THE SOUTHEAST IN A GLOBAL ECONOMY
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Good afternoon! I'm pleased to be involved in this forum on the Southeast's role in the international economy. From my position as one who represents our region in discussions of national monetary policy, this annual conference is one of the most gratifying developments in our area. It demonstrates the admirable desire of business and civic leaders in Alabama and its neighboring states to keep in step with one of the most important trends in recent history—the American business community's rising consciousness of the global market in which it competes.

This growing economic interdependence can bring great benefits to all the world's citizens, but it also places certain demands upon us. Today I'll talk about both these aspects of our internationalization—or should I say re-internationalization—as they affect us in the Southeast. First, I'll show how international developments will be reflected in the general outlook for the region's economy. Then I'll turn to one of the demands placed upon us by changes in the world's economic environment, and that is the requirement that we resume our traditional defense of open markets in the face of a rising tide of protectionist sentiment.

Outlook for the Nation

The main factors that will determine the economic prospects for the nation as a whole will also be evident in the Southeast in the year ahead; so we'll take a quick look at the national outlook before narrowing our focus to our own region. I look for GNP to expand once again at a rate of 2 1/2 percent or even a bit faster this year. The first quarter rise of 4.3 percent is not likely to be sustained since much of that growth was a buildup in inventories. Given this expectation, it is difficult to project an unemployment rate for 1987 much better than the current 6.6 percent, since the number of new jobs will probably just keep pace with the number of people who want them. Inflation, however, should accelerate from last year's average pace of less than 2 percent as measured by the consumer price index to 4 or even 4 1/2 percent in 1987.

The importance of international developments to our domestic economy is driven home in the outlook for 1987. The higher prices in my forecast--an increase that is faster than even in 1985—are in large part due to international developments. These include not only the stabilization of oil prices but also the rise in other import prices, which as of the end of last year were up 8 percent. The international sector is also critical to the outlook for GNP growth. I look to the foreign trade front to provide the stimulus that will maintain our moderate growth rate. The other major components of GNP—consumption, investment, and government purchases—don't look all that strong.

An improvement in the U.S. international sector is expected for two reasons. One is the decline in the value of the dollar in foreign exchange markets. While this factor works with a lag, the dollar has been declining for two years now and we have begun to see an impact: In fact, exports began picking up in real terms in the last 3 months of 1986 while imports flattened. In the first three months of this year, real net exports—the change in exports less that in imports—improved by $13.8 billion. The second is the fact that we cannot keep increasing our borrowing from abroad indefinitely. For some time now we have been spending more on consumption, investment, and government than we actually produce domestically. The substantial expansion of the federal budget deficit has contributed to this situation. To meet our aggregate demands we have been importing far more than we export and borrowing from abroad to finance these imports. Of course, this cannot go on forever. Our creditors may become less willing to lend, and, just as any borrower eventually learns, debt service inevitably rises along with the debt and becomes a burden. So the time has come to start repaying. While GNP or national output will grow at about the same rate in 1987 as it did last year, more of that increase in output will be exported and less of it will be available for domestic use. However, even if overall consumption does not increase much, gains in production to meet greater demand for American-made products should help us achieve the moderate rate of growth I foresee.

Outlook for the Southeast

The satisfaction of more demand domestically, together with another positive development—the recent stabilization in energy prices—would help those areas of the country most dependent on mining and manufacturing. These developments would foster a greater balance among economic sectors and regions of the country than we have experienced in the last several years. More balanced growth would be especially welcome news to certain parts of the Southeast, which includes not only prosperous and fast-growing localities like Atlanta, Nashville, and most of Florida but also weak or even depressed places such as Louisiana. Stabilization of the energy sector will be especially important to Louisiana and parts of Mississippi, both of which have been adversely affected by last year's sharp fall in oil prices. There is at least reason to hope that things will not get any worse even if they don't get much better any time soon. Along with the energy sector, agriculture will be a lingering area of weakness in the Southeast, not only during 1987 but perhaps for several years to come due to continuing imbalances between supply and demand. At least the effects of the drought that devastated much of the Southeast last summer should be largely behind us.

Aside from the effect of macroeconomic factors like energy prices, the Southeast's growth is heavily influenced by some unique regional factors. Probably the most important of these is population growth, or more specifically in-migration. Continuing inflows of people and corresponding gains in employment and personal income are major reasons for the more rapid growth of Florida and Georgia. Expectations of continued growth nationally suggest that movement to the Southeast will persist, since most people who want to relocate will be able to sell their homes elsewhere. In addition, the dollar's decline should have a positive impact on another kind of in-migrant—a temporary one, namely the tourist. Florida attracts more overseas visitors than any other state and, as you know, large numbers of Canadians visit Florida. A lower dollar translates not only into more visitors from other countries but also a shift to more domestic travel by Americans. Tourism tends to stimulate demand for services and trade in much the same way as permanent population growth. Thus, tourism will help boost job creation, especially in the service and trade areas, thereby contributing to an expected increase of about half a million new jobs in the region's total employment in 1987.

