THE ECONOMIC ENVIRONMENT OF THE POST-COLD WAR ERA: CHARTING A NEW COURSE

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It is a great pleasure for me to be back in this lovely city of Buenos Aires, with its cosmopolitan blend of Old World sophistication and New World energy. I am honored to be part of this symposium on the global economy in the post-Cold War era. I intend to talk about the need for greater economic cooperation among nations. The advanced economies have a particular responsibility to lead this process. They must do so by fostering closer economic ties--not only among themselves, but also with the developing nations as the latter make the transition from largely state-run to market-oriented economies. The developing nations also have an important role to play in this process. The end of the cold war opens up vast opportunities for such collaboration in much the same way that the end of feudal warfare in the Middle Ages enabled the Old World 500 years ago to begin linking its future with the New.

The course of the global economy in the years ahead depends critically on the incorporation of countries where economic progress has stagnated during recent decades. These include not only Eastern Europe and Africa, but also significant portions of Latin America and, in terms of population, Asia. Advances in these nations are crucial to continued growth for the industrial nations. Moreover, as bipolar political tensions recede, developing economies must be viewed as more than potential producers and markets for goods and services; the developing economies must also become partners in solving some of the problems that have come in the wake of economic growth, including the threats to the natural environment we all share.

Thus, in my remarks this afternoon, I will concentrate on what the industrialized and developing countries must do in order to make the most of present opportunities. I will begin with a brief overview of the direction in which the global economy appears to be headed. Then I will turn to challenges in three areas--(1) coordination of trade, economic, and regulatory policies, (2) nurturing the economies of developing nations, and (3) preserving the planet's environment.

Direction of the Global Economy

Let me begin with the outlook for the global economy over the next decade in the industrialized countries. Growth in the United States is likely to proceed at a slower rate than in recent years--prior to the recession. One factor contributing to this slowdown will be structural changes in the demographic mix of the United States. These changes are of widespread significance because U.S. consumption has been a driving force in the world's economy. Our population is shifting from having a preponderance of younger people to having many more older households, and these families are likely to devote a smaller portion of their income gains to consumption of manufactured goods. The U.S. housing and auto industries have already felt the effects of this change. Japan is also likely to experience somewhat slower growth as it works through the problems of an overbuilt real estate industry. However, Japan's productivity gains remain high. In addition, its moves to strengthen economic ties with other Asian countries should keep business activity brisk during the 1990s. Europe's economic growth should likewise be enhanced by the closer ties that the European Community's 1992 program will bring about. There will be adjustment costs in the near term as Germany integrates the former

German Democratic Republic in a policy context of considerable fiscal and monetary restraint. However, Germany's actions are really investments in the future--investments which should pay off handsomely over the long term. Moreover, Europe as a whole shows signs of going even beyond the trade and financial liberalization of the 1992 program. Europeans are actively debating the logistics of a transition to a unified central bank and a single currency even though neither is part of the Europe 1992 agenda. This debate shows that even the historically independent nations of Europe recognize the advantages of economic integration.

One especially bright spot for the industrialized countries could be lower defense spending. The sudden disintegration of Soviet communism and the allaying of East-West tensions that has followed suggest that there should be less need to pour money into defense than in the past. The hope, of course, is that money budgeted for tanks and missiles can now be put to pressing domestic needs, such as education, transportation systems, and the like, as well as financing the investment and credit needs of developing countries. However, we in the United States must remain committed to reducing our fiscal deficit. In addition, even while the threat of war driven by ideological differences appears to be diminishing, the proliferation of armaments around the world could exacerbate another source of armed conflict. That is the re-emergence of nationalistic animosities in the political void left by the collapse of communism. The unrest in Yugoslavia and the Soviet Republics is dramatic evidence of this alarming possibility. On balance, though, the end of the Cold War creates very auspicious prospects for economic growth in the industrialized nations.

As for the world's developing countries, current conditions are still relatively bleak. The situation is the most dismal for the poorest countries in Africa. Some are also dealing with civil disorders that continue to disrupt their economic development. Most nations in Latin America are better off, but a number of these have heavy foreign debt burdens. Eastern Europe and the countries both in and out of the Soviet Union also face long-term adjustments. They must develop the basics of a free-market system--including the establishment of a commercial banking system and functioning capital markets--before they can begin to participate significantly in the global economy.

