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Remarks by

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I was naturally greatly honored when Burt Malkiel asked me to take part in this tenth anniversary celebration -- and maybe a little intrigued as well. I am after all a graduate of both the Woodrow Wilson School at Princeton and the Harvard Graduate School -- now the Kennedy School -- of Public Administration. What an opportunity, I thought, to convey to you here as you approach adolescence a little wisdom from your elders about how to go about educating people for public service, and who knows the day might come when you would find a President to name it after.

On second thought -I decided to forego the lecture. There is not in any event any settled wisdom or clear tradition on how to go about the job of preparing men or women for the public service. In that context, it focuses the mind to start fresh, and Yale took a quite different approach.

As I understand it, you took off from the simple proposition that management is management, and there is a common core of concerns and required knowledge among those working in large organizations, public or private. In doing so, the School has had to pioneer in developing new disciplines and particularly in combinations of disciplines. Pioneering is always hard and risky.

The immediate reward is a special sense of challenge and excitement. And with your success, you have already added a new dimension to the educational scene.

So I am delighted to salute all of you who have participated in this enterprise on this birthday and your unique contribution to the educational process.

I speak with some feeling about Yale's commitment, as part of the management program, to prepare men and women for a career in government. In one sense, to most young people, that's where the action has <u>not</u> been. But it also seems to me the area where help is needed. And I suspect that's where Yale can and is, out of the healthy competition in educational philosophies, making a unique contribution.

I have the reputation of worrying too much about where the economy is headed, about inflation, about the financial system. I won't apologize about that -- there is in fact plenty there to keep us concerned. One of the things I don't worry about is whether there are attractive opportunities for newly minted MPPM's -- or even lowly MBA's -- in private business. But my concerns do extend to whether we are, as a nation, attracting and keeping a fair share of the best and the brightest at work on the public's business.

However much it is fashionable to rail at government and the bureaucracy, we are not going to deal effectively with our problems without good and able people willing to serve, and equipping them with the educational tools they need.

I've been in government in one capacity or another so long that I almost consider myself part of the career service. I know something of both the satisfactions and the frustrations.

And I sense that for many young people the frustrations seem greater, and the satisfactions less, than I felt in the 1950's and early 1960's.

There are a lot of reasons. After World War II, there was a special sense of opportunity and challenge for Americans. Government was looked to for indispensable leadership in leading a war-torn world to lasting peace and economic recovery. Government service seemed a specially honorable profession, there was so much to do, and many young people wanted to be part of it. Much of that spirit was still strong in the heyday of the New Frontier.

And, not so incidentally, in those days no one was dangling Cabinet-level salaries at new graduates of prestigious law schools or suggesting that traders or deal makers on Wall Street might get a million dollar bonus in their 20's.

Things are different today. Too often politicians run against, and run down, government in general and the federal career service in particular. Senior civil servants see their real income compressed. Probably as important, their responsibilities are curtailed as more and more political appointees are made four or five levels down in departmental hierarchies. Government _is_ more complicated. That itself can breed frustration when the need to coordinate everything with everything else becomes a recipe for inaction.

However one ranks or appraises the causes, it seems to me evident that, despite the evident exceptions, the reservoir of talent in the government at large is growing thin. That is a dangerous situation for any government -- and any country.

We can endlessly debate the proper bounds of governmental activity. But, of course, there is a central, indispensable core that can't be abandoned -- defending the country, conducting foreign policy, adjudicating disputes, making economic policy, and providing, paying for and managing those services that any civilized society demands. There is now, and always will be, the potential for enormous challenge and excitement in participating in that process at every level of government.

To put it in the language of an economist, the potential demand for talent is clearly there. But unlike those graphs in the textbooks where the supply curve rises to meet demand, somehow a gap remains. We are settling for less than the best.

A lot has to be done to change the situation, much of it beyond the responsibility and scope of any educational institution. But it does seem to me our leading universities can and must play a crucial part. That is why I am particularly glad that the Yale School of Management has risen to the challenge, joining in its own way my Alma Maters. And as one who by now has spent most of his working life in the Federal Government, I can at least testify, for all the difficulties, I would not have wanted to do it differently.

But government is not all of life, and I'd like to turn to some economic issues where government and private enterprise, by their nature, need to play complementary roles.

This decade of the 1980's got off -- to put it mildly -- to a rocky start. Record inflation, a deep recession, record interest rates, soaring oil prices, high unemployment and low productivity. This month, in contrast, we can mark four years of economic expansion. The rate of inflation is lower than in many years. Ten million more people are employed than in 1980, the stock market is near record highs and interest rates are down.

