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THE ECONOMY AND AGRICULTURE IN THE 1990's*

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It is a particular honor and privilege for me to be here addressing the Department's Outlook Conference. Agriculture has been and remains an important part of the American economy and the world economy. Indeed, agriculture will be one of the major issues we will be discussing in the Uruguay Round of the GATT. But it is also a particular honor for me to appear on the same podium with Clayton Yeutter who has made tremendous contributions to this Administration as well as to previous ones. He is doing a spectacular job as Secretary of Agriculture.

Although I am not a specialist in agricultural economics, I am well aware of the importance of agriculture and agricultural policy in overall economic developments in the U.S. and the world. As Chairman of the Council of Economic Advisers to the President, I have a keen interest in Government policies toward agriculture. While today I am going to leave the task of commenting on the agricultural outlook primarily to others, I am going to discuss the general economic outlook for the United States and the world economy and talk about the general principles of economic policy the Administration supports and how they apply in today's world.

First, the U.S. economic outlook remains strong. The American economy can, should and will, I believe, sustain its economic growth. We are in the 84th month of the second longest expansion in the history of the United States.

Tomorrow morning the Commerce Department will report its revised estimate of the third-quarter GNP growth. Its original estimate of 2.5 percent is probably going to be revised up a bit. While we have been forecasting all year long that the very end of 1989 and the beginning of 1990 will be a little more sluggish, we do expect the economy to pick up in mid-1990 and in 1991 to grow at a more robust pace. We believe that the economy will continue to make substantial progress in simultaneously creating additional jobs and maintaining low unemployment and relatively low and gradually falling inflation. We reject the notion that the only way to keep inflation under control is to run a slack economy for a sustained length of time. We have ambitious goals--but realistic ones--for the American economy.

We are in the midst of preparing our economic forecast, which will appear, amongst other places, in the Economic Report of the President in late January or February and in the Budget of the President in January. It is unlikely there will be major changes from our mid-session economic forecast, because

*Based on a transcript

the economy has performed quite close to what we predicted, growing in the 2 to 2.5 percent real growth range. Inflation, which increased somewhat in the beginning of the year primarily due to a blip in energy prices, appears to have stabilized, and we believe that will continue. And the economy continues to provide enough new jobs to keep unemployment rates at the low levels we have not seen since the early 1970's.

A variety of people disagree with our outlook of sustained growth and relatively low unemployment and controlled and gradually reduced inflation over the next several years. Others believe the economy will grow more robustly. We are in the midst of trying to develop new Administration initiatives and repropose some that Congress did not pass which we believe will help expand productivity, entrepreneurial activity, investment and, thereby enhance economic growth. There are some people, some private forecasters, who believe the economy is going to slow more than the slight slowing we expect for the next few quarters. But even the most pessimistic private forecaster does not see any severe slowing of the economy. The most pessimistic forecasts call for only a few quarters of slightly negative growth, followed by a rebound in the economy later in 1990. We believe those forecasts are quite pessimistic.

There are a variety of reasons we believe the economy is capable of sustaining growth, controlling inflation and providing rising employment. All episodes of severe downturns in our economy in the post-World War II era have been preceded by an acceleration of inflation. Except for a blip up in the early part of 1989 in energy prices and a collapse of energy prices in 1986, we have kept inflation relatively steady in the 4 or 4.5 percent range since the early 1980's. And while we can and need to do better than that over time, we have not seen the kind of inflationary pressure that requires draconian action, which in the past has often led to a decline in economic activity.

There are always risks to the economy, there are always potential problems, and we believe the risks are about symmetric: that we are just as capable of better growth as we are of more sluggish growth than what we are currently predicting. We also believe it is important to understand that many factors govern the performance of the economy. For example, there can be external shocks, positive or negative. An example of a negative external shock to our economy was the Arab oil embargo of the 1970's which transferred wealth from the United States to OPEC, contributing to the 1974-75 recession. Alternatively, the economy can turn down because of a policy mistake. We do not see any policy mistakes on the horizon. We believe a continued monetary policy towards sustaining growth and controlling inflation, further progress in reducing the budget deficit, the avoidance of unnecessary regulation, and further progress toward freer and fairer trade will serve us all well in the years ahead. Of course, you only recognize a policy mistake after the fact. Examples of those that turned out bad were the Smoot-Hawley Tariff that worsened and deepened the Depression, and the tax increase and the Federal Reserve tightening that occurred after the stock market crash of 1929.

There are also a variety of other things that could cause the economy to get out of whack. A typical one is an inventory imbalance. Inventories build up and many sectors of the economy simultaneously choose to reduce their production and orders to get inventories back under control. While we have seen a little inventory buildup in the economy, it has been primarily concentrated in automobiles and it does not appear to have been spread widely throughout the economy. This is another reason we believe the economy will continue to sustain its moderate growth for the next few quarters, then rebound to more solid growth in the latter half of 1990 and 1991.

