

SILAS KEEHN REMARKS  
PRESIDENTS FORUM  
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"THE PROSPECTS FOR U.S. ECONOMIC GROWTH"

I. INTRODUCTION

A. PLEASED TO HAVE BEEN INVITED TO MEET WITH YOU

1. VIEW THIS AS A GOOD OPPORTUNITY TO INFORMALLY  
DISCUSS SOME EXTREMELY IMPORTANT ECONOMIC ISSUES
2. I CERTAINLY WILL EXPRESS SOME VIEWS ABOUT THE  
ECONOMIC PROSPECTS FOR 1985 AND BEYOND
3. BUT I WOULD LIKE TO USE THIS PRIMARILY AS A BASIS
  - A. FOR TAKING A LONGER TERM VIEW OF OUR NATION'S  
POTENTIAL ECONOMIC PERFORMANCE
  - B. AND DISCUSSING WHAT MAY BE THE MOST  
THREATENING ELEMENTS TO THE DEVELOPMENT OF  
THAT PERFORMANCE
    - (1) THE DETERIORATION OF OUR ROLE IN  
INTERNATIONAL TRADE AND THE FINANCIAL  
POSITION OF THE U.S.

II. THE CURRENT SITUATION

A. AS EVERYONE HERE IS AWARE

1. OVERALL ECONOMIC PERFORMANCE SO FAR THIS YEAR

A. HAS BEEN POSITIVE

(1) BUT THE GROWTH HAS BEEN VERY SLOW -  
SLOWER THAN 1983 AND 1984

(2) GNP IN REAL TERMS UP JUST OVER 1% AT AN  
ANNUAL RATE

(3) DOWN SHARPLY FROM THE 6.8% LAST YEAR

(4) BUT THE 2% GAIN IN THE 2ND QUARTER  
SHOWED SOME POSITIVE SIGNS

(A) CONSUMPTION STILL MOVING AHEAD AT  
A 5% ANNUAL RATE

(B) CAPITAL SPENDING INCREASED

(C) EMPLOYMENT CONTINUES TO GROW

2. IN BROAD SENSE - CURRENT POSITION AND NEAR TERM  
OUTLOOK POSITIVE

A. BUT UNEVENNESS BY AREA OF COUNTRY AND TYPE OF  
ACTIVITY IS STRIKING AND DISTURBING

(1) MANY SECTORS HAVE NOT REALLY RECOVERED

B. WHILE CURRENT PERFORMANCE HAS BEEN MODEST COMPARED TO  
THE LAST TWO YEARS

1. IMPORTANT TO REMEMBER - 9MM NEW JOBS SINCE END OF  
1982

A. THE UNEMPLOYMENT RATE DECLINED SIGNIFICANTLY  
FROM 1980-81 AND HAS STAYED AROUND 7-1/4%  
DESPITE DEMOGRAPHIC CHANGES IN THE WORK FORCE

