THE CHALLENGES AND OPPORTUNITIES OF THE GLOBAL MARKETPLACE

Remarks by Robert P. Forrestal
President and Chief Executive Officer
Federal Reserve Bank of Atlanta
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I am very pleased to be the inaugural speaker for this new international business lecture series sponsored by the College of Business Administration of Georgia State University. Dean Hogan is well acquainted with my strong interest in international relations, and so I suspect he knew I would have a few opinions on the challenges and opportunities of the global marketplace.

Since I will cover a good deal of material in the next 45 minutes or so, let me explain how I have organized it. I plan to go from a broad view of the international economy to a specific view of the benefits of international trade between the Southeast and Latin America. First, I will provide an overview of the economic and trade outlook for a few areas of the world--specifically the Americas, Western Europe, and the Asia-Pacific region. Next, I will briefly outline the continuing transformation to market economies in Latin America and comment on some of the stumbling blocks this region faces as it tries to become a full partner in the global marketplace. Then I will speak about the importance of free trade and finally conclude with how the United States and the Southeast can benefit from trade with our neighbors to the south.

Professional and Personal Interest in International Affairs

Before I delve into these topics, though, I would like to explain both my professional and personal interest in international affairs. First, on the professional level, as a central banker, I must pay attention to developments in other countries because the increasing expansion of world trade--as well as the globalization of financial markets--means that the Federal Reserve cannot concentrate only on domestic developments in examining the outlook for our economy. For instance, Latin America is and will be an important trading area for this nation. Developments in our trading partners influence domestic macroeconomic conditions. If growth in the gross domestic product (GDP) in other countries accelerates, U.S. exports are likely to rise. If conditions worsen in other countries, our exports typically fall.

Second, on a more personal level, the reason for my keen interest in international relations has to do with my long-held belief that free trade and international development can help to strengthen both our regional and our national economy. During my tenure as president and CEO of the Federal Reserve Bank of Atlanta, I have worked hard to expand the definition of regional economics to include international relations. If that sounds like a contradiction in terms, let me assure you that I am referring to the scope or horizon of Reserve Banks like the Atlanta Fed. To that end, our Bank has promoted the idea of strong international relations by hosting lunches and dinners with the local consular corps and visiting foreign dignitaries. Last year, for example, five distinguished international figures spoke at the Bank to audiences of Atlanta business, academic, and community leaders. Chief among these speakers were Mary Robinson, the president of Ireland, and Raul Granillo Ocampo, the Argentine ambassador to the United States.

The Atlanta Fed has also sponsored several conferences on international themes, including one last year on opportunities for trade and investment in Latin America and the Caribbean. In addition, since we have attracted a fair number of international visitors from central and commercial banks in countries like Peru and Russia, we have also established an Office of International Relations to coordinate these visits.

In my own way, I have tried to augment this international activity at the Atlanta Fed by accepting a few speaking engagements in other countries around the world. Earlier this month, for example, I was in Copenhagen to deliver a talk about the role of the regional Reserve Banks to policymakers at the central bank of Denmark. It seems they are anticipating the day when the European Community will have one central bank, with former central banks in each country serving more as regional Reserve Banks. In the past two years, I have also had the opportunity to travel to Shanghai to discuss the development of financial markets in China and to Stockholm to discuss issues in U.S. economic policymaking. The discussions with foreign central bankers that I have had during these trips have given me very helpful insights into the larger context in which U.S. monetary policy decisions are being made.

This focus on international relations has also led me to this conclusion: In a world that is much more closely integrated economically and financially, it is absolutely necessary for all Americans to be thinking about how they fit into the world, not simply how they fit into the economy of their own country. Yes, it is difficult to understand other cultures and languages, but these hurdles should not bar the human mind from travelling great distances in order to accomplish great things. In this day and age, there are many ways to get around language barriers, and business people are business people no matter where their companies are headquartered. I cannot emphasize strongly enough how important I believe it is for the United States to be competitive in the global marketplace and for each American to understand that for every challenge in that global marketplace, there are many opportunities.

