TRENDS IN THE GLOBAL ECONOMY

Remarks of Mr. Robert P. Forrestal, President
Federal Reserve Bank of Atlanta
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I. Introduction

Good afternoon! I'm pleased and honored to have the opportunity to speak to my friends and colleagues here at the Southern Center for International Studies about the forces shaping change in the world's economy and the directions in which I think that change will lead us. The existence of this unique institution is symbolic of the most important of those changes, the dramatic shift toward internationalization of markets that is an irreversible--and beneficial--factor in these times. As we become ever more involved in global business, we become increasingly aware of the necessity to think of ourselves as internationalists--not simply out of altruism but on the practical basis of comparative advantage. Comparative advantage works to benefit all participants in the international market by encouraging each country to emphasize production of what it is best able to produce. The resulting efficient use of resources means that consumers ultimately have the widest possible choice of goods and services at the lowest price.

I'd like to talk this afternoon about four elements in this movement toward internationalization that will have profound

EFFECTS ON THE WAY WE DO BUSINESS AND THUS ON THE WAY WE LIVE AS THIS CENTURY DRAWS TO A CLOSE. THESE ARE (1) THE SHIFT FROM NATIONAL ECONOMIES TO A TRULY MULTINATIONAL ECONOMY; (2) CHANGING TRADE PATTERNS THAT ARE PROGRESSIVELY BRINGING TRANSPACIFIC TRADE TO EQUAL PROMINENCE WITH TRANSATLANTIC TRADE; (3) THE LDC DEBT SITUATION; AND (4) THE DAMAGE THAT COUNTRIES WHICH ATTEMPT TO REVERSE THE TREND TOWARD INTERNATIONALIZATION WITH PROTECTIONIST BARRIERS COULD DO TO THEIR OWN AND THE WORLD'S ECONOMIES.

II. THE SHIFT TO A MULTINATIONAL ECONOMY

A. SHIFT FROM MULTIPLE NATIONAL ECONOMIES TO A GLOBAL MARKETPLACE IS OCCURRING RAPIDLY.

B. INEVITABLE RESULT OF DEVELOPMENTS SET IN MOTION AT THE END OF WORLD WAR II

1. AFTER WAR, UNITED STATES ENCOURAGED FREE-MARKET ECONOMIC COMPETITION AS ALTERNATIVE TO THE TYPES OF GOVERNMENT-CONTROLLED ECONOMIC SYSTEMS LINKED WITH THE MILITARY AGGRESSION OF THE AXIS POWERS.

2. THROUGH THE MARSHALL PLAN AND OTHER FORMS OF ASSISTANCE, THE U.S. REBUILT FORMER ALLIES AND ENEMIES ALIKE INTO TRADING PARTNERS.

C. AS TIME PASSED, U.S. CONSUMPTION OF FOREIGN-PRODUCED

GOODS REPLACED AID AS THE LOCOMOTIVE PULLING ALONG THE FREE WORLD'S ECONOMY.

1. THROUGH MUCH OF THE 1960S AND 1970S, AMERICANS SEEM TO HAVE BEEN FOCUSED INWARD ECONOMICALLY PERHAPS BECAUSE QUALITY OF MOST FOREIGN GOODS WAS STILL POOR.

2. BUT IN THE 1980S, OIL PRICES AND THE BALLOONING OF THE TRADE DEFICIT FORCED U.S. BUSINESS COMMUNITY TO RETURN TO THE REALITY THAT EVENTS OUTSIDE THE UNITED STATES HAVE AN IMPACT WITHIN.

D. THE IMBALANCE OF TRADE IN MANUFACTURED GOODS WAS ACCELERATED IN LARGE MEASURE BY U.S. GOVERNMENT FISCAL POLICY--TAX CUT IN 1980 COUPLED WITH AN INCREASE IN DEFENSE SPENDING.

1. FEDERAL REVENUES DIMINISHED RELATIVE TO SPENDING, GOVERNMENT HAD TO BORROW INCREASINGLY TO MAKE UP THE DIFFERENCE.

2. DOMESTIC SAVINGS INSUFFICIENT TO SUPPORT BOTH PRIVATE INVESTMENT AND GOVERNMENT FINANCING.

3. SHORTFALL DROVE UP INTEREST RATES IN U.S., ATTRACTING INVESTMENT FROM JAPAN, WEST GERMANY, AND

ELSEWHERE.