2. PERSONAL DISPOSABLE INCOME HAS CONTINUED TO RISE

A. WITH THE 2ND QUARTER 6.8% ABOVE A YEAR EARLIER

3. AND IN COMPARISON TO PRIOR CYCLES THAT HAVE GONE  
INTO THE 3RD YEAR

A. DOING WELL - THAT IS, ON TRACK; THE MIDDLE OF  
THE PACK

B. AGAIN - IN BROAD SENSE, THIS HAS BEEN A VERY  
GOOD RECOVERY

III. LOOKING AHEAD *A bit*

A. IN SPITE OF THE MODEST FIRST HALF

1. SEE NO REASON WHY SECOND HALF SHOULD NOT SHOW A  
PICK-UP

A. OUTSIDE OF THE INTERNATIONAL SECTOR, NO  
TRADITIONAL IMBALANCES

(1) THAT WOULD SUGGEST NEAR-TERM RECESSION

B. INVENTORIES IN RELATIVELY GOOD BALANCE

C. EMPLOYMENT AND INCOME GROWING

D. CAPITAL INVESTMENT PLANS BEING IMPLEMENTED

E. CREDIT READILY AVAILABLE

F. INTEREST RATES DOWN SIGNIFICANTLY

2. WHILE WE HAVE REVISED OUR FORECAST DOWN ON BASIS  
OF FIRST HALF PERFORMANCE

A. STILL FEEL THAT 3% GNP GROWTH FOR SECOND HALF

LIKELY

B. GIVES US ABOUT 2-1/4% FOR THE YEAR

(1) NOT OUTSTANDING BUT STILL CONSISTENT

WITH THIRD YEAR RECOVERIES IN THE PAST

(2) POSSIBLY CONSISTENT WITH LONGER RANGE

PERSPECTIVE

B. OUTLOOK FOR 1986 LESS CLEAR

1. BUT AS OF NOW EXPECT CONTINUATION OF GROWTH

A. STILL AT MODEST PACE - 2-1/2% TO 3%

2. WITH SHEER PASSAGE OF TIME - AS EXPANSION GROWS

OLDER

A. RISK OF RENEWED RECESSION INCREASES

3. OUTLOOK FURTHER OBSCURED BY WHOLE SERIES OF RISKS

A. INTERNATIONAL SITUATION - AMPLIFY LATER ON

IV. FRUSTRATING ASPECTS OF ALL THIS

A. WHAT IS ESPECIALLY DISCOURAGING

1. IS THE LACK OF MORE VIGOROUS GROWTH
  2. GIVEN THE FISCAL AND MONETARY STIMULUS THAT THE  
ECONOMY HAS RECEIVED
- B. THE STIMULUS FROM THE FISCAL SIDE HAS CLEARLY BEEN  
SIZEABLE
1. UNIFIED BUDGET OUTLAYS OF FEDERAL GOVERNMENT
    - A. WILL BE ABOUT \$935 BILLION THIS FISCAL YEAR
    - B. AND EVEN WITH THE REDUCTIONS PASSED IN THE  
AUGUST CONGRESSIONAL BUDGET RESOLUTION
      - (1) WILL BE OVER \$960 BILLION NEXT FISCAL  
YEAR
  2. AS YOU WELL KNOW, SUBSTANTIALLY FINANCED
    - A. BY A \$200 BILLION DEFICIT THIS YEAR
    - B. AND UNDER THE BEST OF CIRCUMSTANCES,  
\$170-\$180 BILLION NEXT YEAR
    - C. 5% OF GNP; THIRD YEAR OF RECOVERY - NEW  
EXPERIENCE

3. DEFICIT SPENDING - EVEN 5% - NOT UNUSUAL IN  
RECESSION - INDEED, APPROPRIATE
  - A. BUT FIRST TIME IN HISTORY HAS BEEN THIS HIGH  
SO FAR INTO RECOVERY
  - B. RAISES OMINOUS QUESTIONS AS TO OUTLOOK FOR  
DEFICIT WHEN NEXT RECESSION OCCURS
    - (1) WHAT MORE CAN WE DO?
- C. MONETARY POLICY ALSO STIMULATIVE
  1. WHETHER MEASURED BY
    - A. INTEREST RATE DECLINES
    - B. INCREASES IN RESERVE SUPPLIES
    - C. OR MONEY GROWTH - OUR TRADITIONAL MEASURES
    - D. MONETARY POLICY ACCOMMODATIVE
  2. REACTIONS TO RAPID MONEY GROWTH SHARPLY DIVIDED
    - A. MONETARISTS WHO ARGUE SETTING THE STAGE FOR  
RAPID INFLATION
      - (1) WE'VE BEEN TOO STIMULATIVE OR EASY

B. OTHERS WHO ARGUE THAT MONEY/INCOME

RELATIONSHIP HAS CHANGED

(1) NEED MORE MONEY FOR SAME OUTPUT GROWTH

(2) HAVE BEEN TOO TIGHT OR RESTRICTIVE

3. HISTORICALLY

A. RELATIONSHIP BETWEEN MONEY AND INCOME HAS

BEEN GOOD

(1) SEEMS TO HAVE GONE AWRY

(A) BUT IS IT A TEMPORARY OR A  
PERMANENT CHANGE?

