

**CHALLENGES OF THE GLOBAL MARKETPLACE**  
**Remarks by Robert P. Forrester, President**  
**Federal Reserve Bank of Atlanta**  
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Good morning! It is a certainly an honor to be involved in this business outlook conference. My task this morning is to place the U.S. economic outlook in the context of the global marketplace. The first thing we need to note is that although our economy has always operated within that global context, it has never before been integrated with outside economies to the extent that it is today. Advances in technology and communications allow business transactions in New York to make their effects felt in London and Tokyo almost immediately. The worldwide stock market crash on October 19 of last year perhaps brought this message home more clearly than any event in recent history. It also underscored the fact that while the global marketplace offers unprecedented opportunities for profit, it presents us with risks that we cannot fully anticipate. Some degree of uncertainty pervades every business decision, of course, but the spectrum of variables we face today often seems overwhelming. In order to reduce the risk associated with these variables, we must carefully anticipate and manage those challenges that we can foresee.

I intend to look at three such foreseeable challenges this morning. One is presented by pressures from some quarters to return to a policy of exchange-rate coordination. A second challenge is the absolute necessity to forego protectionism as a substitute for market forces. The third is to address the problem of our long-term competitiveness in the global market. In order to set the stage for discussing those challenges, I will begin by briefly reviewing my outlook for the international economy.

### **The International Economic Outlook**

I look for the economy of the United States to grow at around 2.5 percent in 1988.

The rest of the world's advanced economies should continue to grow at a slightly slower pace of about 2 percent on average. Inflation in the United States will probably average between 4 and 4.5 percent this year as measured by the Consumer Price Index. Unemployment dropped to 5.6 percent in March, its lowest point in eight years, and I expect it to hover between 5.5 and 6 percent through the end of the year.

The most important dynamic underlying this forecast is a fundamental structural transition under way in most of the world's industrialized economies. On one hand, the United States is in the midst of a transition from an economy driven by domestic consumption to one which will rely upon exports for a great share of its growth. Meanwhile, the mirror image of this process--that is, a shift to domestic demand and away from exports as the main source of growth--is taking place among our major trading partners. Since the last quarter of 1986, the United States has seen the effects of the dollar's depreciation on foreign currency markets show up in steady improvements in real net exports. This stimulus from our export position is helping to revive sectors like manufacturing and agriculture, which had languished when the dollar was high, and should bring more balance to our economy in general. For our trading partners, the adjustment process will probably not be as smooth. Their growth is likely to be slower than in the United States because consumption fueled by domestic demand has not been taking up all the slack left by waning exports in these countries.

In Germany, for example, the export sector is shrinking, but domestic demand is not accelerating enough to compensate for the loss of income. The German government has done relatively little to stimulate growth even though recently there has been some monetary relaxation. As a result, last year's sluggish 1.5 percent pace is likely to persist in 1988. Similar prospects hold for other European countries, largely because of their economic and monetary integration with Germany.

Japan should do considerably better. As its current account surplus contracts, the

stimulus package implemented by the Japanese government is fostering fairly strong spending by the domestic components of its economy--consumers and government especially. Growth there next year will probably be around 3.75 percent. Nonetheless, I believe there is more potential for expansion in Japan's domestic demand.

As U.S. exports pick up and those of Europe and Japan decrease, the impact on workers there will be as great in scope as any in recent memory. It has been suggested that several million manufacturing jobs could be lost in those countries, and such dislocations will obviously require substantial adjustments. Even though Japan has begun increasing imports and reducing exports, its surplus with the United States remains high, suggesting more needs to be done. Still, the Japanese are beginning from a base of low unemployment, and I expect them to weather this transition in reasonably good condition.

Europe, on the other hand, is starting its adjustment with unemployment in the double-digit range despite the strength of their exports in recent years. The primary reason seems to have been that the profits from their export boom did not go as much into the job creation that comes from building new factories or creating new services. Instead, profits were translated into higher wages for those already employed and purchases of machinery, much of which was labor-saving equipment. If unemployment grows larger in Europe, we may see political tensions as a result. In particular, it may strengthen the tendency toward protectionism that is already distorting trade between Europe and the rest of the world.

While some in the United States, particularly manufacturers and farmers, should benefit from the global economic transition, we will by no means be getting a free ride. All of us as consumers can expect to pay more for our purchases as the depreciation of the dollar against foreign currencies pushes up the prices of imports. We may also have to accept slower rates of growth in our standard of living. We have been on a considerable buying spree as a nation, and we borrowed heavily from foreigners to

finance our purchases. Now we must export more goods to provide the foreign exchange necessary to repay that debt.

