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**Remarks by
Cathy E. Minehan
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I'd like to thank Bill Coughlin and Joe Newman for inviting me to speak with you today. I thoroughly enjoy meeting with groups like yours; I find I learn a great deal from the interaction.

Before I begin the main subject of my talk this morning, I'd like to reflect on one aspect of the Federal Reserve Bank of Boston that is relevant both to my desire to speak with you today and the role all of you have come to expect from the Boston Fed. As you may know, the Federal Reserve System was designed in 1914 as a compromise between those who wanted regional central bank functions, and those who believed central control was necessary. The System has a central government agency--the Board of Governors--as well as regional Reserve Banks that are privately chartered depository institutions in 12 Districts around the country. Reserve Banks are managed by local Boards of

Directors, with oversight from Washington, and as such reflect the needs and desires of their regional areas. Here in Boston we've had an especially close relationship with the New England region, and, as you know, have sponsored much research into topics of local importance. When I vote at the FOMC meeting on Tuesday, I will be voting on national monetary policy, but I also will be informing everyone at the table about regional economic conditions. This was especially important during the credit crunch of the early 90's, and Dick Syron's regional focus helped considerably in alleviating that problem.

Congress has questioned various aspects of Federal Reserve System organization over the years, particularly focusing on the private-sector Board of Directors of each Bank and its selection in part by local banks. Some find this a problem, and legislation has been introduced by Congressman Leach, the new chairman of the House Banking Committee, to address this matter by having Reserve Bank presidents appointed by the Board of Governors in Washington, not their local Board of Directors. I may be biased,

but I think this is a mistake. One reason that I and my predecessors have been as active and involved in Boston and New England in general is that the Bank's Board of Directors has made that a priority. We have felt deeply committed to the priorities of our District; and I think that commitment is only enhanced by a direct link between the selection process and the local Board. Beyond that, I worry that the regional Bank presidents will not be viewed as equals at the FOMC table if their colleagues on the Committee--the Governors--are also their formal bosses. I'm here to speak with you today because you represent an important element of my constituency, and because the feedback I get from groups like this helps me to do a better job in contributing to the formation of monetary policy. To a certain extent, I work for you and I worry that this legislative proposal in some subtle ways frays the connection between us. Enough said about that, but I hope you'll agree with me if you hear this subject discussed elsewhere.

Today, I'd like to focus on the opportunities and challenges

facing Boston in a global age. Two forces sweeping the country make this focus topical. First, the new Congress seems determined -- for philosophical and budgetary reasons -- to return power to lower levels of government. Second, without the unifying force of a single major foreign enemy, it is easy to think that we can or should become even more inwardly focused. But like it or not, the forces of globalization are pervasive. Although successive administrations have sought to emphasize domestic issues, vivid pictures of events in Grozny, Kobe, and Chiapas keep intruding. And the consequences of these events affect our businesses, our labor markets, our standard of living and the value of our savings, even -- or, perhaps, I should say particularly -- in Boston.

Just as all politics are local, all economics are, in a sense, local too. Paul Krugman pointed out in his book Geography and Trade, "if we want to understand international specialization, a good place to start is with local specialization." Similarly, the urbanologist Jane Jacobs, who sees cities as generators of

diversity and innovation, emphasizes the symbiotic relationship between cities and trade. While businesses seeking to trade tend to locate in urban areas where they can find ample support services, trade also promotes the cross-fertilization of ideas required for innovation -- the life blood of cities.

To start with the positive aspects of our shrinking world, clearly the progressive opening of foreign markets presents Boston businesses with exciting opportunities for growth and diversification. According to the OECD's most recent Economic Outlook for its members, economic prospects are "better than they have been for several years." Recovery has spread to all major regions; unemployment is declining in many countries, and inflation remains low. In the United States, for example, the "discomfort index," the sum of the unemployment and the core CPI, is at its lowest level in 30 years.

With the United States in the fifth year of the current expansion, however, the consensus of private and foreign official forecasters is that real GDP growth in this country will slow

noticeably this year. For example, among forecasters recently surveyed by Business Week, the consensus forecast for real GDP growth in 1995, fourth quarter to fourth quarter, was about half the expected pace of 4th quarter 1994. Since U.S. GDP has been rising at an unsustainably rapid pace, more moderate growth will benefit the nation over the long run -- although I know such a forecast sounds unpalatable in this state, where the recovery in terms of job gains remains well below the national average. Of course, at the peak labor markets in Massachusetts were awfully tight and it is questionable whether one would want to return to that unsustainable level of activity.