4. ACTIVITY OF THESE COUNTRIES BID THE DOLLAR TO GREAT HEIGHTS AS THEY BOUGHT DOLLARS TO PURCHASE U.S. GOVERNMENT SECURITIES AND OTHER INVESTMENTS.

5. THE RESULTING HIGH DOLLAR MADE OUR PRODUCTS EXPENSIVE OVERSEAS AND SO REDUCED SALES WHILE MAKING FOREIGN GOODS CHEAPER HERE.

6. SOME OF OUR MAJOR TRADING PARTNERS ARE NOW SUFFERING AS THE DOLLAR FALLS.

7. THE REAL WINNERS IN THE DOLLAR'S ROLLER COASTER RIDE WERE THE NEWLY INDUSTRIALIZED COUNTRIES OF TAIWAN, KOREA, HONG KONG, AND, IN OUR OWN HEMISPHERE, BRAZIL.

   A. THOSE NATIONS GAINED INCREASED EXPOSURE FOR THEIR PRODUCTS.

   B. HAVE BEEN ABLE TO HOLD ON TO THE MARKET SHARE THEY BUILT BECAUSE, UNTIL RECENTLY, THEIR CURRENCIES HAD NOT APPRECIATED AS MUCH RELATIVE TO OURS AS HAVE THOSE OF JAPAN AND GERMANY.

E. ANOTHER FACTOR THAT WILL CONTINUE TO PROMOTE MARKET COMPETITION THE WORLD OVER IS THE PRODUCTION OF GOODS BY MULTINATIONAL COMPANIES OPERATING INSIDE FOREIGN COUNTRIES.

1. IT IS ESTIMATED, FOR EXAMPLE, THAT IN 1985 U.S. COMPANIES LOCATED IN JAPAN PRODUCED AND SOLD MORE THAN $53 BILLION WORTH OF GOODS, AN AMOUNT THAT EXCEEDED THE U.S. TRADE DEFICIT WITH JAPAN OF $46 BILLION THAT YEAR.

2. THE MULTINATIONALS ARE THE LEADING EDGE OF GREATER INTEGRATION IN THE WORLD MARKETPLACE

   A. BRING COMPETITIVE FOREIGN PRODUCTS TO MARKET,

   B. ALSO CONTRIBUTE TO THE ECONOMY OF THE COUNTRY IN WHICH THEY ARE LOCATED.

      (1) THIS CONTRIBUTION IS IMMEDIATE IN THE FORM OF WAGES, RENTS, TAXES, AND PURCHASES OF MATERIALS.

      (2) IT ALSO HAS LONG TERM EFFECTS THROUGH THE INTRODUCTION OF ALTERNATIVE METHODS OF MANAGEMENT AND MARKETING.

F. THE INTERNATIONALIZATION OF CAPITAL MARKETS.

1. THE ADVENT OF 24-HOUR-A-DAY TRADING IN COMMODITY, SECURITY, AND CURRENCY MARKETS SYMBOLIZES THE GLOBAL NATURE OF CURRENT ECONOMIC ACTIVITY AT THE SAME TIME THAT IT MAKES FUNDS AVAILABLE IN A VARIETY OF VEHICLES TO ADVANCE THAT ACTIVITY.

2. THE EUROYEN AND EURODOLLAR MARKETS, TOGETHER WITH OTHER FUNDS THAT NOW FLOW EASILY ACROSS NATIONAL BOUNDARIES, PROVIDE POTENTIAL FUEL FOR ECONOMIC EXPANSION NOT ONLY IN THE DEVELOPED NATIONS BUT IN THE THIRD WORLD AS WELL, THOUGH COMPETITION FOR THESE FUNDS WILL BE KEEN IN THE LATTER REGION.

II. SHIFT TO PROMINENCE IN WORLD TRADE OF THE PACIFIC RIM NATIONS

A. OVER THE PAST DECADE, THE SHARE OF U.S. TRADE ORIENTED TOWARD ASIA HAS GROWN FROM ONE-FIFTH TO ONE-THIRD.

B. THE SHARES OF EUROPE, CANADA, AND LATIN AMERICA ALL REMAINED AT ABOUT THE SAME LEVELS OVER THE DECADE, ASIA'S GAIN COMING LARGELY AT THE EXPENSE OF THE OIL-PRODUCING COUNTRIES.

1. INCREASING LEVELS OF QUALITY, ALONG WITH THE U.S. DOLLAR'S APPRECIATION, COMBINED TO ALLOW JAPAN TO

CAPTURE A LARGE SHARE OF OUR FOREIGN PURCHASES.