(B) IF TEMPORARY - BEGIN TO EXERT  
CONTROL OR RISK RENEWED INFLATION

(I) BUT RATES MAY RISE -  
JEOPARDIZING THE EXPANSION

(C) IF MORE PERMANENT - BASIS FOR  
FURTHER EASING



(D) WON'T KNOW FOR SURE UNTIL LATER

(I) NEED FOR EXTREME CARE

(II) EXCRUCIATING DECISION

V. ONE OF THE KEY ISSUES - ARE WE REACHING THE LIMIT?

A. STIMULATIVE FISCAL AND MONETARY POLICIES ARE HAVING  
LESS THAN EXPECTED IMPACT ON ECONOMY'S PERFORMANCE

1. RAISES QUESTION ABOUT THE ECONOMY'S POTENTIAL FOR  
GROWTH

A. HAS IT BEEN REDUCED?

2. SIMPLY BECAUSE WE ARE EXPANDING MORE SLOWLY NOW

A. DOESN'T NECESSARILY MEAN THAT OUR CAPACITY TO  
GROW MORE RAPIDLY HAS NECESSARILY BEEN REDUCED

B. CYCLICAL VARIATIONS IN ECONOMIC ACTIVITY A  
FACT OF LIFE

(1) ALWAYS MOVING AROUND A TREND LINE

3. THE KEY ISSUE/QUESTION: WHAT IS THE LONG-TERM  
GROWTH RATE COMPATIBLE WITH ~~W~~ STABLE OR EVEN  
DECLINING LEVELS OF INFLATION
4. IN 1960S AND EARLY 1970S
  - A. POTENTIAL GROWTH RATE
    - (1) WAS ABOUT 4% A YEAR
5. FROM MID-1970S TO RECENTLY
  - A. POTENTIAL GROWTH RATE A LITTLE OVER 3%
  - B. THUS, THERE HAS BEEN A DECLINE - IS THIS  
TREND CONTINUING?
6. BECAUSE USUAL ECONOMIC STIMULI DON'T SEEM TO BE  
TAKING HOLD
  - A. DOES A LOWER RATE OF GROWTH REPRESENT OUR NEW  
POTENTIAL
  - B. THIS IS THE CRITICAL QUESTION - NO EASY ANSWER

B: SEEM TO BE SOME GOOD REASONS FOR ARGUING THAT

POTENTIAL HAS NOT DECLINED

1. EARLIER IN THIS BUSINESS CYCLE HAD GOOD GAINS IN

PRODUCTIVITY - TYPICAL IN EARLY PHASE OF RECOVERY

A. BUT GAINS SLOWING

2. HAVE UNDER-UTILIZED PLANT AND EQUIPMENT

A. 1967-84 AVERAGE AT 81.7% OF CAPACITY

(1) CURRENTLY ABOUT, SAY, 80%

B. BUT CAPACITY MEASUREMENTS ARE ILLUSIVE

3. STILL HAVE AN UNEMPLOYMENT RATE OF 7-1/4%

A. HIGHER THAN WHAT IN THE PAST HAS BEEN VIEWED

AS "FULL" EMPLOYMENT

B. BUT IMPORTANT DEMOGRAPHIC CHANGES IN LABOR

FORCE

4. CONSEQUENTLY, WOULD SEEM TO HAVE PLANT AND LABOR

CAPACITY TO

A. PRODUCE MORE OUTPUT

B. WITHOUT ANY PRESSURE ON PRICES

5. AND, INDEED, THIS IS ONE OF ARGUMENTS FREQUENTLY  
ADVANCED - PLENTY ROOM TO GROW AND

A. WHY INCREASED INFLATION IS NOT AN IMMEDIATE  
DANGER

C. BUT THERE IS AN ALTERNATIVE<sup>R</sup> ~~IVE~~ VIEW

1. THAT OUR LABOR AND INDUSTRIAL CAPACITY

A. MAY BE OVERSTATED

2. OUR SOCIETY/STRUCTURE HAS MATURED

A. IN THAT PROCESS SOME OF THE IMPORTANT  
ELEMENTS FOR GROWTH MAY NO LONGER BE AS  
POWERFUL AS THEY ONCE WERE

3. INCREASED CONCERN ABOUT OUR INFRASTRUCTURE

A. CONDITION OF OUR ROADS, HIGHWAYS, BRIDGES,  
SEWERS, MUNICIPAL BUILDINGS, CORRECTIONAL  
FACILITIES, ETC.

- B. CAUSE FOR CONCERN BECAUSE SERVICES THEY  
PROVIDE IMPORTANT FOR ECONOMIC GROWTH
- 4. BASIC INDUSTRIES: STEEL, MACHINE TOOLS,  
CONSTRUCTION EQUIPMENT, MOVING OVERSEAS
  - A. AT HIGH LEVELS OF DOMESTIC ACTIVITY WOULD NOT  
BE ABLE TO MEET OUR NEEDS
- 5. GREATER PROPORTION OF ACTIVITY IN SERVICE AREAS
  - A. OPPORTUNITIES FOR PRODUCTIVITY GROWTH MAY BE  
LESS THAN IN MANUFACTURING
- 6. COMPOSITION OF LABOR NEEDS
  - A. QUESTIONS ABOUT ADEQUACIES OF SKILLS FOR NEW  
ENVIRONMENT
  - B. DEVELOPING THE LABOR FORCE AND RETRAINING  
CONCERNS
- 7. THUS, ENTIRELY POSSIBLE THAT EARLIER RATES OF  
POTENTIAL GROWTH NO LONGER REALISTIC