But living in a global economy, Boston firms can take heart, knowing that growth in world output is expected to accelerate in 1995 to its fastest pace in six years. World trade will grow almost twice as fast as world output, with import volumes in the developing countries rising fastest. Moreover, last year's dollar depreciation puts U.S. firms in a particularly good position to take advantage of these robust conditions overseas. Thus, most

forecasters expect that the U.S. trade deficit will, after reaching a record high in 1994, stabilize or fall slightly this year.

Over the longer term, NAFTA and, more importantly, the successful conclusion of the Uruguay Round can only enhance these favorable prospects. Conservative estimates indicate that over time the GATT agreement should boost world trade by 10 percent and raise world income by \$250 billion, or 1 percent, as a result of efficiency gains.

Massachusetts is, of course, no newcomer to international trade. Historically, in fact, Massachusetts has been much more dependent on trade than the typical state. Starting from colonial times, when we built ships for the British navy and, slightly later, machine tools for British armories, Massachusetts exporters have shipped cutting-edge capital equipment overseas; today, about three-quarters of our exports comprise such equipment -- computers, electronics, instruments and the like. But especially with the recent decline in the dollar, plenty of export opportunities for low-tech products also exist. Last week, for example, I met

the CEO of a New England company that exports twine and thread -- a decidedly low-tech product, employing unskilled labor. Selling to niche markets all over the world, this company gets one-third of its revenues from overseas and, by diversifying its markets geographically, enjoys greater stability in demand.

Despite this historic dependence on trade, by 1993, Massachusetts' merchandise exports had fallen slightly below the national average as a share of output (to 7.1 vs. 7.3 percent) -- not too surprisingly, since our merchandise exports have grown about half as fast as the nation's since 1987. This relatively lackluster performance reflects Massachusetts' market ties and its industrial base. Massachusetts firms have focused their export efforts on Canada and Europe, which were mired in recession in the early 1990s; by contrast, the typical U.S. exporter was relatively more dependent on the rapidly growing markets in Latin America and Asia. In addition, a single industry, industrial machinery, accounts for much of the state's export shortfall. While industrial machinery is fairly heterogeneous nationally, here

in Massachusetts, industrial machinery generally means computers, and for much of this period, our local computer industry has faced considerable challenge.

Still, we can hardly afford to be complacent, recognizing that production worker jobs have fallen faster in the region than the nation. While part of this loss reflects productivity improvements, some jobs have shifted to other sites because this state's average hourly earnings continue above the national average. As the state's manufacturing activities increasingly focus on administration, service, and R&D, much of the final processing and export of goods produced by firms headquartered here is likely to occur elsewhere. Thus, we probably can expect the share of merchandise exports in the state's output to continue below the national average.

Now, it may be that this discussion of trade simply doesn't relate to your own understanding of how export oriented the Massachusetts economy is. This is because we have focused solely on merchandise trade, for which state data exist, and not

on service trade for which state data do not exist. With the rapid transformation from a job base made up of about 25 percent manufacturing jobs, to a job base with much heavier service core, events have once again overtaken our ability to measure them, at least locally. Nationally, exports of services like travel and business services have been growing faster than exports of goods. Between 1987 and 1993, when merchandise exports grew about 80 percent, service exports more than doubled. Business services, including computer services, data base management, management consulting and so forth, soared over 200 percent. Of course, Massachusetts has a disproportionately large share of jobs in financial and other business and professional services. In Boston the employment base is even more skewed toward services; at 36 percent of the total, services is Boston's biggest employer, well ahead of all manufacturing or trade. We can assume, thus, that Massachusetts and Boston have produced disproportionately large shares of U.S. service exports.

In addition, exporting is not the only or even the widest

important to Massachusetts and Boston firms than the state merchandise export data indicate. Many local firms tell us that over 40 percent of their total revenues are earned overseas. And contacts in Boston's tourism industry attribute recent record-high hotel occupancy rates to growing numbers of foreign visitors, some of whom came here to do their Christmas shopping because of the favorable exchange rate.

Because the ongoing restructuring of the state economy suggests that Massachusetts firms will increasingly serve global markets through exports of services and overseas investments, the successful conclusion of the Uruguay Round of the GATT talks holds special promise for this state and city. In addition to cutting average tariffs by one-third and eliminating tariffs on some goods altogether, the Uruguay Round extends international rules, like most-favored-nation and national treatment principles, to trade in services and to international investment activity for the first time. Other provisions of particular importance to local firms refine and expand the rules covering government procurement and

intellectual property rights. For example, the government procurement provisions, which now apply to governments below the national level, will open up new opportunities for our telecommunications, engineering and construction firms. Similarly, progress on intellectual property rights, even if not entirely satisfactory, is extremely important to our computer software and biotech firms.