2. RECENTLY TAIWAN, SINGAPORE, KOREA, AND HONG KONG HAVE ALSO BOOSTED THEIR SHARES AS A RESULT OF THESE FACTORS AND THEIR LOWER COSTS.

3. EXPECT MANUFACTURING TO CONTINUE TO SHIFT TOWARD THE EAST, PARTICULARLY IN LIGHT OF THE FACT THAT THERE ARE EVEN CHEAPER SOURCES OF LABOR--THAILAND AND CHINA--ON THE HORIZON.

C. EUROPE'S SHARE OF U.S. TRADE REMAINED AT A CONSISTENT 24 PERCENT OVER THE TEN YEARS JUST ENDED, AND I EXPECT THAT TO CONTINUE.

1. THE POTENTIAL DANGER EUROPEANS FACE OVER THE LONGER TERM IS THE SELF-INFLICTED ONE OF PROTECTIONISM.

2. EUROPEAN ECONOMIC COMMUNITY RELUCTANCE TO PARTICIPATE MORE FULLY IN RESTRUCTURING TARIFFS WILL, IF PRESENT TENDENCIES CONTINUE, ISOLATE THOSE COUNTRIES MORE AND MORE UNTO THEMSELVES, A DEVELOPMENT THAT WOULD LEAD TO STAGNATION.

D. IN GENERAL, THE RESTRUCTURING OF TARIFFS THROUGH GATT (THE GENERAL AGREEMENT ON TARIFFS AND TRADE) AND OTHER FORMS OF NEGOTIATION WILL PLAY A MAJOR ROLE IN THE

EVOLVING PATTERN OF TRADE.

1. MEXICO HAS JOINED GATT, AND WE HAVE HAD ENCOURAGING SIGNALS OF INTEREST FROM TWO NON-MARKET ECONOMIES, CHINA AND THE SOVIET UNION.

2. A CONSIDERABLE DEGREE OF BALANCE COULD BE RETURNED TO THE INTERNATIONAL TRADE SCENE IF GATT WERE EXTENDED TO COVER SERVICE INDUSTRIES LIKE INSURANCE, HOSPITAL MANAGEMENT, AND DATA PROCESSING--POTENTIALLY SOME OF AMERICA'S MOST PROFITABLE EXPORTS.

3. TO REALIZE THE BENEFITS OF A GLOBAL MARKETPLACE, WE MUST ALLOW THE PRINCIPLE OF COMPARATIVE ADVANTAGE TO OPERATE.

   A. THE UNITED STATES IS CONCEDING THAT LESS DEVELOPED COUNTRIES HAVE A COMPARATIVE ADVANTAGE IN MANUFACTURING MANY OF THE INDUSTRIAL GOODS LONG MADE DOMESTICALLY.

   B. DEVELOPING NATIONS MUST PLAY BY THE RULES OF THE GAME AND ALLOW THE U.S. TO REAP THE BENEFITS OF OUR PRESENT COMPARATIVE ADVANTAGE IN GENERATING IDEAS FOR NEW PRODUCTS AND IN PROVIDING HIGH QUALITY SERVICES.

III. ONE OF THE MOST CHALLENGING ISSUES FACING BANKS, GOVERNMENTS AND INTERNATIONAL AGENCIES LIKE THE IMF AND THE WORLD BANK IS LDC DEBT

A. THIS IS A TRUE DILEMMA BECAUSE THE SIZE OF LDCS' EXTERNAL DEBTS MAKES IT EXTREMELY DIFFICULT FOR THESE COUNTRIES TO REPAY OR EVEN MAKE INTEREST PAYMENTS GIVEN THEIR PRESENT LEVELS OF ECONOMIC GROWTH.

B. THEY ARE, HOWEVER, ALSO IN NEED OF FRESH CAPITAL TO INVEST IN NEW FACTORY EQUIPMENT AND MATERIALS FOR PRODUCTION.

C. THE CREDITOR NATIONS HAVE A STAKE IN BOTH SIDES OF THE DILEMMA.

1. ON THE ONE HAND, THE BALANCE SHEETS OF SOME OF THEIR LARGEST BANKS HAVE SHOWN SIGNS OF STRAIN BECAUSE THEY HAVE BEEN THE MOST VULNERABLE TO NONPERFORMING LOANS TO LDCS.

A. IN THE U.S., FOR EXAMPLE, THE EXPOSURE OF THE NINE MAJOR MONEY CENTER BANKS, ALTHOUGH REDUCED BY MORE THAN A THIRD FROM THE BEGINNING OF THE DEBT CRISIS IN 1982 TO THE END OF 1986, IS STILL AT ABOUT THE AVERAGE FOR all U.S. banks in 1982.