A. PROBLEMS CAN BE CORRECTED BUT WILL TAKE TIME

D. THE APPARENT INEFFECTIVENESS OF THE USUAL POLICY

MOVES MAY SUPPORT THIS LATTER VIEW

1. BUT TO COMPLICATE THE ISSUE

2. THE POSSIBILITY OF A LOWER POTENTIAL FOR THE  
ECONOMY

3. MAY BE JUST AN ILLUSION

A. CREATED BY THE TWO MAJOR IMBALANCES IN OUR  
ECONOMY TODAY

(1) THE <sup>Huge</sup>~~UNUSUAL~~ INTERNATIONAL TRADE DEFICIT

(2) THE INCREDIBLY LARGE FEDERAL BUDGET  
DEFICIT

VI. BEGIN WITH THE TRADE DEFICIT

A. WHILE TOTAL OUTPUT GROWTH (GNP)

1. RELATIVELY SLOW AT ABOUT 1% IN THE FIRST HALF

A. PURCHASES OR CONSUMPTION HAS BEEN GROWING AT  
MORE THAN 3-1/2%

B. IN OTHER WORDS, ARE WE CONSUMING,  
DOMESTICALLY, GOODS AND SERVICES AT A RATE OF  
INCREASE OF 3-1/2% A YEAR

(1) BUT PRODUCING HERE IN THE U.S. AT A 1%  
RATE

(2) THE DIFFERENCE IS BEING MET BY GOODS  
FROM ABROAD

C. ON ANOTHER MEASURE, FINAL SALES TO CONSUMERS,  
WE ARE CONSUMING AT A 5-1/2% RATE SO FAR THIS  
YEAR

D. ON EITHER MEASURE THAT IS A GOOD CONSUMPTION  
RATE

(1) PRETTY GOOD MEASURE OF OVERALL ECONOMIC  
PERFORMANCE

(2) IN A CONSUMPTION PERSPECTIVE, OUR LEVEL  
OF ECONOMIC ACTIVITY IS VERY STRONG

(3) AND IN EARLIER YEARS, WITHOUT THE TRADE  
DEFICIT

(4) THAT WOULD HAVE BEEN REFLECTED IN A  
STRONG OUTPUT PERFORMANCE AS WELL - A  
VERY STRONG PERFORMANCE

2. SO THE STIMULUS OF MONETARY AND FISCAL POLICY IS  
WORKING

A. ON CONSUMPTION; NOT ON OUTPUT

B. THAT MEANS MORE STIMULUS COULD RESULT IN MORE  
CONSUMPTION FROM ABROAD NOT NECESSARILY MORE  
DOMESTIC OUTPUT

B. THE IMPACT OF THE FOREIGN TRADE SIDE ON OUR OUTPUT IS  
OBVIOUS TO ALL OF US

1. WE APPEAR TO HAVE THE POTENTIAL OR ABILITY TO  
PRODUCE MORE DOMESTICALLY



2. BUT NOT AT A COMPETITIVE PRICE GIVEN THE EXCHANGE RATE
3. SO PERHAPS THE QUESTION IS NOT OUR POTENTIAL BUT OUR COMPETITIVENESS
  - A. THE DOMESTIC MARKET IS THERE BUT WE CAN'T EFFECTIVELY COMPETE FOR ALL OF THAT MARKET
  - B. HAVE ABILITY TO PRODUCE BUT CAN'T "REALIZE" OUR POTENTIAL
  - C. *we simply aren't competitive*  
~~"REALIZABLE OUTPUT" IS BELOW OUR POTENTIAL~~ IN THE CURRENT WORLD ENVIRONMENT
- C. THE MAJOR REASON FOR OUR LACK OF PRICE COMPETITIVENESS IS THE HIGH EXCHANGE RATE OF THE DOLLAR
  1. FURTHER DECLINES IN THE EXCHANGE RATE
    - A. WILL HELP OUR EXPORTERS AS OUR GOODS BECOME LESS EXPENSIVE ABROAD