International Economic Outlook

Let me now give a brief economic outlook for some of the major areas in the world, starting with that part of the world I know best, the United States. Growth in output last year was 4 percent. This rate of growth was very strong relative to our potential, and the current slowing is not entirely unwelcome. Of course, that will be true only to the extent that we do not slow too much. Considering that the expansion has been going on for four years, a moderate growth rate this year of about 2-1/2 percent on an annual average basis is absolutely appropriate and necessary. In fact, we welcome this development since we would like to ensure that current pressures on prices will prove to be a temporary and cyclical phenomenon. With growth decelerating, it is unlikely that the unemployment rate will decline much further. My best guess is that it will be close to 5-1/2 percent on an annual average basis, but it could run above this level at times. Inflation may rise to an average of somewhat above 3 percent. It is clear that the possibility of a recession has increased given the deceleration in GDP growth, but, in my view, a recession is not the most likely outcome.

Moving on to the rest of the Americas, I can report that U.S. trade with the developing countries of our own hemisphere has skyrocketed over the last five years. From 1990 to 1994, total trade with Mexico has doubled to more than $100 billion. Trade with the other developing countries in Latin America has gone from $60 billion in 1990 to $80 billion in 1994--an increase of 33 percent. Five of our fastest-growing export markets this decade are located in Latin America, and the region accounts for 15 percent of all U.S. trade.

However, this has been a trying year for many economies in our hemisphere, and growth in trade with Latin America will decelerate this year. The developing nations of Latin America and the Caribbean continue to feel the effects of the Mexican financial setback that began last December when Mexican authorities let the peso depreciate. The causes of this setback may be better pursued at another forum. Nonetheless, I would like to point out that, faced with a difficult financial situation, Mexican leaders did not retreat into protectionism or nationalization as they did in the early 1980s. The fact that Mexico has enacted long-term policies designed to fix the current problem, and to prevent futures ones like it, encourages me to be optimistic about the future of Mexico.

Also within the Americas region is Canada. As our single largest trading partner, it takes 22 percent of U.S. exports and ships 19 percent of U.S. imported goods. The economic outlook for Canada is very positive. Although economic growth is decelerating from the 4-1/2 percent rate of last year, Canadian real gross domestic product (GDP) should still average just under 4 percent in 1995 and 3 percent next year. The slowdown should allow Canadian inflation to remain below 3 percent annually through 1996.

Looking across the Atlantic Ocean, I am pleased to see that Western Europe has cast off the last remnants of its early-1990s recession. These economies should see growth near 3 percent this year as well as in 1996. U.S. trade with the European nations--which accounts for 20 percent of all U.S. trade--should pick up in the coming years. It does not seem likely that the move to incorporate more European nations into the European Union and further steps toward monetary union will have an adverse impact on U.S. trade with Europe.

Let me turn now to the third key area I would like to discuss, the Asia/Pacific region. The economy of our second-largest trading partner, Japan--which accounts for 15 percent of all U.S. trade--should stay weak through 1995, but could do better next year if domestic demand picks up as expected. However, the benefits of financial deregulation, lower taxes, low interest rates, and increased government spending may be offset by the appreciation of the yen. Over the last year, the value of the yen has risen 12 percent compared to the currencies of major trading partners of Japan. Over the last five years, that figure is more than 80 percent. The strength of the yen is forcing many Japanese firms to slow down production or to relocate industrial facilities offshore, mainly in developing Asian countries, since products made in Japan are becoming more and more expensive overseas. This could affect corporate profits and lead to a further rise in Japanese unemployment, which would likely dampen consumer spending in Japan. After growing a scant 1/2 percent last year, the economy in Japan is expected to grow just over 1 percent this year and a bit above 2 percent in 1996. Slow growth combined with trade tensions between Japan and the United States do not bode well for an increase in U.S. trade with Japan in the near future.

The economies of the developing Asian economies provide a brighter picture. I mentioned earlier that five of the top 10 fastest-growing U.S. export markets are in Latin America. The other five are found in Asia. Excluding Japan, trade with the Asian nations accounts for 20 percent of total U.S. trade. These economies are expected to grow more than 7 percent in 1995 and 1996, down a bit from the 8 percent pace of last year. The potential for increased U.S. trade with this region is bright because of this growth forecast and continued efforts toward freer trade taken by Asian nations.