If that sounds like part of a political campaign, don't be misled. There is also, for good reason, a pervasive sense of uneasiness, a sense that all is not economically secure. Important sectors of the economy are in distress -- agriculture and energy. Manufacturing output has been sluggish. Even with the evidence of strains in the financial system, we continue to pile debts on debts at a record rate. And over the past two years, the overall rate of economic growth has slowed appreciably in the United States to about 2-1/2 percent, and it has been little better in the rest of the industrialized world.

When we are importing almost 70 percent more than we are exporting, and when the Federal Government is spending 25 percent more than its revenues, it doesn't take sophisticated economic analysis to suggest something is out of kilter -- common sense is quite enough. Or, if you are not convinced by those statistics, let me point out that since the end of 1984, the increase in consumption expenditures in the United States has actually been greater than the total increase in the GNP -- I'm not talking about the percentage rate of growth, I'm talking about actual dollar expenditures.

To put it another way, investment has not been increasing, we are saving less and relying more on borrowing abroad, and the great growth industry (apart from Wall Street) has been importing. If all that sounds as though we are living beyond our means, well that's my conclusion, too.

The obvious question is what to do about it. More specifically, we want to go about it in a way consistent with preserving all those good things that have happened: economic growth, progress toward price stability and higher employment.

In broad outline, what is required seems clear enough. Some significant steps have already been taken. Moreover, I think there is a substantial intellectual consensus, here and abroad, about how to proceed. But there are also large obstacles to translating that consensus into concrete, effective, and sustained progress extending over several years.

For one thing, we are by far the largest economy in the world, and what we do inevitably affects the world economy as a whole. Most obviously, <u>our</u> external trade deficit is <u>other countries</u>' surpluses; our foreign borrowing is a sizable fraction of their savings. As a consequence, if our policies are to be successful, there is a plain need for complementary policies among leading countries abroad.

Too often, that simple analytic point is seen abroad in divisive <u>political terms</u> -- the United States asking other countries to extricate us from our problems. But what is really at stake is the health of the world economy.

Another hazard is that the domestic political process generates demands for immediate and direct responses to perceived problems that may, in fact, be counter-productive. A classic case arising again and again in history is the urge to deal with inflationary forces by imposing price controls. Today, the threat is an inward looking protectionist reaction to a world increasingly, and irretrievably, committed to economic and financial interdependence.

The common perception that our huge trade deficit can't be sustained and is damaging to the health of the American economy is certainly correct. But one of the oldest lessons of economics and international politics alike is that simply cutting off imports by huge increases in tariffs or arbitrary quotas can't be a constructive answer. We would feel the economic effects promptly in higher prices and less competition, even if others did not retaliate. We have had a small taste of that already as a result of compromises made to a liberal trading order. But there is a large difference -- a difference in kind -- between reluctant compromises to ease one pressure point or another and a turn toward sweeping protection as a matter of national policy. That kind of approach could only breed retaliation elsewhere, damaging the world trade system in an atmosphere of mutual recrimination conducive to neither economic prosperity nor political harmony. Among the first victims would be developing countries already extremely hard pressed to restore growth and maintain financial equilibrium, with direct consequences for our own exporters and financial institutions.

Perhaps the greatest difficulty in making broad generalizations about the appropriate direction for economic policy, is that we neglect and underestimate the practical difficulties of translating those prescriptions into action, both for us and for our trading partners.

Let me illustrate some of the "sticking" points. There has by now been a major realignment of the value of the dollar relative to most other industrialized countries, with declines ranging to about 40 percent against the yen and the German mark. That realignment has been generally accepted as an essential part of an effort to restore a competitive balance to the world economy, and a necessary base for greater growth in exports and restraint of imports. But, in terms of the impact on the U.S. economy, exchange rate changes of that magnitude are not unalloyed joy. There are inevitable pressures on our own price level associated with a depreciating currency and higher costs for imports, complicating the job of maintaining reasonable price stability.

Equally important, we have to recognize that, like it or not, as a nation we remain heavily dependent on a massive flow of funds from abroad. There is no other way at present to bridge the enormous gap between our low savings and the combined demands placed on our capital markets by the federal deficit and our investment needs. Experience demonstrates that at some point -- and that point is heavily dependent on confidence in the prospects for the U.S. economy, its stability, and its policies --

a depreciating currency can undercut incentives for that capital inflow. Among other things, the pattern of lower interest rates would be placed in jeopardy.

Looked at from the perspective of other nations with appreciating currencies and trade surpluses, the export industries that have been so important in stimulating their own growth find themselves under pressure. That is an inevitable and necessary part of the adjustment process. But the clear danger is that, without offsetting adjustments elsewhere in their economies, their own growth prospects will suffer. That's no more in our interest than theirs, given the need for buoyant markets for our exports.