B. ~~SUPPLIERS TO OUR~~ <sup>Manufacturers</sup> DOMESTIC MARKETS NOW

COMPETING WITH FOREIGNERS WILL BENEFIT

BECAUSE FOREIGN GOODS WILL BE MORE EXPENSIVE

(1) UNLESS PRICES ARE HELD CONSTANT TO

PROTECT MARKET SHARE

D. BUT THE PROBLEM OF POTENTIALLY MORE INFLATION ARISING  
FROM A DECLINING DOLLAR

1. WHILE PRODUCING SOME VERY DIFFICULT PROBLEMS FOR  
MONETARY POLICY

2. IS NOT THE CRITICAL ONE

A. THE EVEN MORE SERIOUS AND THREATENING ASPECT  
IS THE FUNDAMENTAL RESOURCE ADJUSTMENTS THAT  
ARE AND WILL BE TAKING PLACE

3. THE PUBLIC HAS NOT YET FOCUSED ON THE MAGNITUDE  
OF THE PROBLEM THAT HAS BEEN CREATED OVER THE  
LAST FEW YEARS

- A. AS USUAL, FOCUS HAS BEEN ON ASSUMING THAT  
  
ONCE THE DOLLAR IS DOWN WE WILL BE BACK TO  
  
WHERE WE WERE BEFORE
  
- 4. UNFORTUNATELY, THAT ISN'T THE CASE - OVERALL  
  
ENVIRONMENT DYNAMIC NOT STATIC
  
- A. THE SITUATION THAT HAS BEEN CREATED
  - (1) OF LIVING ON FOREIGN CAPITAL
  - (2) AND THE U.S. BECOMING A NET DEBTOR NATION
  - (3) HAS VERY FUNDAMENTALLY CHANGED OUR  
  
ECONOMY - *an international economy*
  
- B. AND, PERHAPS SURPRISINGLY, THE PROCESS OF  
  
ADJUSTING TO A LOWER EXCHANGE VALUE OF THE  
  
DOLLAR
  - (1) WHILE DESIRABLE IN SOME RESPECTS
  - (2) WILL HAVE SOME VERY UNPLEASANT  
  
CONSEQUENCES

(3) AND COULD IMPACT ON OUR LONG-TERM GROWTH

POTENTIAL

5. WE ARE IN A "CATCH-22" SITUATION

A. THE HIGH VALUE OF THE DOLLAR SO NECESSARY TO  
THE CONTINUED IMPORT OF FOREIGN CAPITAL  
CANNOT CONTINUE

(1) THE EFFECTS ARE DEVASTATING

B. YET, A SIGNIFICANTLY REDUCED VALUE CREATES  
QUITE A SEPARATE SET OF PROBLEMS

C. AND THE LONGER THE CURRENT SITUATION LASTS,  
THE MORE DIFFICULT THE ADJUSTMENT

VII. THE CURRENT INTERNATIONAL TRADE SITUATION

A. STARTING ADJUSTMENT FROM A VERY AWKWARD POSITION

1. VERY FRANKLY, LIVING ON A HIGH INFLOW OF FOREIGN  
CAPITAL - OUR STANDARD OF LIVING SUPPORTED BY THIS

A. CURRENT ACCOUNT HAS GONE FROM SMALL SURPLUS  
IN 1981

- B. TO A \$125-150 BILLION DEFICIT
- 2. MEANS FOREIGNERS ADDING AT TREMENDOUS RATE TO  
THEIR HOLDINGS OF U.S. DOLLAR DENOMINATED ASSETS
  - A. HAVE GONE FROM THE LARGEST CREDITOR COUNTRY  
TO BEING A LARGE DEBTOR COUNTRY
  - B. FOREIGN CAPITAL LARGELY ATTRACTED BY RELATIVELY  
HIGHER RATES OF RETURN ON U.S. DENOMINATED ASSETS
    - 1. OUR RELATIVELY HIGH INTEREST RATES HAVE BEEN  
PRIMARY CAUSE OF INFLOW
    - 2. ON THE SURFACE, IT MIGHT APPEAR THAT OUR  
CONSUMPTION OF FOREIGN GOODS CREATED THE LARGER  
HOLDING OF DOLLARS BY FOREIGNERS
      - A. CERTAINLY OUR PURCHASES GAVE THEM DOLLARS
      - B. BUT UNLESS THEY WERE WILLING TO HOLD,  
EXCHANGE RATE WOULD HAVE DECLINED
        - (1) JUST THE OPPOSITE OCCURRED

