Efficiency and Competition: Is the U.S. Handicapped?

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What are businessmen saying about the internationalization of markets and what questions do they ask? Clearly, they first say that the dollar is too strong. Why? Because it undermines their competitiveness. Every businessperson in this country realizes that all the effort, all the hard work, all the technical advances any well-run company can put together in a year can be wiped out by exchange rate changes in a week.

It's a monumental, back-breaking effort for any kind of company to achieve a 10 percent improvement in efficiency, yet a 10 percent change in the exchange rate in a week is rather ordinary these days. And so exchange rate changes outweigh anything that can be done in the company to improve competitiveness. U.S. business people are at the mercy of these unpredicted and unpredictable movements in this important currency relationship, and they feel threatened and vulnerable.

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Market share can be lost because of the change in competitiveness, particularly in Third World markets where the loss is permanent. In fact, there's a fear of irreversibility among U.S. businesses, a fear that a prolonged period of overvaluation of the dollar permanently undermines the nation's position even after the exchange rate adjusts back to more reasonable levels.

The theory behind that is simple. During the period when the dollar is overvalued, foreign companies make profits that are plowed back into their businesses. In particular, these profits go toward increasing market share. Our businessmen have a sense that we've done permanent damage to America's export capacity by tolerating this long period of an overvalued dollar.

Obviously, that high dollar also pulls in imports artificially, and many companies believe this trend to be both undesirable and possibly irreversible. Of course, the extent and permanence of the impact depend on the particular product.

Finally, businessmen complain, perhaps a little less legitimately but still with quiet forcefulness, that a prolonged period of overvaluation undermines the profitability of their otherwise well-run operations abroad. If the dollar goes to sky-high levels, common sense says that if you have an operation in Belgium or Germany, earning Belgian francs or German marks, then those profits are not worth as much. Considering the extent of American companies with major world-wide operations—and Coca-Cola is probably as good an example as you can name—earnings are undercut and the shareholders' wealth is hurt when the exchange rates get away from the fundamentals.

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Such complaints, many of which I feel are legitimate, did not change policy thinking in Washington significantly until about two months ago.

Another category of complaints from American businesspeople stems from the concern that foreign exchange rates are too volatile—that not only are the rates wrong, but that they fluctuate too much. Excessive volatility makes planning impossible. It's difficult to go through an elaborate planning mechanism, since scenarios must be based on certain exchange rate assumptions. Abrupt rate changes can wipe out those plans instantaneously. In such an environment, the planning process becomes less credible and, really, not very effective.

A broader, more practical complaint that we hear from a lot of chief executive officers is that volatile exchange rates tempt a company to start playing around in the financial markets when it should be concentrating on production. Managers start thinking that the driving force in a company's profitability is not what it produces, but what the cash advantage may be. The sense of superficiality worries the top leaders of American business.

Finally, an allegation tied in with most complaints is that trade is unfair. Of course, trade is unfair in many ways, and one businessperson's unfairness is another's opportunity. You have to view this with a certain amount of discretion. But clearly there is no level playing field in international trade, and I don't think anybody familiar with international business will claim that one ever existed.

Open and Closed Cases

Certainly, there is a broad appreciation by businessmen and women the world around, that the U.S. market is the most open. You can go to Malaysia, you can go to Greece, you can go to Chile, and you ask businesspeople to name the world's most open market, and generally they answer the United States.

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There is no argument about this; it is a reality. The question remains, however, precisely where we stand in the openness spectrum. Just look at the statistics. I recommend a booklet called *Japan 1985, An International Comparison,* which is chock-full of interesting and useful statistics. It makes a strong case against Japan's unfair trading practices. It points out that 84 percent of Japanese-made wrist watches are exported as are 78 percent of microwave ovens. The figure is lower

for bicycles, only 13 percent. Japan exported $33 billion worth of motor vehicles in the most recent year for which they have data, and imported only $619 million worth of vehicles. That's a pretty dramatic picture, although I will grant that the structure of economics can be different. For instance, the Japanese still look at the share of manufactured goods imported into Japan as a share of total imports, excluding oil, which means you'll see that Japan's ratio is only 47 percent. If you do the same calculation for Germany, which doesn't produce any oil either, the number rises to 73 percent.

I would argue, even to businessmen who don't want to hear it, that Japan's trade restrictions themselves are not our fundamental problem. The Japanese system of "zaibatsu" involves setting up administrative roadblocks to new products. Every U.S. company has a war story about trying to sell something in Japan that Japan did not manufacture when we were trying to penetrate the market.

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All of those war stories seem to have the same ending—our manufacturers were stalled until the Japanese companies were able to develop and manufacture a similar product. By that time, we had lost the advantage of timing. And so we encountered delay, administrative distortion, all of the little things we do not handle well. Such obstructions are difficult to quantify, yet they occur frequently.

Even if we eliminate all of Japan's direct and indirect controls, our problems will not end if the exchange rates are wrong. Japan will have incentives to import more—but not necessarily from the United States. Even if Japan cancelled all of its controls on beef, how much beef would be imported from the United States at 250 yen to the dollar? None. Now at 180 or 190 yen to the dollar, which we're not too far from now, American producers would get a real crack at additional beef sales, if Japan removed those controls. So, things go hand in hand. Sophisticated businesspeople realize these days that we must deal with exchange rates before we start talking about trade practices.

Businessmen and women also know that Europe is not exactly "Simon Pure." Italy, for example, does not import Japanese cars. That diverts much of the Japanese effort to the world's most open market for cars, which happens to be our nation's. We see the world is interrelated in various ways.

Finally, and probably most fundamentally, our business community is perplexed and dazzled by the opportunities and the worries concerning less-developed countries (LDCs). There are many kinds of LDCs, but all of them boast lower labor costs than the United States. And that's a reality every American business must confront.

Flocking to Foreign Shores

Many major U.S. companies, with wide-scale publicity, have set up subsidiaries and manufacturing facilities in low-wage areas because they feel they must do it. A cold-blooded economist would say they are right—that there is no God-given right for the American worker, performing the same task with similar skills and possibly less education, to earn 10 times as much as a Korean worker.

The economist will also say that, as the Korean worker becomes more productive, his standard of living ought to rise. That should offer opportunities for other businesses to sell to the Korean workers more furniture for their new houses and all of the other things that a rapidly growing productivity and standard of living should afford. But that's not happening.

The newly industrialized countries of Asia have not expanded their demand as fast as they've expanded their exports. Thus, we have a major, and I think dangerous, problem dealing with the trading practices of what you might call the step-children of Japan.

Other groups of LDCs, particularly in Latin America, are in the throes of an adjustment process that puts us on hold in the short term.

It's hard to lecture Brazil, for example, about the openness of its markets and its receptivity to U.S. products at the same time Brazil is desperately trying to earn foreign exchange to repay the banks because it borrowed too much. There is no easy way of handling such situations, I think the best way to cope is to spread out that debt burden. The second best way is to force down U.S. interest rates.

The Budget Deficit

That brings us to the final problem—and I think the U.S. business community is increasingly aware of its importance. In trying to cure our international trade problems and put ourselves on a more solid international footing for the next 15 years, we have to cut the federal budget deficit.

That huge deficit represents a tremendous drain on our limited savings capacity and is a major factor in keeping interest rates high. In turn, this becomes a primary reason for the overvalued dollar. In order to set things right and put the American business community in a fair position to compete, we must bring that budget deficit down.

That won't solve the problems of Japan's unfairness, which we'll have to keep working on, probably for many years to come, but if we do not start by correcting our homemade problems, we lose any leverage to change their policies, too.