sure that inflation will no longer be a problem in the United States. In that light, it is critical for us to fend off inflation before it starts recurring.

Before moving on to my outlook for the state of Georgia, I would like to say a few more words about inflation. It may seem to many people that the Fed spends too much time worrying about inflation, particularly since the economy is healthy now, and inflation seems to be quiescent. However, an important point to remember is that the costs of inflation are significant. One reason for having an independent central bank is that it allows us to take a longer view of the economy. This long-term vision is especially important when dealing with inflation because price increases accelerate with a long lag. For example, inflation peaked in 1982, long after monetary policy saw it coming and moved strongly to counter it and long after the early 1980s recession began. We all recognize the importance of avoiding this situation again.

At the same time, to achieve this goal, the Fed does not pursue a single-minded effort to reduce inflation without regard to transition costs and social preferences. While inflation
undermines and distorts economic growth, I am not so single-minded as to believe that we must achieve zero inflation immediately or that we necessarily have to reduce inflation at every stage of the business cycle. As I see it, there are always trade-offs to be made when trying to bring inflation down. Businesses, labor, and consumers must be given time to adjust their financial behavior in light of changing economic policy. Too quick an adjustment can cause too much pain, and I personally believe policymakers must be attuned to these social costs.

Outlook for Georgia and the Southeast

Now, I would like to focus on the economic outlook for Georgia, which is quite bright. As background, let me point out that since the recession, the southeastern region has been outperforming the nation in terms of job growth by about 1-1/2 percentage points. In 1994, that advantage is diminishing--not because the Southeast is decelerating, but rather because the U.S. rate is accelerating. The good news is that on both the regional and national level, the pace of job growth is stepping up. Individual states will vary in performance, but even the weakest states in the region are seeing at least modest growth.

Three sectors in the Southeast will continue to outshine national growth: service industries, manufacturing, and construction. For several years, the service sector has been the main source of job growth for both the region and the nation. Specifically, the Southeast should get most of its gain from business services employment. New-home construction across the nation brings special benefits to the Southeast because of its traditional manufacturing concentration--a combination of lumber, furniture, textiles, appliances, and other construction-related products.
This help from the rest of the nation should allow the manufacturing sector to grow modestly or at least to hold its own as the region loses jobs in the apparel industry to international competition. Finally, construction in the Southeast itself is likely to outperform the nation this year thanks to the strength of the regional economy, although housing construction may begin to taper off as the year progresses.

Comparing the economic outlooks for each state in the Southeast, the clear winner in terms of 1994 growth is Georgia. Since the end of the 1990-91 recession, Georgia has reestablished itself as a growth leader in the Southeast. A resurgence in single-family construction across the nation after catastrophes like the earthquake in California and the floods in the Midwest should spark increased demand for building-related products. Since Georgia has a relatively heavy concentration of textiles and wood products manufacturing, the state benefits economically from disasters in other states. Corporate relocations of both domestic and international companies should also continue to increase demand directly and in the construction and service sector. As in other parts of the Southeast, business services will contribute to growth. About the only negatives to be noted in the outlook for Georgia are the recent announced cutbacks by Lockheed and Delta.

Turning briefly to the impact of the upcoming 1996 Olympics: The Olympic games will mainly affect the Atlanta metropolitan area. Retailers and tourist-oriented businesses that are thinking ahead are expanding into the Atlanta market to take advantage of the Games. However, you may be able to divine what I am going to point out next—that, following the Olympics, there
is likely to be an economic letdown in the Atlanta area for purely technical reasons as the temporary employment burns out after the Olympic flame has been doused. The question is, how serious will this letdown be and how long will it last?

**Issues in Health-Care Reform**

Now let me return to the topic of health-care reform. The main point I would like to leave you with is that reform could affect the economy in many ways for the better, but the one way that it must not affect the economy for the worse is by increasing the deficit. No matter how we eventually decide to reform the system to cover all people, we must also settle on a way to pay for it. The quirk in the American psyche that has contributed to the current deficit is that Americans can usually agree on what benefits we want, but we do not want to be taxed more to pay for them. Health-care coverage for all could easily fall into this category, although I believe that people everywhere—including policymakers and politicians—are much more attuned to the importance of reducing the deficit.