Latin America in Transition

Since I plan to comment in a few moments on the merits of increased trade with Latin America, let me go into more detail about its economic reforms. Over the past decade, Latin American nations have undergone profound economic and political change--and those changes have generally been for the better. Not too long ago, most countries in the region were beset by huge external debt burdens, rampant inflation, crushing government budget deficits, and general economic and financial malaise. In the wake of significant macroeconomic reforms, we have begun to see economic growth in a number of countries, such as Chile and Argentina. A good deal of the capital that had fled these countries in search of safer investment opportunities abroad returned--at least, before the peso shock--and foreign investment was on the rise. Democracy and free-market economies are now the norm where dictatorships and centralized economies once were. Since these have been dramatic and far-reaching changes, it would not be realistic to think that these nations could make this transition without occasional setbacks. In the long run, however, Latin America will be an increasingly important economic force in the world.

Overall, it is important to remember that the desirability of closer international economic integration has not been negated by the developments in Mexico since the end of last year. It is also worth noting that, although growth in Mexico has slowed following the depreciation of the peso, other countries in Latin America are expected to continue to do well. For example, in Chile growth could reach 6 percent in 1995, up from nearly 4 percent last year. Prudent economic policies in Chile have enabled that country to post positive rates of growth averaging 5 percent over the last decade. Inflation in Chile could fall to 8 percent this year from nearly 9 percent in 1994. Chile has a high domestic savings rate and a financial system that is less susceptible than some of its neighbors' to destabilizing outflows of capital. Both of these attributes have helped it through the fallout from the Mexican peso depreciation. In essence, Chile is an example of a country that is benefiting from the kind of economic and political stability other Latin American nations are striving toward.

It is true that there have been problems in Latin America--including the economic troubles in Mexico, the resulting effects upon foreign investment in that country and others in Latin America, and financial problems in Venezuela following the bankruptcy of its second-largest bank, Banco Latino. In addition, some Latin American countries still face serious obstacles to continuing growth, a few of which I would like to address. In my view, a lack of strong financial systems and comprehensive bank supervision is at the top of the list. I believe that the recipe for continued long-term, stable growth in Latin America--in addition to the macroeconomic policies that have already been put in place--is to have a strong financial system of well-regulated banks and an efficient payments system in place in each country. Such a financial system requires an independent central bank to ensure that the making of monetary policy is separate from fiscal decision making and is not vulnerable to political pressure by members of the government. Whether or not the bank regulatory authority is part of the central bank, it too needs to be independent to ensure that short-term political considerations do not distort and compromise the regulatory framework of the financial system.

Legal reform is another major challenge for Latin American policymakers. Among the evolving economic and political reforms taking place in many countries, one area that has not yet become firmly implanted is private property and contract law. In the industrialized world, such laws are taken for granted. However, in countries where nationalization has been a recurring theme, the concept of private property exists on shaky grounds. Setting up an enduring legal system as a foundation for newly privatized companies and property is a daunting challenge, but one that should, in my opinion, be met. Otherwise, private and corporate citizens, as well as foreign investors, will continue to operate as though the government could take their property at a moment's notice. It is in fact this very real fear of enforced nationalization that caused the extremely complex pattern of offshore holdings that developed in many Latin American countries.

A third stumbling block to market reform has to do with a lack of transparency in the financial markets of many Latin American countries. Many of you are familiar, no doubt, with the way depreciation of the Mexican peso roiled the stock markets not only in Mexico but also in Venezuela, Brazil, Argentina, Chile, and Peru. A larger issue for Latin America, though, is that events of this sort may cause foreign investors to become less willing to give Latin American countries the benefit of the doubt. I am afraid that even if the long-run fundamentals of a country are good, potential investors may worry unduly as a result of what happened in Mexico.

