SOUTHERN COMPETITIVENESS IN INTERNATIONAL MARKETS: THE PERILS OF PROTECTIONISM
Remarks by Robert P. Forrestal, President
Federal Reserve Bank of Atlanta
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Good afternoon! I'm honored to have this opportunity to speak to you the leaders and supporters of the Southern Growth Policies Board. I've worked with some of you on occasion and share your objective of raising living standards in the South through enhancing our economic competitiveness. Many of your latest proposals for accomplishing that goal involve improving education, an idea which again I heartily endorse. Recently, I have found myself involved in an educational endeavor of another kind, one which is not always well-received despite the fact that it aims at promoting the economic viability of the South as well as the rest of the nation. My mission in this case is to help us protect ourselves from protectionism, from the threat to competitiveness which would inevitably arise from avoiding competition with foreign producers. These days free-traders seem to be in the process of becoming an endangered species in our region because some of the South's most important industries—apparel and lumber, for example—have suffered losses as a result of foreign competition. Some southern politicians, along with others hoping for an easy solution to a complex problem, have raised the call to arms for a war on imports, and their alarm has all too often fallen on sympathetic ears. I believe that your sympathies probably lie with mine in opposing such tactics. Still, before I discuss positive steps that might help enhance our competitiveness in international markets, I would like to take a few minutes to examine the roots of this rising protectionist sentiment.

Current Economic Conditions and Near-term Outlook

The roots of this view can be easily obscured by the prosperity we see around us in places like Atlanta, Nashville, and Orlando. The rapid population growth which has favored many southern cities and states brings with it the need for new homes and shopping centers, more doctors and hospitals, more transportation facilities, and a myriad of economic activities that in turn boost jobs and incomes. The influx of new people and businesses is one reason the South has, on average, been outpacing the rest of the nation economically. Looking ahead, this trend is likely to continue.

There is, however, a change on the horizon. The margin between the pace of growth in the South versus the nation seems to be diminishing, and one of the chief reasons is that the outlook for some of the region's basic industries such as lumber is far less bright. It is true that the dollar has declined substantially against the currencies of our major trading partners over the past two years. Indeed, we have experienced two consecutive quarters of improvement in real net exports, and I expect this pattern to continue. The anticipated improvement in the international sector is the driving force engendering continuation of this lengthy economic expansion. As the prices of foreign goods increase here, American-made products become more attractive and manufacturers can increase output to meet greater demand. This development would, of course, affect southeastern manufacturers along with those in other regions.

Unfortunately, the improvement in many industries in the Southeast has been slow. This lag is due to the fact that the chief foreign competitors of locally important industries are in countries such as Canada and the newly industrializing countries of the Pacific rim. Until recently their currencies did not appreciate much against the dollar. 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, at least against the Asian nations. 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 relatively 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 the average the region will continue to outpace national growth, a large part of the south's economic structure is tied to industries competing with developing nations whose cost structures are much lower.

Protectionism

From the point of view of people dependent on these industries it is easy to see why protectionism has such appeal. It represents an easy and immediate solution to a problem that is long-run and structural in nature. These solutions are false, however, and cannot lead to the hoped-for long-term improvement in living standards. Protective trade barriers are detrimental 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 retaliatory measures that in sum could wreck the world's economy the way it has in the past. I'd like to examine each of these spheres in more depth.

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 which 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. 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 such as 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.

The apparel industry is one which 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 is 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 which could benefit as the textile producers have benefitted. This will not 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, while we would certainly commiserate with their situations, it seems rather inconsistent to seek to preserve jobs in low-wage industries to achieve the long-term goal of income growth and economic development. Would it not make more sense to seek solutions of economic growth and development for everyone based on more productive, higher value-added activities?

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 which 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 your nose to spite your 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, though, 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. 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 such as 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 external dynamics. Internally, our political process is such that when the pet industry of one member of Congress 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 on ad valorem basis. 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 which 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.

All of these measures, of course, are national or even international in scope. What can we do here in the South to boost our economy? One public policy approach that would help the region's 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 which 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 the ingenuity and adaptability of the American business community, which led the world's post-war recovery, will collapse rather than face the challenge of competition if unaided by protection from its government? 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 including southerners 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.