Still, I think we need to focus on the future benefits that will accrue from the many positive changes taking place in the developing countries, particularly in Latin America. Governments here have been making great strides in the past few years to strengthen their economies and restructure their debt. In Argentina, the annual inflation rate, while still high, has fallen to a fraction of what it was last year, and it is still going down. This progress has resulted in large measure from an economic stabilization program that features privatization of state-run businesses and a more stable currency, which is now pegged to the U.S. dollar. Mexico, too, has made dramatic adjustments. The Mexican government has engineered a significant reduction in public intervention in trade and domestic business activities. Specific measures include a drop in trade-weighted tariff rates, liberalization of foreign investment controls, and privatization of more than half of the previously state-owned enterprises.

Changes like these have raised the prospect that Mexico might link its economy more closely to those of the United States and Canada through a North American Free Trade Agreement (NAFTA). I hope such an agreement will be consummated as quickly as possible. However, negotiations earlier this year highlighted several of the critical questions that must be confronted in the effort to give Mexico and other developing nations a stronger role in the global economy. First, these talks have raised the issue of international trade liberalization. Will we proceed through multilateral talks to worldwide free trade, or stop at the less-than-optimal level of regional trade blocs? Will these multilateral efforts be limited to trade in manufactured goods or will they be extended to other, increasingly important areas like services and finance. A second issue involves nurturing emerging market systems like those of Argentina and Mexico. Do these economies still require special attention if they are to consolidate their gains and serve as positive examples for other developing nations? Third, and in many ways most difficult, are the environmental concerns that were raised by opponents of the North American accord. Is there merit to the views of those who argued that the United States should not allow Mexico to reap the benefits of freer trade without first tightening its comparatively lax environmental standards? I would like to offer my observations on each of these points and discuss how we might achieve greater coordination.

Coordinating Economic and Trade Policies

Beginning with trade negotiations, I am somewhat concerned that a shift toward regional trade blocs could undermine momentum toward a multilateral agreement through the General Agreement on Tariffs and Trade (GATT). I say this even though, in my opinion, any step toward freer trade among nations--even if it is only bilateral to begin with--takes us in the right direction. Arrangements like the European Community, the European Free Trade Association, a North American Free Trade Agreement, the "Enterprise for the Americas" concept advanced by President Bush, or a strengthened Andean Pact can all be productive if they keep the world on track toward absolutely unobstructed trade. It is essential, however, that we refuse to stop short of that objective. Continued progress that embraces the developing nations as well as the industrialized economies depends on gradually removing the remaining trade barriers until all market participants can compete on an equal footing. For this reason, it is somewhat disheartening that the progress on the GATT has become stalled, even though it is encouraging that more talks have been scheduled. The advanced economies, in particular, need to play a leadership role in renewing the momentum of multilateral trade liberalization and to help in other ways to fortify the foundations of free trade. Aside from a general reaffirmation of GATT, ironing out differences over one of the current obstacles--agricultural subsidies--could be enormously beneficial to the many developing nations that have a comparative advantage in farm products.

Aside from reinvigorating worldwide trade liberalization through GATT, nations also need to find more ways to coordinate their monetary and fiscal policies. There are those skeptics who question whether such coordination is possible or desirable. To that charge, I would answer that policy coordination does not mean that every nation must follow the same policies. Coordinating does not mean sameness. It means harmony. When coordination is achieved through federation, as perhaps will occur in Europe, individual countries can pursue--at least temporarily--different policies. For example, one nation might adopt more inflationary polices than others if such a policy formula better suited domestic preferences. It would bear the associated costs in terms of exchange rates and trade balances.

From my perspective as a central banker, I believe another vital aspect of multilateral coordination involves the regulatory structure in which financial institutions operate around the world. In my view, the stronger the financial system, the stronger the economy. Thus, in a global economy, we may be no stronger than the weakest financial system. I would particularly like to protect developing and industrialized countries against the kinds of activities the Bank of Credit and Commerce (BCCI) has allegedly perpetrated. The real tragedy of BCCI is the terrible effects its actions have had on developing countries, whose people can least afford to shoulder the losses they incurred when the bank collapsed. Some of these were in Latin America. BCCI was able to conceal many unlawful maneuvers it allegedly made because its chartering framework was designed to evade regulatory oversight. This affair points to the need for more effective international regulatory coordination among central banks. The Basle accords on capital standards have certainly demonstrated how effective such coordination can be. It is important for banks in Latin America, many of which are being privatized, to have such standards as a guiding principle and ultimately to join formally with other countries in agreements that enforce adequate standards of safety and soundness.