Of the two issues that I would like to discuss, cost seems to be one that nobody argues about. The cost of health care is going up; therefore, we must do something about it, particularly since nearly 15 percent of gross domestic product is being spent on health care—and that share is growing by about 1 percentage point every year. The issue is not quite so clear-cut, however. From a broader macroeconomic perspective, I would like to point out that it is not completely unreasonable for the United States, a highly developed nation, to be spending this amount of GDP on health care. Let me explain why. People in less developed countries must spend most
of the small amount of money they make on the basics of food and shelter. Thus, a high proportion of GDP in less developed countries is devoted to basic needs. As a nation becomes more developed at what we might call the second stage, people generally have more money and use it to buy more manufactured goods, such as cars and televisions. Finally, when a nation becomes highly developed, people spend proportionately more of their increased income on services, such as entertainment and health care. In other words, as income increases, the percentage of income people spend on different things changes.

So, as a large and well-developed country, it is not surprising that the United States spends a larger proportion of GDP on health care. From a business point of view, this fact may be difficult to swallow, but from a macroeconomic point of view, it may be appropriate. That said, though, it is also true that the inflation rate of health care has outstripped the general inflation rate by nearly 40 percent over more than 25 years. That figure is based on an annual average percentage change of 5.5 percent in the total consumer price index from 1965 to 1993, compared with an annual average percentage change of 7.6 percent for medical care. Although health care is a special industry in that people expect to receive whatever care they need without regard to cost, it does not seem reasonable for the nation to tolerate such epidemic-like health-care inflation. I believe, therefore, that it is very legitimate for us to go through this exercise.

Perhaps it is precisely because health care is an industry that gets special treatment, not unlike banking, that we should also be debating exactly what kind of care and coverage we want. Banks get the de facto subsidy of deposit insurance. Doctors and hospitals get the de facto
subsidy of third-party health-care payments, in the form of insurance or Medicaid and Medicare. Without some kind of common understanding of what is necessary for adequate care or else some change in the way health care is financed, the United States can only continue to spend an ever-increasing percentage of GDP with no useful means to rein in the spending. One question I believe we may have to answer is whether we can afford as a nation to guarantee government programs, such as health care and social security, irrespective of income. It seems clear that without a means test of some kind, we will have a ballooning deficit. As a central banker, I cannot warn too often that federal deficits do great harm to the long-run economic prospects of this nation.

As regards the issue of equity in health-care coverage, the central question that is being asked is one of fairness. Is it fair for millions of people not to have access to medical care? Even if you do not accept the Administration's estimate of 37 million and choose to cut the figure down by half or more, it still amounts to millions of people. Since before World War II, the United States developed an employer-based program, thanks to tax incentives. The problem is that health-care benefits do not flow through all businesses, particularly not small businesses. Since this is a nation where small business creates a large share of new jobs, the inequity of health care is exacerbated. In a speech I gave at a symposium of Roman Catholic universities in Argentina last year, I quoted an encyclical of Pope Leo XIII, written in 1891, on the dignity and rights of workers in an industrialized economy. He wrote passionately about the moral necessity of employers to pay workers a living wage, one that would support human dignity. In this country, that living wage (also known as fair compensation) has grown to incorporate methods
to offset health-care expenses. I would argue that we have an ethical problem if small employers
do not or cannot offer compensation to workers that also includes some kind of health insurance
benefits.

Therefore, in my view, the Administration has done a good thing in recognizing that
something is terribly wrong with the system as it now exists. Interestingly, even the threat of
proposed changes has already led to some cost containment in the industry. But as I have said,
without open debate that leads to new methods of handling health care in this nation, costs will
continue to increase. On the other hand, debate and uncertainty about a future program has led
to uncertainty and negativity in corporate America. Let us hope this will be only a short-term
effect. Overall, I support the fact that the Administration is bringing health-care reform to the
center of the policy forum, but I feel strongly that the end-result must be mindful of the deficit.
In the end, we cannot afford to negate our hard-won deficit reduction.

Conclusion

In conclusion, the economic expansion in the nation promises to be quite strong in 1994
yet at a rate of growth that does not create its own problems; the southeastern region is
outperforming the nation; and Georgia is doing the best of all the states in the region. From a
long-term perspective, as a nation, we have taken significant strides to correct difficult problems,
such as the deficit. Now we are beginning to take on one of the most difficult issues of all,
health-care reform. I am hopeful that the debate on this topic will lead to a truly better solution
than the one we have now, both in economic terms and in human terms.