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Since 1981, it has become fashionable for Republicans to praise the incumbent President for all the good things that happen in the American economy while he is in office. Simultaneously, Democrats have been attacking the occupants of the White House for all the negatives that have arisen. Both approaches share a common shortcoming: they implicitly credit government and especially the presidency with awesome powers over the economy. But our private enterprise system derives its strength from the fact that most decisionmaking is decentralized.

Under these circumstances, I will attempt to undertake a more modest assignment—to provide a window on the American economy and in passing to comment on government policy during the Bush Presidency.

The Reagan Legacy

I find it instructive to describe the conditions under which Ronald Reagan's presidency ended as a necessary prelude to evaluating more recent developments. Any claims to impartiality on my account are very weak. I readily confess some participation in and responsibility for the early development of Reaganomics.

Reaganomics was the most ambitious reform effort in the United States since FDR's New Deal. Its legacy is a fascinating mixture. It is an economy that contains lower inflation and higher budget deficits, less unemployment and larger trade deficits, fewer strikes and more

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government jobs, the deepest recession in half a century and the longest peacetime recovery ever.

Clearly, serious economic problems arose during the early- and middle-1980s. They continue to bedevil the American economy. But it is also heartening to note the positive "demonstration effect" that results from virtually simultaneous attempts in both the United Kingdom and the United States to reduce the heavy hand of government. Witness the recent spread of market-oriented economies in various parts of the globe, including some unexpected quarters such as the command economies.

The Bush Presidency

Not surprisingly, George Bush assumed the Presidency in a lower key than Ronald Reagan did eight years earlier. Unlike 1981, there was little desire to undo the policies of his predecessor. George Bush's administration has been focusing much of its attention on incremental changes in the budget. To those who still believe that government budgeting is a green eyeshade activity occupying the attention of accountants and statisticians, I recall the statement of England's great Prime Minister William Gladstone:

> Budgets are not mere matters of arithmetic, but in a thousand ways go to the root of prosperity of individuals, and relation of classes, and the strength of kingdoms.

The good news is that the Bush administration and Congress have jointly attempted to wrestle seriously with the huge federal budget deficits. That has been obscured by the messy way in which the decisions were reached. There is no need, however, to endorse each and every part of the recent budget compromise. Personally, I would have preferred far more emphasis on cutting spending and less attention to tax increases.

What is noteworthy is that there was little debate over the need to reduce those awesome deficits. Rather, the serious deliberations focused on specific tax increases (e.g., on gasoline) and specific spending programs reductions (e.g., in medicare). The bad news, as cynics will quickly point out, is that, with all of the public grunting and groaning, the deficit continues to rise. The combination of savings and loan bailouts and a weak economy are pushing the annual borrowing requirement to the neighborhood of $300 billion. Fiscally that is a rough neighborhood.

Moreover, the advent of the first recession in eight years is hardly a time to extol the economic policy of a sitting president. Please note that I use the "R" word (recession) without equivocation. Of course, the recently ended record-long expansion had the key attribute of the talking dog: the amazing feature was that it existed at all. I see no need for flagellating ourselves over the end of the recovery. If anything, the unusual length of the expansion is cause for some celebration. Without downplaying the pain that arises during downturns in the economy, I believe that it is useful to look across the valley to the next recovery. There are many reasons for long-term optimism.

Looking Across the Valley

Admittedly, economic forecasting today requires a special blend of heroism. In addition to analyzing trends in the economies of many nations, it is necessary to make a prognostication concerning military actions in the Persian Gulf and elsewhere in the Middle East.

For example, a successful conclusion to the Middle East crisis would bolster business and consumer confidence substantially and thus contribute to a stronger economic expansion. If the economic embargo and political standoff continue, however, the upturn likely will be more moderate, as would the Federal Reserve's response to a soft economy. Of course, an extended shooting war would force forecasters—including this intrepid economist—back to the drawing board.

In the division of labor for this conference, I have been asked to concentrate on matters beyond the current business cycle. In that spirit, I would like to focus on five key factors which make for continuing long-term strength in the American economy. In a burst of nonpartisanship, I am not assigning President Bush exclusive responsibility for these positive trends.

1. The Transition from Cold War to Hot Peace

Recent events in the Middle East underscore the stubborn fact that, even if the Soviets continue their more peaceful pursuit of foreign relations, we still live in a dangerous world. Moreover, despite the buildup of forces in Saudi Arabia, the pace of military contract awards in the United States continues downward. Layoffs by defense contractors are rising.