That is why policymakers in the United States have emphasized the need for countries with appreciating currencies and declining export prospects to sustain domestic sources of growth. My own feeling is that -- despite all the real political sensitivities that are raised -- there is indeed a high degree of understanding on that point. Nevertheless, doubts and questions remain. Will the strong performance of the German economy during recent months carry forward into 1987 and beyond? In Japan, where a slowdown in growth has been pronounced for some time, will recent initiatives in monetary and fiscal policy be adequate?

Answers to those and similar questions are naturally matters of judgment, not certainty. What is clear is the need for maintaining close and continuous consultation among major countries so that those judgments can be made in the light of all the circumstances. There is a common judgment that exchange rates are reasonably close to a broad competitive equilibrium among major countries. Secretary Baker and Japanese Finance Minister Miyazawa recently suggested that is now the case with respect to the important yen-dollar relationship, and, provided growing markets are open to us, that may well be the case more broadly.

The relevant question today seems to me not how much further, if at all, the dollar might decline, but what kind of policies and approaches are necessary to complement what has already happened in the exchange rate area. And there may be a danger that in talking about the responsibilities of others in that respect, we don't emphasize enough our prime responsibility to put our own house in order.

One aspect of that is we have to be prepared to live with a smaller net flow of savings from abroad -- with, in fact, no net inflow -- if we are to eliminate our trade and current account deficits. Today, with a budget deficit remaining in the neighborhood of $180 billion for the current fiscal year, we must count on some $150 billion of foreign money to help balance the demands on our domestic financial markets. Under the circumstances, we are hardly in a position to complain if some of that money is reflected in foreign purchases of some of our large and proud companies and intense competition for our financial institutions.

Moreover, as we look ahead, there is no experience or analysis that would suggest that the existing imbalance in our domestic sources and uses of funds will be substantially corrected by a higher rate of domestic savings. We cannot reasonably contemplate closing the gap by reducing already sluggish investment. I see no escape from the remaining possibility -- reducing the budget deficit.

That analysis is, by now, so familiar and widely shared I need not linger on the point. Actually achieving the needed progress is the rub.

Resolving that situation will remain a matter of high national policy -- or low politics, depending on your taste -- for years to come. Meanwhile, there has been much less discussion of another related challenge more directly for business enterprise and business management.

Let me set out a few numbers to make the point. Suppose, we succeed in balancing our trade account in five years -- an improvement of about $150 billion. Assume, too, that that change has to be accomplished almost entirely in manufactured goods -- that essentially changes in agricultural and oil trade balance out, which is probably optimistic.

The implication is that our manufacturing output will have to rise about 15 percent to close the trade deficit, on top of normal growth of say another 15 percent to meet the needs of a growing domestic economy.

Now that's not an impossible job by any means. But it implies a much more rapid growth in industrial production -- maybe about 5 percent a year -- than we have sustained for a long time. And that growth has to be concentrated in new products and advanced products where we can have an edge in world markets. As things now stand, we are not investing in industry at a rate to support that growth. To the contrary, we seem to read more reports of capacity reductions than the reverse -- not exactly surprising when we look back at the trends of the past five years. And I wonder if business planning and business psychology are really tuned, even now, to the need to export.

On the other side, there is quite a lot going on that is encouraging. Industry does have costs under better control than in many a year. Productivity is improving in manufacturing, if not elsewhere in the economy, and we are slowly learning to live with price stability. As a result, we have had virtual stability in prices of goods for a couple of years.

The question I pose is whether we can maintain and build on that performance when demands for manufactured goods are rising strongly, or will the gains once again be dissipated in rising prices. And the related question is whether management can and will seek out and exploit the new competitive opportunities here and abroad made possible by better aligned exchange rates.

I don't know right now whether that challenge sounds so exciting today as making paper deals on Wall Street or using all one's ingenuity and talent to defend a client's interests. But I suspect the way we meet the challenge will have a lot more to do with the basic health of the American economy and the American nation.

It also seems to me directly relevant to the concerns and responsibilities of a place like the Yale School of Management.

Productivity, efficiency, technology, competitiveness, salesmanship -- we only kid ourselves if we think we can build a growing economy without excelling in those areas. No manipulation of economic policy, no change in exchange rates, not even eliminating those budget deficits, can be a substitute, essential as they may be.

In that sense, all of those at work to bring better methods of management are in the front lines of economic policy. I have no doubt that will remain so on your 20th anniversary, and the years beyond.

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