### **The Problem of Policy Coordination**

Having outlined the current economic outlook and highlighted the transition that will be shaping the world's economy with gathering force as time goes on, I now turn to three challenges posed by the global marketplace. All three--the challenges of exchange-rate policy coordination, protectionism, and American competitiveness--are related to some extent to the transition I have described. With reference to policy coordination, for example, we might well ask why we do not try to work more closely with our trading partners to keep currencies in line. Isn't it possible to avoid the kinds of swings in exchange rate values that have set the stage for adjustments like the ones we are all experiencing? Joint policy measures by the countries with the world's advanced economies might seem especially appropriate given the fact that those economies seem to have plenty of excess capacity. The high unemployment in much of Europe suggests that there is room for stimulus. Meanwhile, inflation is almost nonexistent in Germany, although in countries like the United States and Italy prices are rising in the range of 5 percent annually.

We must acknowledge that the world has changed since 1985 when the leaders of the industrialized nations sat down and agreed on a policy of bringing the world's currencies into better alignment. It is now much more difficult to coordinate policies. We cannot expect to speed up business activity by doing more of what we did two and a half years ago. In fact, the strategy of currency alignment is reaching the point of diminishing returns, in my judgment. There are limits to how far we can go toward targeting particular exchange rates unless the values chosen are consistent with underlying conditions and domestic economic policies. Targets must also be sustainable in financial markets. Money and capital markets are simply too interconnected, as we

saw during the October stock market crash, for governments to maintain artificial exchange rates.

Those who point to the era of fixed exchange rates as a model for policy coordination tend to forget that there were no significant differences in inflation rates at that time. Such differences do exist now and confound attempts even in the Common Market countries to maintain some sort of constancy among currencies. Moreover, there was more widespread international agreement on policy objectives during the time when exchange rates were fixed. When that consensus diminished in the 1970s, the system of pegged exchange rates no longer worked. This divergence of policy objectives is the crux of our current problem. Recent history has shown quite clearly that the German public will tolerate far more unemployment and far less inflation than will Americans, for example. Disparities of this nature tend to move our exchange rates continuously out of line. They also make it more complex for the leaders of Germany, the United States, and other advanced economies to agree on the advisability of a course of action like domestic stimulus in Germany as a catalyst to faster growth there, in the rest of Europe, and ultimately the entire world.

### **The Challenge of Protectionism**

I would prefer that we leave the question of relative exchange rates to market dynamics and concentrate our efforts at policy coordination on our second global challenge. That is the challenge of protectionism. We simply cannot yield to the pressure that is mounting not only in the United States but also in Europe to distort markets with artificial barriers against the products and services of others. All countries--including our own--already have protective mechanisms in place. Rather than adding to them, our goal should be to bring down every protectionist wall in the interest of ever freer and more open trade.

In agriculture, as just one example, all kinds of subsidies distort trade flows and cost governments, taxpayers, and consumers considerable amounts of money, yet we tend to be oblivious to such trade barriers. For this reason, we have given all too little attention to the recent round of GATT talks begun in Uruguay. On the surface it might seem that this avenue of negotiation will prove no more fruitful than the other forms of policy coordination whose complexities I have just outlined. However, I am optimistic that as the world's economies become more closely entwined, not only through trade flows but also through the proliferation of direct investments in other countries, people will become more aware of the advantages of free and open economic transactions among nations.

Several areas of our country have already benefited in terms of employment and income from the establishment of foreign-owned manufacturing facilities. Such operations often introduce new technologies and management styles that can be adopted by local businesses with beneficial effects on their productivity and profitability. State and local leaders in many areas--and particularly in my own region, the Southeast--have recognized this benefit and actively recruit foreign firms. Since the dollar's decline is making foreign direct investment in the United States relatively more attractive than exporting to this country, I expect to see more of such activity. This leads me to hope that popular attitudes will change, not just in the United States but in other countries too. In this way, the groundwork could be laid for more policy coordination to reduce protectionism at the national level.