In the short-term, the reduction in jobs for scientists, engineers, and other skilled technicians is painful—to the individuals directly involved, their families, and their communities. But the prospect, after an initial adjustment period, of the return of these vital resources to the civilian economy is a positive development. It will provide the opportunity for investing these high-powered resources in productivity-enhancing activities. The shift from defense to civilian markets will reenforce another strategic but much less dramatic change that has been occurring.

2. The Shift to Private Sector Research and Development

A careful reading of the statistics yields a surprising crossover. We all know about the massive military buildup in the United States in the early- and middle-1980s. Supposedly, the Pentagon has been hogging America's scientific and technological talent. However, that is not what the data show.

In each year since 1981, the amount of money spent by the private sector to finance research and development has exceeded the R & D outlays of the federal government, including the massive military disbursements. The long-term implications of this crossover are striking. For the entire post-World War II period, through the 1970s, the federal government was the primary decisionmaker on R & D activity in the United States by virtue of choosing the majority (by dollars) of the projects to be undertaken and by selecting those who would do the work.

Over the past decade, in contrast, private industry has become the primary voice. A majority of the R & D now performed in the United States is sponsored by business to meet its needs and, ultimately, consumer demands. Although we cannot pinpoint the specific results, it seems reasonable to anticipate that the 1990s will witness improved production processes and a heightened flow of new products. All this will serve to enhance the productivity and competitiveness of American civilian industry.

3. The Restructuring of American Business

In response to both foreign competition and domestic takeover threats, a great many American companies have restructured and streamlined their operations during the last several years. Simultaneously, they are giving new attention to the quality production of the items they sell. The upshot is a reduction in the cost of producing goods in the United States. A substantial depreciation in the value of the dollar since 1985 has reenforced this trend and made American goods more competitive.

4. The Second Renaissance of Western Europe

The economic integration of the European Community by the end of 1992 (EC '92) is a mixed blessing for the United States. Of course, industrialized nations are the best customers of other industrialized nations, such as the United States. However, the European Community is becoming a more inward looking economic area. I am scrupulously avoiding pejorative terms such as Fortress Europa. Nevertheless, the evidence is clear. Back in 1960, the great bulk (over 60 percent) of the foreign trade of the twelve nations now in the EC was with other nations. Currently, the ratio has been reversed. Sixty percent or more of the foreign trade of the EC-12 stays within the EC. The economic integration being carried out should accelerate that trend.

From the viewpoint of the United States, the movement toward EC '92 will produce winners and losers on both sides of the Atlantic. Some of the strong U.S. firms with established presences in the EC will do well. Quite a few European companies, no longer protected by national trade or regulatory barriers, fear this new competition. More virulent competition is expected from the larger, better-capitalized, higher-tech U.S. firms who have more experience in selling to continent-wide markets.

On the other side of the Atlantic, many American firms believe that a variety of barriers—such as reciprocity and domestic content restrictions—will hurt their exports. Our friends in the EC tell us not to worry, that those trade restrictions are aimed at Japan. We Americans don't know how good their aim is. We do know that, if the Asian rim exporters are kept out of Western Europe, their major alternate market is North America.

Speaking of losers from EC '92, a great many small- and medium-size American companies are unprepared for another wave of imports. Their unanticipated new competitors are likely to be the larger and more productive European companies who will be enjoying economies of scale in serving the expanding EC marketplace. It is sad to note that less than half of all American companies have even heard of EC '92. Of those who have, only a modest portion have established strategic plans to respond, either offensively or defensively.

In the larger perspective, we can anticipate that—like Japanese competition in the auto market—a more virulent band of European competitors will force American companies into another round of productivity-enhancing actions.

5. The Asian Rim May Be Moving Closer to Us

My last point is admittedly the most conjectural. The Asian rim nations have raised their per capita GNPs by focusing on business investment at the expense of docile consumers who suffer the high price of such items as rice and beef. Now pressures are rising in those nations to share the fruits of economic growth more widely. A shift in favor of consumers should open up new opportunities for imports.

The Asian rim nations could easily establish themselves as the most rapidly expanding marketplace for North American and European goods and services in the coming decade. Asia's population is estimated to grow by about 240 million during the 1990s. This dramatic increase in labor-force potential, coupled with Asia's advanced technology and work ethic, would also increase its productivity. In turn, that trend would generate both greater consumer purchasing power and stronger business competitors.

To sum up—neither Congress nor Parliament has outlawed recessions. They could not do so even if they wanted to. From the viewpoint of the United States, short-term problems should not cloud the economy's bright long-term skies. Our current difficulties, albeit serious, are not fundamental. So much of the communist and socialist world is moving towards freedom and the competitive marketplace in which private enterprise can flourish. The model they have in mind is the United States and also the United Kingdom. We must be doing something right.