C. NET RESULT

1. FOREIGN INFLOW HELPED TO FINANCE ECONOMIC  
EXPANSION OF 1983 AND 1984

A. WOULD NOT HAVE ACHIEVED THESE RESULTS WITHOUT  
FOREIGN CAPITAL

2. OFFSET THE DRAINS ON DOMESTIC PRIVATE CAPITAL  
MARKETS FROM FINANCING THE LARGE GOVERNMENT  
DEFICITS

3. AND INFLOWS HAVE MAINTAINED OUR CURRENT  
CONSUMPTION

4. BUT CERTAINLY NOT OUR OUTPUT

D. DONE SO AT A SIGNIFICANT COST

1. TO U.S. EXPORT FIRMS

2. AND DOMESTIC FIRMS UNABLE TO MAINTAIN SALES IN  
OUR MARKETS BECAUSE OF FOREIGN COMPETITION

3. AND SOME OF THE LOSSES MAY BE PERMANENT

- A. AS FIRMS SHIFT PRODUCTION OFF-SHORE RATHER  
THAN BUILDING PLANTS HERE
- B. FOREIGN FIRMS HAVE STRENGTHENED THEIR  
COMPETITIVENESS IN OUR MARKETS
- C. THESE ARE PRETTY PERMANENT CHANGES
- 4. MAY INDEED HAVE DAMAGED OUR "REALIZABLE OUTPUT"  
POTENTIAL FOR SOME TIME
  - A. MEANING SLOWER U.S. GROWTH FOR THE NEXT FEW  
YEARS
- E. DO NOT WANT TO IMPLY THAT CAPITAL INFLOWS ARE  
NECESSARILY BAD - DEPENDS ON THE USE
  - 1. INDEED, IF INFLOWS ASSIST IN EXPANDING OUR  
CAPACITY AND IMPROVING PRODUCTIVITY
    - A. THEN WE CAN ULTIMATELY PAY BACK THE  
"BORROWINGS"
      - (1) GENERATES DEBT SERVICING CAPABILITY

- B. AND STILL HAVE HIGHER ECONOMIC GROWTH AND  
IMPROVED ECONOMIC CIRCUMSTANCES
- 2. BUT, UNFORTUNATELY, THE INFLOW OF CAPITAL HAS NOT  
ALWAYS RESULTED IN EXPANDED CAPACITY AND  
PRODUCTIVITY
  - A. THEY HAVE FINANCED, IN PART, OUR DEFICITS TO  
MAINTAIN CURRENT CONSUMPTION NOT INVESTMENT
  - B. IN FACT, THE HUGE FISCAL DEFICITS RESULTED IN  
HIGHER INTEREST RATES
    - (1) WITH HIGHER YIELDS ON FINANCIAL ASSETS
    - (2) AND ATTRACTED FOREIGN CAPITAL
- 3. I REALIZE THAT THE ARGUMENT THAT THE INFLOWS  
HAVEN'T RESULTED IN CAPACITY AND PRODUCTIVITY  
INCREASES
  - A. MAY SEEM STRANGE, GIVEN WHAT WE HAVE ALL  
HEARD ABOUT THE VERY CONSIDERABLE PLANT AND  
EQUIPMENT INVESTMENTS IN 1983 AND 1984
  - B. AND, IN FACT, THE NUMBERS WERE LARGE



- (1) IN COMPARISON WITH PRIOR BUSINESS CYCLES  
OVER PAST 30 YEARS
  - (2) PLANT AND EQUIPMENT SPENDING GREW MORE  
RAPIDLY FROM THE 1982 FOURTH QUARTER  
TROUGH THAN IN ANY PRIOR CYCLES
  - (3) UP 43% FROM TROUGH; PREVIOUS BEST 36%
4. BUT THESE EXPENDITURES DID NOT INCREASE  
PRODUCTIVITY TO THE SAME EXTENT
- A. CERTAINLY PRODUCTIVITY INCREASED AS WE  
RECOVERED
  - B. BUT THE GAINS IN MANUFACTURING PRODUCTIVITY  
WERE ABOUT IN LINE WITH PRIOR CYCLICAL GAINS
  - C. THUS, THE IMPLICATION IS THAT
    - (1) IN SPITE OF LARGER INCREASES IN  
SPENDING, PRODUCTIVITY INCREASED ABOUT A  
NORMAL RECOVERY PACE