If, on the other hand, we do not accept the challenge of free and open markets but opt instead for greater protectionism, the outcome will be fairly certain. A few protected producers will profit temporarily at the expense of everyone else. Because protective barriers reduce competition, the rest of us will face higher prices and fewer choices. We will see foreign countries retaliate with measures of their own that will cut

down our exports to them. Americans will lose jobs. Finally, as more and more countries protect and retaliate, we will encounter the kind of gridlock the world brought upon itself in the 1930s when international trade stagnated because of outrageous tariffs. When we have come this far toward a worldwide agreement to compete peacefully in the marketplace, one may ask why we would we choose to make the kinds of mistakes that once brought about a disaster in world trade and in world affairs.

### **The Challenge of Competitiveness**

What protectionism is, of course, is an attempt to avoid confronting the third major challenge of the global marketplace--the challenge of competitiveness. The more we have become aware of our own difficulties in competing against the goods of foreign producers, the louder the demands for protectionist measures have grown. Protective barriers might temporarily rig the market for certain goods and give us a price advantage, but any such advantage would be quickly balanced by losses in other product areas.

Another way of gaining a temporary price advantage would be to accept the counsel of those who would like to see the dollar pushed considerably lower on foreign exchange markets. While this would make our products cheaper, I feel that we are reaching the point of diminishing returns from the currency realignment we have already experienced. We have returned to the levels from which the dollar began its ascent in the early 1980s and have seen our exports revive in response. However, we probably have more to lose than to gain from further rapid depreciation. If the pattern of precipitous decline resumed, it would increase the likelihood of inflation and the probability of economic downturns in those foreign economies to whom we hope to export more. Alternatively, defensive maneuvers on the part of our trading partners could lead to a series of competitive devaluations and trade wars.

Since protectionist and exchange-rate strategies will fail to deliver relief in price competitiveness, we must reassess the way we go about producing goods and identify where improvement is needed in the other basic determinants of competitiveness--productivity and quality. To increase productivity we need to invest more in both our physical and human capital. We cannot expect to squeeze much more out of labor costs. I do not deny that we have made considerable productivity gains in manufacturing during the 1980s, largely in response to heightened foreign competition. Unfortunately, much of our recent investment has not been directed to resource-saving equipment or new factories but rather has been sunk into hotels, offices, and the like--perhaps so we can spend more time meeting to discuss productivity!

In addition to spending more on new equipment, research, and so on, we must also invest more in our public infrastructure--roads, mass transit, and the like. We must also pay particular attention to building up human capital. Unless U.S. workers are better educated, they will be unable to use new technologies. Moreover, they will lack the flexibility to make the necessary adjustments, not only to technologically advanced production processes or ways of providing services, but also to another fundamental change we must make--toward higher quality.

It is quite clear that in the eyes of foreign consumers and of many Americans, too, a good number of American products in recent years have not measured up to comparable foreign goods in quality. In the past, Americans have tended to make standard, mass-produced goods especially for our large home market. We made the Ford family sedans and the Kodak Instamatics and let others turn out specialized, high-quality products--Mercedes and Leicas--for a variety of markets. Again, the arrival of much lower cost producers has meant that we can no longer hope to survive by concentrating on low-end goods.

As we rethink our production objectives and move into the better quality niches,

U.S. business leaders and workers alike will be called on to change old habits and ways of thinking. This shift will require a better educated work force at all levels. In particular, we need managers who can think analytically and creatively, who have the vision to see market opportunities in the far corners of the world. Clearly, our competitors in the global marketplace have taken the trouble to learn how to sell us their products effectively. We can no longer afford to know less about our competitors than they know about us.

### **Conclusion**

The correct response to all three of the challenges I have outlined this morning is to reaffirm the principles and responsibilities of the free market and to let our actions be guided by them. The transition from consumption to exports in our economy and the corresponding shifts in other economies may bring with them some discomfort, but they will also bring greater balance. That balance will, I hope, help to mute the more strident calls for spurious solutions to current imbalances like exchange-rate targeting and protectionism. It should also provide us a breathing space that we can use to determine how best to direct our energies toward addressing the problems of productivity and quality and improving our competitiveness.

Let me remind you that the world's advanced economies are likely to grow by 2 percent on average this year--certainly a respectable rate and by any standard better than a recession. For all the challenges we face, as global market participants we are still progressing. The longer we continue, the brighter the prospects for less developed countries to be pulled along by our expansion. I hope this level of growth will give us breathing space to agree on the kind of coordination that will bring the greatest benefit to the global marketplace. That is the dismantling of all the protectionist barriers that cripple the functioning of free and open markets.