One source of potential help in this situation would be efforts to increase the transparency of economic and financial data for countries in Latin America. Quite simply, these countries need to increase their financial reporting. If countries want to attract capital, they need to have better measurements of both financial and nonfinancial matters. It is true that international standards of reporting are not necessarily explicit, but, at their heart, they call for well-defined data that are consistently reported and available to the public. Although such data may, at times, raise concerns about the health of a country, these same concerns would ultimately emerge even in the absence of data. By reducing uncertainty, better flows of information would likely bolster capital flows on average. Let me be clear, however, that better reporting is a burden not just for Latin American countries. The problem is even greater in Eastern European countries where business enterprises at one time reported only to their highly centralized governments.

But, in my view, it is not only reform efforts on the part of Latin American countries that will result in their transformation to market economies. I believe they need strategic help from the outside. To wit, if the United States wants to ensure that our Latin American neighbors remain on the path they have chosen, we must persist in our efforts to forge closer economic ties with them through increased trade. Expanding the North American Free Trade Agreement (NAFTA) to include other Latin American economies that have embarked on market-oriented policy reforms is a logical next step to achieve this goal. The Free Trade Area of the Americas, launched in Miami last year, should remain a top priority for the United States.

The Importance of Free Trade

Since I believe that free trade is the cornerstone of open-market economies, let me digress a moment to describe the long-term good brought about by free trade in general. Essentially, free trade enhances the welfare of all countries involved. People in all countries that trade freely with one another are able to purchase goods and services that would either not otherwise be available to them, or would be available only at a higher cost. In addition, the production of these goods and services adds to the income of each country.

In the United States, we may have become so accustomed to the benefits of generally moderate trade barriers that we sometimes take them for granted. For instance, on the consumption side, a wide array of consumer goods--from Brazilian shoes to Chinese toys--are available at reasonable prices because U.S. tariffs are relatively low or nonexistent. On the production side, this nation has benefited from the creation of additional jobs as a result of both importing and exporting activity. Over the past 20 years, the United States has become much more export- and import-oriented. For example, imports have doubled from about 7 percent to nearly 15 percent of domestic demand, while exports have grown from about 7 percent to a little more than 12 percent of gross domestic product. The resulting increase in trade-related jobs has contributed to the overall increase in total U.S. jobs.

Free trade also allows each country to benefit from its comparative advantages with other countries in what can be described as a "win-win" situation. To understand the benefits of comparative advantage, we need only think about the concept within the context of the southeastern states. Taking the state of Georgia as an example, it clearly is wiser for Georgia not to try to produce its own citrus fruits or energy resources, such as oil, mainly because it does not have the natural attributes to do so. Georgia could develop alternative in-state supply sources through, say, the use of greenhouses or wood, but citrus fruit can more cheaply come from Florida and the energy resources can come from Louisiana.

Meanwhile, the state of Georgia has an advantage in supplying other states or parts of the world with some of the items it is good at producing, such as poultry and lumber. These examples rest--at least partly--on absolute advantages in resource availability, but the same points hold even when there is only a comparative advantage. Georgia might be quite good, even better than another state, at producing autos, but if Georgia can make paper relatively more efficiently than that other state, both are better off if Georgia concentrates on paper and the other one on autos.

In recent years, economists have increasingly recognized that comparative advantage can be based on economies of scale or agglomeration effects--not just on differences in climate or natural resources. If an industry is concentrated in a particular area, new ideas and technological advances can spread through the industry quickly. Moreover, a concentrated industry can support a variety of specialized suppliers that become highly efficient at their jobs. For example, the concentration of movie and television production in Hollywood supports an array of suppliers, from caterers who bring food to the set to film labs that edit the finished product. In the Southeast, Atlanta may be developing as a center for communications services, and Orlando is a major vacation destination with the many theme parks and attractions that have been built there.

The same logic works for countries at the global level. The United States is a leader in supplying higher value-added items, such as computer software, while other countries assemble the hardware. In the same vein, the United States does not emphasize production of videotapes but, rather, the creation of the movies that are recorded on videotapes. This comparative advantage derives from having a large group of creative, highly skilled workers. It works to the benefit of the United States because other countries that lack the numbers of such workers find it difficult to produce items such as software or movies in significant quantities, whereas it is easier for them to copy the relatively low-skill technology for assembling computer hardware or duplicating videotapes.