Construction—the other population-driven economic sector—will not, however, do as well as one might expect, given the anticipated amount of population expansion. Single-family housing may continue to expand, but multi-family building along with construction of offices and retail space is likely to be weak. The reasons for this apparent anomaly are the tax law changes. These were necessary since tax changes in 1981 had overstimulated construction to the point where many local markets in the Southeast are substantially overbuilt and need time for all the new space to be absorbed.

On a more positive note, improvements in the trade balance nationally would spell good news for many southeastern manufacturers who have been subject to either intensified import competition or greater difficulty in marketing abroad for the past few years. One particular problem that has slowed improvement in many industries here was the dollar's failure to depreciate against major foreign competitors such as Canada and the newly industrializing countries of the Pacific rim. Consequently, the Southeast's important forest products industry continued to be battered by Canadian softwood; the same has been true of apparel makers who compete with clothing manufacturers in Taiwan, Korea, and Hong Kong. Fortunately, this situation has finally begun to show some progress. In recent months the new dollar index, developed by economists at the Atlanta Fed in part to measure the differential impacts of currency changes on particular regions and industries, has indicated that the dollar is on a downward trend relative to most of these currencies. However, the margin of decline is still quite small. Thus, the amount of improvement in some traditional southeastern industries—and those areas dependent on them—may not be very dramatic even though on average the region will continue to outpace national growth.

Protectionism

In this environment it is tempting to seek easy and immediate solutions to prop up faltering industries and the communities that depend on them. However, the Southeast, along with the rest of the nation and even the rest of the world, could end up much worse off in the long run (and much sooner) if we opt for one of the quick fixes currently gaining support, namely, protectionism. I'd like to examine this concept with you and explain why I consider it a serious threat despite the degree of support it has seemingly mustered among the American people and some of our leaders in the past few years. My reasons can be expressed in terms of the effects of protective trade barriers in the marketplace, in the workplace, and on the international stage. In the market place, protectionism raises consumer prices and limits choice. In the workplace, it creates distortions by attempting to save low value-added jobs at the expense of other, more productive jobs. On the international stage, it evokes retaliatiatory measures that in sum could wreck the world's economy as it has in the past.

Let's look at the marketplace effects first, since every one of us is affected by higher consumer prices. In an open market, consumers benefit from the competing efforts of several companies that produce and market similar products because the prices of each are held to their lowest profitable level. When foreign products are made artificially expensive by tariffs, the test of market discipline is eased for American producers. Imported goods now cost consumers more, and even domestic prices for the same items often rise because there is less competition driving them down. Another form of import barrier is the quota. Quotas serve not only to raise prices but to limit the variety of goods available as well. In the case of quotas like those imposed on cotton cloth imports or "voluntarily" accepted by the Japanese auto industry, foreign manufacturers are able to take advantage of the basic law of supply and demand when supplies of their products are artificially limited. They often respond by narrowing exports to the more expensive items covered by the statutory limits and raising their prices. In this way they make up much of the difference and even increase profits. Here at home we are left with fewer selections and ones that cost more. Even if they don't make such substitutions, our choices as consumers are limited to some extent by the quotas. The cumulative effect of elimination of competition through these and other types of non-tariff barriers like subsidies and local content requirements are considerable. A recent government study estimates that if all existing tariffs and quotas were removed, the benefits to our economy would be nearly $13 billion per year. That's a rather hefty amount in itself, but one might be willing to pay it if doing so could preserve American jobs. However, if we turn to the effects of protectionism in the workplace, we will find this is not the case.

It is true that certain manufacturers have been forced to lay off workers after being hurt by foreign competition. In our own region, the apparel industry comes immediately to mind. Plants have closed across the Southeast as retailers have turned to cheaper products from outside the country, and in particular from the newly industrialized countries of the Pacific rim--Taiwan, Hong Kong, and Korea. The protectionist argument is that relatively cheap labor in those countries constitutes an unfair advantage, one that could and should be remedied by discriminating against countries that discourage the organization of trade unions, have no minimum wage, and otherwise "deny worker's rights." I would remind advocates of this tactic that trade unions and laws which place floors under wages emerged in our own country only when industrialization had reached a level of maturity that allowed the economy to support them. I believe that the interests of labor will be better served in those countries too as their economies grow, but it is inappropriate for us to attempt to impose the organizational forms of an industrialized nation on developing economies.