Lest I seem a Pollyanna in a world of earthquakes and currency crises, let's turn now to the risks and competitive challenges Bostonians face in an increasingly open world economy. Obviously, global ties expose us to natural disasters, political upheavals and crises of confidence all over the world. Kobe's tragedy, we now know, may touch workers as far away as Wayne, MI and Hermosillo, Mexico if delays in getting Japanese auto parts halt production at Ford plants in those cities. Similarly, Boston investors taking advantage of new opportunities in emerging markets may have experienced short-term losses as a result of the peso crisis. With the benefit of hindsight, many now

argue that the Mexican peso remained overvalued for far too long with the result that its current account deficit reached an unsustainably high share of GDP. But it also seems likely that relatively few investors availed themselves of the chance to hedge their peso assets.

Market discipline clearly is and will be essential in avoiding the problems that arise if, for example, LDC governments were to pursue irresponsible policies in the belief that the industrialized world would "bail them out." But I would like to suggest that investors also bear much responsibility for the peso crisis that now threatens to slow economic growth in Argentina, Brazil and other developing countries. All too often, investors take large, one-sided bets on market trends and then reverse that view abruptly. Such pack behavior contributed to the LDC debt crisis of the early '80s, the New England real estate problems of the late '80s, this year's bond market turmoil, and, most recently, the crisis of confidence hitting the emerging markets.

Mark-to-market accounting methods, explicit loss limits and

other measures have been quite successful in limiting the consequences of this year's bond and exchange market disruptions for the industrialized countries. However, regulatory and supervisory authorities still face the challenge of ensuring that investors can bear potential losses without those losses spilling over onto innocent bystanders through breakdowns in payment and settlement systems or in weakened macroeconomic performance. Steps to price market risk, improved disclosure standards, and efforts to implement large position and information systems for banks and nonbanks are also helpful. Ultimately, however, the responsibility for avoiding periodic crises must rest with individual investors and financial institutions. In a world of almost limitless investment options but limited ability to scrutinize those choices, there's no substitute for prudence on the part of individual financial institutions and individual investors.

In addition to providing additional opportunities to take or to diversify risk (the choice is ours), the new economic order also exposes Bostonians to increased competition for sales, capital and

entrepreneurial talent. Take the labor markets, for instance.

Service workers used to provide a "nontraded" product within a local economy. Recently, however, we've seen U.S. firms set up airline reservations systems and insurance claims processing centers offshore; thus, Boston data processors and software designers now compete with cadres of well-educated workers in Ireland and India.

Similarly, Boston's Big Dig and port expansion now compete with the reconstruction of Kobe harbor and Singapore's underground highway for investor favor. As developed and developing countries have opened their financial markets to foreign investors and financial institutions, menus of viable investment opportunities have expanded phenomenally. For example, even in Southeast Asia, where internal savings are multiples of our own, the gap between local savings and planned investment is seen as huge. Last December when I spoke at a conference in Singapore on financing Asian infrastructure and development, I learned that more than \$1.5 trillion will be needed

over the next decade in that area alone.

In the current world-wide upturn, the demand for capital in these newly open economies will add to upward pressures on long-term interest rates everywhere. At all levels of government, moreover, in developed as well as developing countries, investors are looking for credible economic policies that avoid large fiscal deficits, accelerating inflation, overvalued currencies, or deteriorating current account positions.

A final area of competition for Boston and other cities stems from their need for innovative and entrepreneurial talent. As we have seen in computer hardware and software, Boston now competes not only with Silicon Valley but also with Silicon Prairie (TX), Beach (FL), and, most likely, Gulch. To return to Jane Jacob's point, raised early in my talk, cities thrive when they serve as hotbeds of creativity, to which firms are drawn in large part because they need to buy, borrow or absorb the output of a diverse set of creative people. An obvious example is Boston's medical/industrial cluster. Time and again, CEOs of biotech and

medical equipment companies say that they are in Greater Boston to be near the scientists, doctors and clinical research facilities found in the area's universities and teaching hospitals. As Paul Krugman points out, however, these clusters can dissolve quite suddenly when the balance of advantages tips in favor of another center. Because innovation occurs worldwide, facilitating the in- and outbound direct investment that brings local entrepreneurs into contact with new technology generated both in the U.S. and abroad seems crucially important to the city's future.

In sum, then, as domestic demand slows in the coming year, Bostonians face unprecedented trade and investment opportunities in rapidly growing foreign markets. But because these opportunities are expanding faster than our ability to fully understand the political and economic forces affecting them, they also bring unprecedented risks. Indeed, recent events underscore the need to expect the unexpected and maintain balance and perspective in all areas. In addition, the new economic order exposes this city and its people to increased competition in every

arena -- from the market for capital to the market for innovative talent. When all is said and done, however, increased competition and international exposure are likely to spur the forces of creativity that give Boston, like other cities, its reason for being.

Thank you.