U.S. gains in areas that use the newest technology and call for highly skilled and more educated workers have been shifting the composition of U.S. exports away from lower value-added products like food, bulk chemicals, and other commodities. In the Southeast, in contrast, such lower value-added products remain our main exports. However, low-skill, labor-intensive jobs, like many piecework jobs in the apparel industry, have been moving to other nations that have much lower-paid labor, particularly China and other Pacific Rim countries. As you would expect, the Southeast has felt the effects of this shift. Southeastern apparel employment, for example, has fallen from more than 280,000 in 1977 to less than 240,000 last year. As a share of manufacturing, apparel employment has declined from 13 percent to 10 percent.

As hard as this process of change may be on some communities in the Southeast and nation that once relied on industries like apparel as a main source of employment and income, it must be remembered that this course of events is natural for a dynamic, wealthy country like the United States. Clearly it makes no sense for the wealthiest nation in the world to try to sustain certain industries simply to keep low-paying jobs within our borders. We are ultimately better off creating the kinds of products and services whose added value is higher and heightens our comparative advantage in the world.

This process of change, however, cannot happen overnight. It involves raising the educational level of all Americans so that an increasing number will possess the education and skills needed in the production of higher value-added items. Unfortunately, in the South our investment in primary and secondary education, as opposed to higher education, has historically lagged behind the rest of the nation, and this lag represents a serious stumbling block in our bid to continue long-term growth and to expand exports. This is not a new argument in regard to the South, but it cannot be ignored in the face of mounting pressure to compete not only with other regions in the United States but also with other countries in the world.

In areas of the country where low-skill, low-wage jobs are common, as in the South, so, too, is sentiment toward protectionism. Therefore, it is particularly important to increase understanding about how free trade benefits those countries involved over the long run. There is still a widespread view that trade is essentially static; in other words, it is frequently thought of as a zero-sum game. Too often we hear international trade discussed in terms of job losses, forgetting that jobs are also *created* through trade. In fact, trade is dynamic. The more trade there is, the larger the pie gets, with the result that no country loses in the long term. Consider

Mexico and NAFTA, for example. Even though that country is currently dealing with economic problems stemming from the depreciation of the peso against the dollar, over time the new system of free trade will allow Mexicans to create more jobs. Higher income from these jobs will enable Mexican workers to purchase more U.S. goods and services. In the long run, both countries will be better off.

Implications for the United States and the Southeast

These lessons about free trade apply not only to Europe and Japan, with whom we are already trading on a large scale, but also to Latin America. For this reason, it is encouraging to see the great strides made toward market economies in Latin America because the resulting stronger economies also create more opportunities for trade.

But what exactly are the implications for the United States and the Southeast? At the most fundamental level, as I have mentioned, the result will be more jobs--jobs in the United States and jobs in Latin America, all tied to increased trade. According to the Commerce Department, U.S. manufacturing exports to the world increased by 95 percent in the period between 1987 and 1993, whereas they increased by 138 percent to Latin America and the Caribbean. Argentina, Chile, Colombia, and Mexico saw the greatest increases in manufacturing imports from the United States during that period. Unlike the vicious cycle of retaliation that protectionism leads to, free trade is a virtuous cycle that creates jobs and makes all countries better off.

Once the benefits of free trade are recognized, the next question is where the United States and, in particular, the Southeast, should focus its exporting efforts. Proximity is one of the characteristics of enduring trading partners, and the current experience of the United States bears this out, since Canada is our No. 1 export market and Mexico has been close behind second-place Japan, whose economy is much larger. Thus, from a purely geographical point of view, trade with our neighbors to the south makes good sense.

But there are other reasons to focus trade efforts on Latin America. From the point of view of the United States, we are better off when our neighbors to the south as well as to the north are thriving economically--thus increasing their imports from us--rather than deteriorating. In view of the current problems in Mexico, it may seem that now is not the right time to be recommending that the United States and the Southeast look southward for trade opportunities. But one must take the long view when thinking about trade, and in the long view the focus should return to the positive fundamentals of the Latin American economies and the enormous potential they hold.