It should also be pointed out that the apparel industry is one that we have protected with tariffs and quotas for some time through the multi-fiber arrangement, and that protection did not stem the loss of jobs. The reason? Apparel is an industry that has always thrived upon low wages because it is labor intensive. In the late nineteenth and early twentieth centuries, apparel companies relocated from northern states to the South in search of cheap labor. Many of them are now repeating that process abroad, where relatively lower cost structures enable them to turn a profit. It's folly to think that stemming the tide of imports will also staunch the flow of U.S. multinational firms abroad, where they can earn higher profits by lowering their costs. Thus protectionism will not solve the problem of job losses in certain industries where the comparative advantage we once had has eroded. If we still want to keep the factories at home, the textile industry's approach is the best example. By substituting capital for labor, fabric and carpet producers were able to turn record profits last year. Not every industry lends itself as readily to automation, but we should be able to do better than we have done lately in applying technological advances in industries that could benefit as the textile producers have. This won't save jobs, of course, since more efficient producers need fewer workers to produce the same output. Those that are left, however, can earn legitimately higher wages—because they are more productive. As for those who are displaced, there are other remedies that are less costly—and dangerous—than protectionism, and I'll get to these in a moment.

Before I leave the employment issue, I want to point to another facet that is often overlooked, namely that protecting jobs in one industry can lead to losses in another. For example, one estimate put at over 14,000 the number of retailing jobs that would have been lost in the South alone had the President not vetoed the 1985 textiles and apparel trade bill. By blunting competition, tariffs cause prices to rise and so hurt retailers. Thus from the viewpoint of the larger economy, protectionism is like cutting off our nose to spite our face. Aside from costing at least as many—probably more—jobs than it saves, protectionism robs our economic system of one of its great advantages, the continuous process of change that makes industry responsive to the needs of consumers. By keeping capital and labor resources in noncompetitive industries which survive only because they are propped up by trade barriers, we choke off the creation of potential new firms, industries, and jobs.

Aside from protecting jobs and whole industries from import competition, some advocates of protection feel we need to use such measures as a bargaining chip to open foreign markets for U.S. exports. They point out that Japan, Taiwan, and the European Economic Community have measures in place which pointedly discriminate against our products and cause us righteous indignation. Lest we appear self-righteous, however, we should examine our own practices to see if we are free from using such devices ourselves. Tariff rates are on average somewhat lower than those of our trading partners, but these duties are unevenly applied from sector to sector. Apparel products are probably protected at an effective rate over three to four times higher than the average U.S. tariff, for example. U.S. farm products are also heavily subsidized, so much so that current projections of higher agricultural exports are based largely on the effects of subsidies. Countries that export such products might well claim they are at a disadvantage against their American competitors in our markets because they are so heavily protected. What's more, we have a range of non-tariff barriers like subsidies, quotas, licensing requirements, safety inspections, "buy-American" provisions, and variations on these themes.

These types of trade-distorting measures can lead to great costs on the international stage, where protectionism guarantees more protectionism. This arises from both internal and an external dynamics. Internally, our political process is such that when the pet industry of one congressman is protected, industries with political clout in other areas begin clamoring for similar preferential treatment. The great disaster of the Smoot-Hawley tariff in 1933 came about as vested interests were added to the list in just this way until in general tariffs ended up at over 50 percent ad valorem. The relative inflexibility of achieving protection through legislation also presents a problem. Even if the country changes its mind, it is very difficult to get a law off the books—once it's passed, we're stuck with it for a while.

Externally, protectionist measures are almost assured of evoking retaliation. In the recent confrontation between the United States and Canada over softwood lumber we saw very specific examples of this process. Were we to slap a duty on their wood, the Canadians were prepared to tax feed corn accordingly. Again in attempting to help one industry, another type of producer entirely removed from the original dispute is threatened. The Smoot-Hawley tariff helped tip the world toward just such a spiral of tit-for-tat maneuvers, and the end result was the collapse of world trade and a lengthy depression. Do we really want to retrace that unhappy course? I firmly believe we have come too far toward internationalization to fail to learn from our past mistakes.