(1) Money center exposure to non-OPEC developing nations as percent of capital: 223% June 1982; 141% Dec. 1986.

(2) All U.S. banks: 149% June 1982; 88% Dec. 1986.

b. Recent Citicorp move to increase loan-loss reserves has been followed by almost all other banks with large exposures.

c. Banks like Morgan Guaranty and Bankers Trust are relatively strong and will probably not be hurt overmuch, but others like Manufacturers Hanover and Bank America could be weakened in the long run.

2. On the other hand, one could argue that the banks in creditor nations along with manufacturers of potential export products industries have a stake in the economic progress of LDCs.

a. Stronger markets in the LDCs would help reduce our trade deficit, since those countries could resume their role as major purchasers of our

PRODUCTS.

B. INCREASED TRADE WOULD IN TURN STIMULATE DEMAND FOR LOANS AND IMPROVE BANKS' BUSINESS.

D. DESPITE THE URGENCY OF THE SITUATION, CURRENTLY PROPOSED SOLUTIONS ALL HAVE WEAKNESSES.

1. BAKER PLAN WOULD HAVE PROVIDED FRESH LOANS FROM BANKING INDUSTRY IN ORDER TO ALLOW SERVICE OF CURRENT DEBT ALONG WITH PURCHASE OF IMPORTS.

A. INSPIRED CONSIDERABLE ENTHUSIASM LAST FALL

B. FALTERED BECAUSE BANKS HAVE NOT SHOWN THEMSELVES WILLING TO COME FORTH WITH ADDITIONAL LOANS.

2. BRADLEY PLAN CALLS FOR WRITING OFF LARGE PORTIONS OF LOANS

A. BUT THIS IS AN ANATHEMA TO THE BANKING COMMUNITY

B. POSES SERIOUS "MORAL HAZARD" PROBLEMS IN THAT THE EASING OF THE DEBT BURDEN MAY MAKE THE LDCs LESS VIGILANT IN INSTITUTING ECONOMIC

REFORMS.

3. DEBT-EQUITY SWAPS ENTAIL CONVERSION OF DEBT TO LOCAL CURRENCY AND SUBSEQUENT INVESTMENT OF THAT CURRENCY IN THE DEBTOR NATION'S INDUSTRIES.

   A. THE MARKET FOR THIS DEBT IS QUITE THIN, HOWEVER.

   B. LDC EQUITY INVESTMENTS ARE INHERENTLY RISKY DUE TO CURRENCY VOLATILITY, INFLATION, FOREIGN EXCHANGE RESTRICTIONS, DANGER OF NATIONALIZATION, AND THE LIKE.

   C. POTENTIAL PURCHASERS OF THE SWAPS ARE LIMITED FOR THE MOST PART TO MULTINATIONALS HAVING OPERATIONS IN THE LDCS--SUCH COMPANIES COULD PROFIT FROM CONVERTING DEBT BOUGHT AT A DISCOUNT TO HOLDINGS DENOMINATED IN THAT LDC'S CURRENCY.

E. ULTIMATELY, IT SEEMS THAT INTERNATIONAL BANKING AGENCIES WILL HAVE TO BE SOURCES OF THE NEW LOANS NECESSARY TO KEEP THE LDCS ON THE NECESSARY GROWTH PATH.

F. RECENT INCREASES IN LOAN-LOSS RESERVES HAVE ACCELERATED A TREND OF LESS PARTICIPATION ON THE PART OF COMMERCIAL BANKS, WHICH IN THE PAST HAVE BEEN THE MAIN SOURCE OF

LENDING TO LDCs.

IV. As weighty a problem as the LDC debt poses, the reemergence of protectionism is perhaps an even more serious problem because it threatens the very existence of the free market as a basis for international commerce.

A. Because it limits the ability of a country's economy to do what it does best, protectionism places artificial restrictions on internal economic development along with the artificial barriers presented to import competition.

B. Protectionsism affects all consumers when the price of foreign goods goes up because of tariffs or when their quantity is limited by quotas.

1. We are left with fewer selections and ones that cost more.

2. One recent study estimates that if all existing tariffs and quotas were removed, the benefits to the U.S. economy would be nearly $13 billion per year.