Right now, the developing economies, in particular Latin America and Asia, are growing faster than our largest trading partners--Western Europe and Japan. As Latin Americans have more money to spend on products and services from the United States, it seems very likely that U.S. export shares will continue to increase to this and other growing regions of the world. The Southeast can take advantage of this increased trade by focusing on products most likely to be needed by emerging market economies: capital equipment, commercial services, and consumer goods.

Now that we are in the fifth year of the economic expansion since the 1990-91 recession, the strength of the economic recovery in much of the Southeast has cemented the reputation of the region as a full partner--if not a leader--in the national economy. In fact, this region of the country has been outperforming the United States in job growth for a number of years, with the nation playing catch-up.

In particular, we in the South need not bow to any other region of this nation when it comes to being able to work with international visitors. We have been leaders in understanding the importance of the international economy to the economic well-being of the region. For instance, long before economic developers in other parts of the nation began to think internationally, Southerners--led by those in North and South Carolina--were already laying the groundwork and attracting European investors. The early result in the 1970s was that of all the foreign industrial development in the nation, half was being put into the South. Now we have German and Japanese car makers as well as Dutch, Irish, and British manufacturers, to name just a few. I might add that all of the marketing that is being done in the name of the Olympics can only increase the desirability of locating in the Southeast for international companies.

Early in the recovery following the 1990-91 recession, the Southeast was "fast out of the gate," so to speak, thanks to the upsurge in home building throughout the nation and the region's concentration in building-related industries and durable goods manufacturing. For instance, much of the lumber, carpeting, and appliances needed to build and furnish new homes comes from the Southeast. Building on these successes, it is in the best interest of the region that its economy should continue to evolve and diversify.

Over the past few decades, the Southeast relied heavily for its growth on attracting companies from other parts of the United States with its warmer climate, lower wages, weaker unions, and lower taxes. However, most of the firms that could make such moves have already done so, and it is time for the region to move on to new strategies for further development. Through trade with other countries, we can promote further growth of many of the industries that are now well established in our region as well as the development of new industries. The happy consequence of such exports will be a greater diversification of the southeastern economy.

In reality, though, the opportunity for exporting may not have been fully tapped in the Southeast in that, as measured by the share of jobs that is export-related, the region does some 20 percent less exporting than the United States as a whole. Moreover, given that the Southeast tends to export more lower value-added products than does the nation, the region faces certain problems. For instance, exports such as bulk chemicals and certain paper products put some areas of the Southeast in the same league as a developing nation, compared with other regions of the United States that export more high value-added items, such as machine tools, transportation equipment, and electronics.

Exactly how does the Southeast stand to benefit by increasing trade with Latin America? Before the depreciation of the peso in Mexico, the region had significantly increased its trade of poultry and commodities to that country. Although common wisdom has it that the volume of these exports should fall off due to the depreciation of the peso, it is difficult to say whether--or to what extent--income from them will fall. Tourism has also traditionally been something that this region has exported, in a manner of speaking. When people from abroad come to the many theme parks in Florida, we are really exporting a service, albeit primarily to Canada and western Europe. However, Latin Americans are the fastest-growing group of tourists visiting Florida. Another area that has been buoyed by foreign demand is housing, particularly in Miami where Latin Americans who are doing business have been buying homes in increasing numbers.

Now that NAFTA is in place, the question for business people is, what should the Southeast be trading to Latin America in the future? Statistics from the Inter-American Development Bank indicate that, for exports to Argentina, Brazil, Chile, and Mexico over the last five years, the fastest-growing value-added areas were construction, transportation, communications, utilities, financial services, and wholesale and retail trade. Some of these are industries in which businesses in the Southeast have a comparative advantage--and many have already begun to do more trading with Latin American countries.

Conclusion

In conclusion, international trade should continue to be a strong avenue of growth for the Southeast and its businesses. We must understand that free trade with Latin America, and the rest of the world for that matter, is not a threat to our economy. Instead, it as an opportunity waiting to be captured by businesses in the Southeast. I can think of few better ways to step up to meet the challenges and opportunities in the global marketplace than to set our sights on increased trade with our friends and neighbors to the south.