Nurturing Fledgling Market Economies

A second challenge on the way toward a fully integrated global economy is the need to nurture fledgling market economies. In practical terms, that means the industrialized nations must explore ways to ease the debt burdens of developing countries. The Brady Plan offers a constructive example of efforts to decrease the foreign debt loads that frighten off investors. As you know, U.S. Treasury Secretary Nicholas Brady proposed a method of debt relief that hinges on combining economic reforms with meaningful reductions in commercial bank debt. I think this concept helped Mexico, for example, strengthen its resolve to undertake the dramatic changes its economy sorely needed. However, the Brady Plan was only a beginning. The industrialized economies must look for every opportunity to draw developing economies even more into the community of nations in the confidence that, over time, doing so will bring all countries higher living standards. If we in the wealthier, market economies fail to take advantage of this momentous opportunity among developing countries, history will surely judge us harshly.

Can We Have Generalized Growth and Also Preserve the Environment?

Only if we can build on the foundation of international cooperation in trade and finance that is slowly taking shape can we hope to tackle another problem of global proportions. That is the question of whether we can have economic growth for all countries and still preserve the natural environment. Obviously, if we allow growth to continue at the expense of the air and water around us, any gains we achieve will be hollow indeed.

Whether the environment is threatened by new technologies, such as biohazardous materials, or old practices, such as deforestation to open new land for agriculture, I think we can all agree that the erosion of living conditions is not a rational trade-off for higher living standards. To envision the scope of this potential problem, we need only picture the more than one billion Chinese people, for example, using fossil fuels at the same rate as we do in the United States. Likewise, imagine the impact on the ozone layer if the 650 million Africans were to begin using as many aerosol sprays as people in the industrialized nations do. Still, the developing nations have more immediate demands than environmental ones. They must first feed their people and provide them housing and medicine. Moreover, they might point out, the industrialized nations were able to raise the standards of living for their citizens by, in effect, disregarding how new industries would harm the environment: Why should developing nations be encumbered by environmental regulations as they struggle to meet basic needs?

I acknowledge we need to devise approaches to conserving and regenerating our environmental resources that are sensitive to the concerns of the world's developing countries. It is also true that a major share of the responsibility for addressing environmental degradation lies with the advanced economies. These are the world's leading polluters--simply as a function of their industrialization and wealth. Nonetheless, developing nations must change their ways too. The environmental issues raised in the United States in opposition to free trade with Mexico show that such concerns can no longer be discounted in international economic negotiations. If broadly based accords are to be struck, environmental advocates will have to be convinced that polluting industries will not be allowed simply to migrate to the countries with the lowest standards. More and more, I think, countries that refuse to adhere to environmental protocols are likely to face economic isolation. Ultimately, the environmental problem is an economic problem. Its solutions to a great extent involve finding ways to factor in the indirect costs of environmental maintenance and waste disposal as a direct cost of production--and consumption.

Conclusion

In conclusion, we stand at a watershed in world history. An important and terrifying chapter--the ideological conflict between the United States and the Soviet Union--has been closed. We are not yet sure how the next chapter will read. However, an underlying theme will be the manner in which we overcome the tendencies toward self-centered nationalism that have emerged following the collapse of Soviet communism. In another sense, nationalism and regionalism remain potential stumbling blocks to bringing about the kind of coordinated effort in trade and finance that could, if successful, lead to a more fully integrated global economy. This global economy need not--and, indeed, cannot work any longer to the exclusive benefit of the industrialized nations, as it has too often in the past. With sufficient vision and leadership in those richer nations, it can expand to encompass the developing countries as well. Working from this base of economic cooperation, we can turn our attention to the great challenge of the twenty-first century. That is the need to ensure that the quality of life on this planet will not be compromised in the course of extending the material advantages of economic development to all nations of the world.