C. Contrary to the often-heard argument that protectionist policies preserve jobs for one's own countrymen, they do not.

1. ANY PRESERVATION OF JOBS PROMOTED IN THIS MANNER CAN ONLY BE TEMPORARY, SINCE PROPPING UP AN INDUSTRY THAT HAS BECOME INEFFICIENT ULTIMATELY BECOMES AN UNSUSTAINABLE TASK.

2. EVEN MORE IMPORTANT, PROTECTING JOBS IN ONE INDUSTRY CAN LEAD TO LOSSES IN ANOTHER.

   A. FOR EXAMPLE, JUST IN THE SOUTH AN ESTIMATED 14,000 RETAILING JOBS MIGHT HAVE BEEN LOST HAD PRESIDENT REAGAN NOT VETOED THE 1985 TEXTILES AND APPAREL TRADE BILL.

   B. BY BLUNTING COMPETITION, TARIFFS WOULD HAVE CAUSED PRICES TO RISE AND THEREBY HURT RETAILERS WHO WEREN'T INVOLVED IN THE TRADE DISPUTE THAT LED TO THE CLAMOR FOR PROTECTION IN THE FIRST PLACE.

D. ASIDE FROM COSTING AT LEAST AS MANY--PROBABLY MORE--JOBS THAN IT SAVES, PROTECTIONISM ALSO ROBS OUR ECONOMIC SYSTEM OF ONE OF ITS GREAT ADVANTAGES, THE CONTINUOUS PROCESS OF CHANGE THAT MAKES INDUSTRY RESPONSIVE TO THE NEEDS OF CONSUMERS.

E. 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.

F. WORST OF ALL, TRADE-DISTORTING MEASURES CAN LEAD TO GREAT COSTS ON THE INTERNATIONAL STAGE, WHERE PROTECTIONISM GUARANTEES MORE PROTECTIONISM.

1. THIS ARISES FROM BOTH INTERNAL AND EXTERNAL DYNAMICS.

   A. INTERNALLY, WHEN ANY PET INDUSTRY OF A POLITICALLY POWERFUL GROUP IS PROTECTED, INDUSTRIES WITH POLITICAL CLOUT IN OTHER AREAS BEGIN CLAMORING FOR SIMILAR PREFERENTIAL TREATMENT.

   B. THE GREAT DISASTER OF THE SMOOT-HAWLEY TARIFF IMPOSED BY THE U.S. GOVERNMENT IN 1933 CAME ABOUT AS VESTED INTERESTS WERE ADDED TO THE LIST IN JUST THIS WAY UNTIL ON AVERAGE TARIFFS ENDED UP AT OVER 50 PERCENT ON AN AD VALOREM BASIS.

2. EXTERNALLY, PROTECTIONIST MEASURES ARE ALMOST ASSURED OF EVOKING RETALIATION.

A. In the recent confrontation between the United States and Canada the Canadians were prepared to tax U.S. feed corn in retaliation were we to place a duty on their lumber.

B. Again in attempting to help one industry, another type of producer entirely removed from the original dispute is threatened.

C. 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.

V. Conclusion

I have talked about four elements influencing the direction of the global economy. Two of those--the movement toward a truly international economy and the change in trade patterns that is bringing the Pacific Rim nations to greater importance--are constructive. The third, LDC debt, is a challenge that will, I hope, evoke a constructive response from government and banking leaders and lead to greater cooperation in the worldwide business community. The fourth element, protectionism, holds no constructive virtue for the present or the future. It represents a reaction against internationalization which, if unchecked,

COULD RETARD AND EVEN DESTROY PROGRESS IN THE DIRECTION OF GREATER ACCESS TO WORLD MARKETS FOR ALL.

IT IS TRUE THAT WE AMERICANS FACE GREATER COMPETITION TODAY, PARTICULARLY FROM THE NATIONS OF THE PACIFIC RIM, THAN WE HAVE AT ANY TIME IN THE LAST FORTY YEARS. WE SHOULD UNDERSTAND, HOWEVER, THAT SUCH COMPETITION WILL ULTIMATELY IMPROVE OUR OWN LIVING STANDARD FOR THE REASONS I DESCRIBED THIS AFTERNOON. OUR FREE ENTERPRISE SYSTEM HAS LED THE WORLD INTO THIS INTERNATIONALIZED MARKETPLACE. WE CAN BEST CHAMPION THE CAUSE OF AMERICAN INDUSTRY IN THAT MARKETPLACE NOT BY HIDING FROM COMPETITION BEHIND PROTECTIVE WALLS BUT BY WORKING FOR MORE OPEN MARKETS EVERYWHERE.