Policy Recommendations

We have seen, then, that arguments for the benefits of protectionism wear thin when viewed from an overall economic perspective. Protectionism cannot save jobs; it costs jobs in non-protected industries and prevents creation of new jobs by robbing resources from potential start-up industries. Protectionism is expensive to the consumer, and, perhaps worst of all, spreads like a communicable disease through the international business community. For these reasons we dare not consider protectionist barriers as viable instruments of international economic policy. Instead, policymakers need to do precisely the opposite and push to diminish trade barriers further in concert with our trading partners.

It is critical for us to continue expanding our vision to include all the opportunities held out by the evolving international order rather than to overreact to the short-term imbalances. Since the end of World War II it has been the strategy of our country to encourage free trade as the sound economic basis for higher living standards in the rest of the world and here at home. That farsighted strategy has borne fruit in forty years of relative peace that is in no small way related to a worldwide standard of living that is much higher than anyone would have predicted at the end of the Second World War. The spirit of cooperation rather than confrontation should continue to inform our relations not only with former enemies but also with the newly industrialized countries.

That does not mean we should forbear from calling on Taiwan and Japan, for example, two nations with extraordinarily high trade surpluses and substantial import barriers, to lower the protective walls which make it impossible for many of our goods and services to penetrate their markets. Nor should we refrain from pressing in the upcoming round of GATT talks for the general agreement to be extended to cover service industries like insurance, hospital management, and data processing—potentially some of our most profitable exports. With direction from GATT and continued pressure on our part, intellectual properties also could be better protected so that, along with earnings from our books and musical compositions, American research and development efforts—an extremely valuable and undercompensated export—might be returned to us together with the inflow of products they inspire. However these pressures should be exerted through the skillful dialogue of negotiations, not through the monologue of protectionism. I believe that through persuasion our trading partners will assume more of their own responsibility for keeping the exchange of goods and services, together with labor and capital, as unrestricted as possible and remove at least some of the pressure from us.

Aside from direct steps to open markets, foreign governments could adjust their domestic economic policies. In particular, other advanced industrial economies need to rely less on exports and more on domestic demand. Japan and West Germany could stimulate their economies by accelerating tax cuts and implementing a generally more expansive fiscal policy. Not only would fiscal stimulus relieve the high levels of unemployment now prevailing there, but it would also make more money available for consumption of both imported and domestically manufactured goods.

If I have been somewhat critical of Japan and Germany for dragging their feet on easing fiscal policy, I must also emphasize that we have been far too slow ourselves in correcting the intemperate fiscal policy that has contributed in no small measure to the very problems the protectionists purport to address. Government borrowing to finance the deficits of the early eighties pressed beyond the ability of American citizens, with their relatively low rate of savings, to carry the debt. This pushed interest rates to a level that made government securities attractive to foreign investors. The subsequent scramble for dollars to buy our dollar-denominated assets eventually made our currency so expensive relative to others that our goods lost price competitiveness on foreign markets. In order to maintain the momentum I see building toward a turnaround in international trade, we in the United States need to sustain the attack on federal budget deficits.

Other government efforts that would help the economy adapt to competition rather than avoid it could be aimed at education. From our elementary and high schools to our colleges and on into the business community, Americans must acquire the familiarity with international conditions that translates into greater sensitivity to foreign markets. We must find ways to sell as aggressively in outside markets as we do at home, and this means becoming more familiar with other cultures, learning to speak the languages of foreign purchasers, and interpreting their unspoken signals. With Americans' experience in the psychology of marketing, it should be obvious that the product's appeal to overseas consumers is conditioned by subtleties of local taste and custom. Yet we persist in remaining international illiterates, paying much less attention to understanding foreign cultures than foreigners pay to investigating ours. It may be that the loss of our competitive edge that so many mention is due more to our failure to understand others than it is to inefficient production and lack of quality. Finally, legislative bodies could best show their concern for workers who have lost jobs in noncompetitive industries by directing funds toward retraining them. Those parts of the Administration's trade bill that called for programs to assist dislocated workers, including farmers, affected by imports or poor market conditions abroad and a proposed job-training program to help disadvantaged youths were moves in the right direction.

Conclusion

In conclusion, I think that the protectionist sentiment abroad in America today reflects a crisis in confidence and not a crisis in trade. Do we really believe that after leading the world's postwar recovery through its ingenuity and adaptablilty, the American business community, if unaided by protection from its government, will collapse rather than face the challenge of competition? Competition is the essence of the free market and of our system of government. It is probably our favorite leisure pastime--it is something we Americans do well. Let us not fear that we will fail in this moment's challenge any more than we have in the past. Economic forces, especially the exchange rate realignment, are already at work to level the playing field of international trade. It's time for us to take the field and do what we do best: size up the opposition, devise a strategy, and come out ahead.