Because the outlook for the overall economy is good, the outlook for agriculture bodes well also. The gradual decline in inflation we expect implies that interest rates should move down gradually. Our proposed reductions in the Federal budget deficit should help lower interest rates. And lower interest rates will help the agricultural sector continue its recovery from the financial difficulties of the mid-1980's.

There are exciting market opportunities going on all around the world, which I am going to leave to Carla and Clayton to discuss. But we have opportunities to reduce trade distorting barriers, and we have opportunities to open new markets for agriculture.

I want to say a word or two about the economic achievements of the current expansion to place it in some perspective. I have said we are in the 84th month--7 years--of economic expansion. Some people interpret that as meaning because the expansion is long, it must end soon. Nothing could be further from the truth. There is no statistical relationship between the length of an economic expansion and the probability of a downturn. This expansion didn't die when it became the longest post-war peacetime expansion, but it has continued for a year and a half longer. No one can say we will never have another recession. But just because the expansion is long it needn't soon "run out of gas," or "run out of steam," or "have a crash landing." Indeed, with all due respect to my colleague, Sam Skinner, our Transportation Secretary, I am getting a little tired of these transportation analogies for the economy!

I have said that I believe the expansion can, should and will continue and I have given a hint of the kinds of things that might cause it problems--an inadvertent policy mistake, an external shock or some imbalances. We do not have any of those brewing, in my opinion, but I am the first to admit those kinds of problems are easier to see after the fact than beforehand.

Longer term, we believe the economy is capable of growing at around 3 percent after inflation, or a little better. Achievement depends heavily on adopting policies to enhance our productivity growth, to enhance research and the commercialization of that research and to expand investment and improve education and the like.

In the context of this outlook, the Administration has also developed a set of economic principles. They are similar to--not necessarily identical with--those of the Reagan Administration. There are four major areas of economic policy, let me say a word or two about each. Since there are an infinite number of economic decisions and economic policy issues you may be concerned about, if I say a word or two about our general philosophy and principles in each, you will have a way of figuring out how we are likely to develop policy in each area.

First, we support a monetary policy which sustains economic growth while predictably controlling inflation. That is quite feasible and doable. We also support a gradual reduction in the budget deficit along the guidelines of the Gramm-Rudman-Hollings targets that will help take pressure off interest rates. It will give the Fed a little more elbow room, and it should provide some extra saving for investment by decreasing the Federal Government's drain on our modest private saving pool.

We want to avoid unnecessary regulation, deregulate where desirable and possible, as we have just done with natural gas at the well-head. And where regulation is necessary and desirable, we want to do so in a manner that gives the firms and the workers involved the maximum flexibility to achieve any necessary standards or targets or social goals at the least cost and the least economic disruption. If you look at our clean air proposal and some other proposals, we have tried in some novel new ways to harness the power of the marketplace and reduce the cost of achieving any given set of regulatory goals. I think you will see more of the same when and if we decide that regulation is desirable or necessary in other areas.

Finally, let me say a word about trade policy. We remain committed to helping lead the world to freer and fairer trade. We are working hard in the Uruguay Round of the GATT to bring 15 areas, including agriculture, into the GATT. You will hear more about that later. We take this very seriously. It is highly important to successfully conclude this most ambitious round of the GATT. Maintaining a free and open world trading system is vital to our economic prosperity, the economic prosperity of our trading partners, and the economic prosperity and potential of the developing economies. We have serious trade tensions. We need to work hard to remove them. There are various countries that don't always play fair, and we have been criticized ourselves in that regard. We are going to need to work hard to open markets both here and abroad to both the flows of goods and capital.

Those are our economic principles. We are trying to implement them on a daily basis as we make economic decisions. Let me also tell you that one of the things that has been most educational for me in my first year in Washington is the enhanced appreciation for the difficulty of making various decisions. Many of the decisions we make, whether dealing with macroeconomic policy, the budget, agriculture, or clean air are multi-faceted. Economic costs and benefits are important components, but sometimes other dimensions like the environment or foreign policy can loom large also. It is only the person in the Oval Office who can balance all the important considerations.

Finally, I want to tell you an apocryphal joke about transitions. After President Carter took over from President Ford, he asked Ford for advice on how to be a better President. President Ford handed President Carter three envelopes. The first said open only in case of emergency; the second, only in the case of a disaster; the third, only in case of a catastrophe. When the inflation rate accelerated from 4 percent to 8, 9 and 10 percent in the late 1970's, that looked like an emergency. President Carter opened the first envelope and it said, "Blame the Federal Reserve."

Things got worse. We had a run on the dollar, inflation accelerated, and it looked like a disaster. So President Carter opened the second envelope and it said, "Blame Me."

Well, things got worse. President Reagan won the next election. And so President Carter opened the envelope. It said, "Prepare Three Envelopes." All I can tell you is that with talented people like our Agriculture Secretary and our U.S. Trade Representative and with all of your help and your hard work, we will all be making sure that President Bush isn't preparing three envelopes in 1992.

Thank you very, very much.