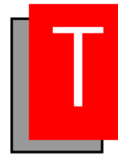
Settling Into a Sustainable Pace of Economic Growth

Lawrence S. Davidson

Professor of Business Economics & Public Policy and Director, Global Business Information Network, Kelley School of Business, Indiana University, Bloomington

he world suffered an economic slowdown in 1999 but the United States economy powered ahead, almost entirely unscathed by the lingering effects of the Asian crisis. Though the demand for U.S. goods and services from abroad did slow in 1999, any resulting decrease in external aggregate demand was more than compensated by a healthy increase in domestic consumer and business spending.

On the eve of the new millennium, the U.S. economy is strong, but set to return to a slower and more sustainable pace of growth. As we move closer to the New Year, we find interest rates moving up and equity prices stabilizing. There is speculation that the Federal Reserve will increase interest rates again in the near future. As the economies of our trading partners continue their recoveries from the Asian crisis, they should also attract more foreign investment-money that temporarily flowed in record amounts into the U.S. in 1999. In short, expected domestic monetary policy and world financial flows in the coming year could lead to financial conditions that will rein in spending and growth.

The upshot is that we expect GDP to increase by 2.8% in 2000, considerably slower than the 4 percent plus rate that prevailed over the past three years. The unemployment rate should be little changed, averaging 4.3% for the year. Other highlights of the 2000 outlook include:

- GDP inflation of no greater than 2%
- An employment increase of more than one million jobs
- A modest deterioration of the U.S. balance of trade in goods and services
- Short-term interest rates rising to 5.5%
- Interest rates on long-term treasuries approaching 7%
- Housing starts down to 1.56 million units
- Indiana nominal income growth of 4.7%
- Indiana job growth of 25,000 jobs
- Indiana exports growing by nearly 10%

Y2K: The U.S. Economy at the Millennium

R. Jeffrey Green* and Willard E. Witte**

**Associate Dean, Research and Operations, Kelley School of Business, Indiana University, Bloomington*
***Associate Professor of Economics, Indiana University, Bloomington*

The final years of the old millennium will go down as one of the most remarkable and impressive periods in United States economic history. Since the end of the last major recession in 1982, real GDP growth has averaged 3.5 percent per year, well above the 2.9 percent per year rate recorded in the preceding seventeen. Once the great recession of 1980-1982 was completed, only one very short recession was recorded in the next seventeen years, an achievement unprecedented in the more than 150 years over which recessions have been measured.

The good news goes far beyond real economic growth. The unemployment rate has generally fallen over the period to low levels not seen in decades. Inflation, which had been particularly severe in the 1970s, has also generally fallen from near double-digit levels to less than two percent per year, a level generally consistent with the notion of price stability. This development is all the more remarkable, and frankly unexpected, because it accompanied swift economic growth and a declining unemployment rate.

The three major keys to these positive economic trends are the emergence of a truly global economy, the fall of Communism, and the explosion of technology, particularly in communications and information processing. These trends are related. The new forms of communication helped bring about the fall of Communism, as did the emergence of a world economy. The fall of Communism in turn accelerated the globalization of industry.

A few statistics give a feel for the strength of these events. Globalization can be measured in a variety of ways, but one simple measure is the share of constant dollar exports in constant dollar GDP. This ratio rose from 6.7 percent in 1982 to an estimate of 12.9 percent in 1999 as real exports grew at an average rate of 7.6 percent per year, making exports one of the key engines of economic growth.

Likewise, the fall of Communism has led to many changes. One of the most dramatic has been the opportunity for the Federal government to reduce defense expenditures. Right after the Gulf War in 1991, defense expenditures were 6.1 percent of GDP.