(2) NO EVIDENCE THAT THE CAPITAL INFLOW  
ENHANCED PRODUCTIVITY

(A) WHICH WOULD HAVE BEEN A PLUS FOR  
FUTURE GROWTH

(3) IN EFFECT "CONSUMED" THE IMPORTED FUNDS

(A) VERY SIMILAR TO MANY LATIN  
AMERICAN COUNTRIES THAT WE'VE  
CRITICIZED

5. WE ARE THEN NO BETTER OFF FROM THE CAPITAL INFLOW

A. INSTEAD, WORSE OFF BECAUSE OF INCREASED  
INDEBTEDNESS OF FOREIGNERS

B. WITHOUT AN ENHANCED ABILITY TO REPAY SO THAT  
DOMESTIC CONSUMPTION AND INVESTMENT CAN BE  
MAINTAINED

VIII. THE EXCHANGE MARKETS WILL OPERATE - THE ADJUSTMENT WILL  
OCCUR

A. ALREADY ON THE WAY TO A LOWER DOLLAR

1. OBVIOUS THAT COSTS OF HIGH EXCHANGE VALUE OF THE  
DOLLAR CANNOT CONTINUE
    - A. NOT ACCEPTABLE
  2. BUT AS NOTED EARLIER, ADJUSTMENT TO LOWER DOLLAR  
WILL NOT BE AN EASY ONE
- B. DIFFICULT TO FORECAST WITH ANY CLARITY
1. BUT IN ANY CASE THE NET IMPACT OF A DECLINING  
DOLLAR
    - A. WILL BE HIGHER PRICES AND HIGHER INTEREST  
RATES
    - B. SHIFTING OF PRESSURES FROM THE EXPORT  
INDUSTRIES TO THE INTEREST-SENSITIVE  
INDUSTRIES
  2. THE ESTIMATES OF THE IMPACT ON PRICES AND  
INTEREST RATES ARE ROUGH AND THE SUBJECT OF MUCH  
DISPUTE - ALTHOUGH EVERYONE AGREES ON DIRECTION
    - A. THE MOST COMMON ESTIMATES SUGGEST THAT

(1) A 20% DECLINE IN THE DOLLAR FOR TWO  
YEARS MIGHT RAISE INFLATION TO 7% OR  
HIGHER - ABOUT DOUBLE CURRENT RATE

(2) THAT INTEREST RATES COULD RISE BY AS  
MUCH AS 5%

B. IF THESE ARE IN THE BALLPARK

(1) WE'RE IN FOR A SLOWDOWN IN OUR RATE OF  
ECONOMIC GROWTH

(2) AND RENEWED INFLATION

3. AND THESE ARE ESTIMATES OF A SMOOTH TRANSITION

A. IF THE DOLLAR PLUMMETS - MARKETS DON'T ADJUST  
EASILY

(1) RATE INCREASE RATHER SUDDEN

(2) TRAUMA IN THE MARKETS

C. IN TERMS OF THE IMPACT ON OUR LONG-TERM "REALIZABLE  
OUTPUT" OR OUR POTENTIAL

1. IMPOSSIBLE AT THIS STAGE TO IDENTIFY AT ALL  
CLEARLY
2. BUT OUR LONGER TERM POTENTIAL COULD BE DAMAGED
  - A. BECAUSE OF LARGE FOREIGN DEBTS WE WILL HAVE  
TO RUN A LARGE TRADE SURPLUS IN ORDER TO  
SERVICE THE EXTERNAL DEBT
  - B. MAKING IT MORE DIFFICULT TO MAINTAIN DESIRED  
BALANCE OF CONSUMPTION AND INVESTMENT
  - C. IN OTHER WORDS, INVESTMENT NECESSARY FOR  
INCREASING PRODUCTIVITY MAY REQUIRE REDUCED  
DOMESTIC CONSUMPTION
    - (1) IMPLICATIONS FOR STANDARD OF LIVING
    - (2) HAVEN'T BEGUN TO THINK ABOUT

IX. ALL OF THAT IS THE GOOD NEWS - NOW THE BAD: THE FEDERAL  
DEFICIT

- A. NOTED EARLIER THAT THERE WERE TWO UNUSUAL ASPECTS TO  
CURRENT ECONOMY

1. NOT ONLY INTERNATIONAL TRADE DEFICIT BUT DOMESTIC  
FISCAL DEFICIT AS WELL
  
2. TWO ARE VERY INTER-RELATED
  - A. FEDERAL BUDGET DEFICIT ONLY
    - (1) ADDS TO TOTAL FINANCIAL NEEDS
  
  - B. GIVEN THAT DOMESTIC SAVINGS INADEQUATE TO  
FINANCE
    - (1) PRIVATE INVESTMENT AND
  
    - (2) GOVERNMENT DEBT
  
  - C. BALANCE MUST BE MADE UP BY THE CAPITAL INFLOW  
FROM INTERNATIONAL MARKETS
  
3. UNDOUBTEDLY HEARD MORE THAN CARE TO ABOUT DEFICIT
  - A. ESPECIALLY SINCE CONGRESS HAS NOW ACTED ON  
BUDGET RESOLUTION FOR THE NEXT FISCAL YEAR
  
  - B. BUT NOT AT ALL CONFIDENT THAT AS SPENDING  
BILLS WIND THEIR WAY THROUGH CONGRESS

(1) THE CUTS, WHICH WERE DISAPPOINTING, WILL  
HOLD UP

C. WE SIMPLY MUST HAVE SIZEABLE AND SUSTAINED  
REDUCTIONS IN FEDERAL DEFICITS

(1) AS THE DOLLAR DECLINES, IF WE ARE TO  
MINIMIZE THE COSTS

(2) CUTTING THE DEFICIT REDUCES THE NEED FOR  
FOREIGN CAPITAL AND THUS REDUCES THE  
PRESSURE ON INTEREST RATES

(3) INCREASINGLY THE DEFICIT WILL HAVE TO BE  
FINANCED IN THE DOMESTIC MARKETS

(A) THE IMPACT ON INTEREST RATES ~~HUGE~~

X. CONCLUSIONS

A. HAVE TO ADMIT - A DISTURBING PICTURE

1. CAN'T ELIMINATE THE NEED FOR ADJUSTMENT

A. WE'VE GOT A GREAT MANY ADJUSTMENTS TO MAKE

(1) AGRICULTURE; LCD EXTERNAL DEBTS

2. ONLY CAN TRY TO MAKE THE ADJUSTMENT IN THE LEAST  
DAMAGING WAY
- B. OVER THE NEXT FEW YEARS
1. LIKELY TO SEE LOWER RATE OF ECONOMIC GROWTH
    - A. AND PROBABLY WON'T BE SMOOTH
  2. NO REASON TO ARGUE YET THAT OUR POTENTIAL GROWTH  
IS LOWER
    - A. BUT CURRENT AND PROSPECTIVE "REALIZABLE  
OUTPUT" MAY BE
    - B. AND COULD BECOME LOWER IN LONG RUN IF BUDGET  
DEFICITS REMAIN
    - C. TO SAY THE OBVIOUS, THE FISCAL DEFICIT IS THE  
CRITICAL ISSUE - REALLY THE LINCHPIN TO OUR  
FUTURE ECONOMIC PERFORMANCE
- C. HAVING OUTLINED A GLOOMY SCENARIO
1. PEOPLE USUALLY EXPECT SOME SOLUTION



- A. BUT REALLY DON'T HAVE ONE IF WE ARE UNWILLING  
TO ADDRESS THE FISCAL DEFICIT
- 2. AS I'VE EMPHASIZED, THERE IS NO EASY SOLUTION
  - ~~A. BUT NEED TO CONSIDER POLICIES AND STRATEGIES  
TO SMOOTH THE ADJUSTMENT~~
- ~~3. IMAGINATIVE THINKING ON WAYS TO STIMULATE  
INVESTMENT AND ENCOURAGE SAVINGS~~
- 4. MAY ALSO BE NECESSARY TO TAKE ACTION ABROAD
  - A. WE NEED CONTINUED PRESSURE ON BARRIERS THAT  
INHIBIT THE EXPORT OF OUR PRODUCTS
  - B. MORE EXPANSIONARY MONETARY AND FISCAL  
PROGRAMS BY MAJOR INTERNATIONAL COUNTRIES
    - (1) PROVIDE BETTER MARKET OPPORTUNITIES FOR  
OUR PRODUCTS
    - (2) REDUCED PRESSURE ON THEIR MANUFACTURERS  
TO EXPORT TO THIS COUNTRY

D. BUT THESE CHALLENGES - THOUGH SEEMINGLY PRETTY  
FORMIDABLE

1. ARE NOT NEW, GO ON CONSTANTLY
2. WE HAD TO ADJUST TO RISING RATES OF INFLATION IN  
1970S - PRETTY SCARY
3. THEN TO DECLINING INFLATION RATES IN EARLY '80S -  
AND THE RIPPLE EFFECTS OF THIS WILL CONTINUE
4. NOW THE HUGE INTERNATIONAL IMBALANCES LOOM VERY  
LARGE - AND WE WILL HAVE TO WORK THROUGH THIS  
ADJUSTMENT
5. LOOKS AS THOUGH THIS IS GOING TO BE A CHALLENGING  
PERIOD FOR ALL OF US

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