QUEST FOR EXCELLENCE '98
ILLINOIS MANUFACTURERS ASSOCIATION ANNUAL MEETING

Springfield, Illinois
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I. Introduction

A. Thank you, Tink [Campbell], for that kind introduction. I'm very pleased to speak at the Annual IMA meeting: Quest for Excellence '98. IMA is one of the most important associations in the state in helping Illinois and the Midwest maintain its competitiveness in the global market.

1. It's always an honor to speak before a group that represents the best in management and values the importance of teamwork.

2. I'd like to congratulate the winners of the 1998 Illinois Team Excellence Awards for setting the standard of excellence in teamwork and raising the bar a little higher for all of us

B. As Tink mentioned, I'm an economist by trade. Don't know if an economist has ever been on a team that won this prestigious award. I doubt it, though, given economists' inclination for hedging their bets.

- I recently heard about the tombstone of a famous economist. The inscription on the stone read: "I am guardedly optimistic about the next world but remain cognizant of the downside risks."

C. The winners of the Team Excellence Award aren't likely to hedge their bets. They can't afford to. They have to go all out. The competition is too intense not to. Competition on a global basis.

1. Like the athletes competing in the Olympics, Illinois manufacturers are up against the best in the world. And that type of intense competition means there's a thin margin between winners and losers.

2. Consider—a runner in the women's 100-meter finals at the 1992 Barcelona Olympics finished 6/100ths of a second behind the winner. For that she came in fifth place!

3. Think of it— there was only 15 inches and 6/100ths of a second difference between the gold medal winner and the runner who came in fifth.

D. So congratulations to tonight's winners. You're engaged in a very tough, very competitive race against the world's best. You can be truly proud of your accomplishments.

- And in the same breath, I'd like to congratulate all the firms that participated.

- It's this devotion to quality and innovation that is helping to keep Illinois and the Midwest competitive in world markets.

E. Tonight, I'd like to discuss the Midwest economy and its success in staying a step ahead of its competitors in the global economy. I'd also like to briefly discuss the developments in the national economy.

1. In discussing both these topics, there's a common theme that emerges-the crucial role of the international economy.

2. Today, one of the key questions for the national economy is how quickly Southeast Asia can bounce back from its economic difficulties.

3. Back in the early 1980s, one of the key questions facing the Midwest was how quickly the manufacturing sector could bounce back from intense overseas competition.

4. Two sides of the same coin. Each situation highlights the interconnected nature of our global economy.

F. Before I discuss the economy, let me give you some brief background on the Federal Reserve.

1. The Fed's mission is to foster a safe and sound financial system and a healthy, growing economy:
   - We formulate monetary policy.
   - We supervise and regulate banks.
   - And we provide financial services to the U.S. Government and depository institutions.

G. The Board of Governors in Washington, D.C., oversees the 12 regional Reserve Banks across the nation.

- The Chicago Fed serves a five-state region consisting of most of Indiana, Illinois, Michigan, and Wisconsin, and all of Iowa.

- In addition to our head office in Chicago, we have offices in Detroit, Des Moines, Indianapolis, Milwaukee, and Peoria.

H. As a regional institution, the Chicago Fed has a strong interest in understanding the Midwest economy. And we have a particular interest in the manufacturing sector since it makes up a significant portion of the Midwestern economy.

1. In 1997, the Midwest's share of earnings derived from manufacturing was 27 percent compared to the national average of 18 percent.

2. As I mentioned earlier, I plan to discuss the Midwest's dramatic turnaround since the early 1980s, particularly in the manufacturing sector.

3. But first I'd like to briefly review some recent developments in the national economy.

II. National Economic Developments

A. As I'm sure you know, the Federal Reserve has eased monetary policy three times since late September.

    1. The Federal Open Market Committee lowered its intended federal funds rate in three one-quarter percentage point steps-from about 5½ percent to around 4¾ percent.

    2. In conjunction with these actions, the discount rate was reduced in two one-quarter point steps—from 5 percent to 4½ percent.

    3. The actions were taken to cushion prospective U.S. economic growth from the effects of increasing weakness overseas and less accommodative financial conditions domestically.

B. To understand where the U.S. economy is going and why these policy actions were taken, I think you have to consider where we've been.

    1. Over the last few years and so far in 1998, inflation and unemployment rates have been quite low.

    2. We've also experienced strong growth in real GDP—3.9 percent in 1996, 3.8 percent in 1997, and an average 3.7 percent over the first three quarters of 1998.

    3. During this period, consumer confidence has been very high, employment and personal income have grown strongly, and financial wealth has increased sharply due to surging stock market values, even after accounting for the sharp fall from mid-July to late August and the subsequent rebound.

C. Beginning in mid-1997, however, other economic events began to unfold, events that accumulated to the point of potentially restraining U.S. aggregate demand more than desired.

    1. The financial crisis that began in Thailand spread throughout East Asia.

    2. U.S. export growth slowed due to lower demand in Asian countries and a strong dollar against Asian currencies.

D. Last year, the U.S. shipped 27 percent of its exports to Asia. That figure dropped to 23 percent during the first three quarters of 1998.

1. On the import side, we've seen an increase in Asian imports of about 4 percent in dollar terms compared to a year ago. The prices of these imports are well below year-ago levels.

2. On the one hand, the developments in Asia helped to dampen inflationary pressures here in the U.S.

3. On the other hand, they've placed pressure on domestic manufacturers that compete with overseas firms.

4. This has certainly been the case in the steel industry, for example.

E. In addition to the developments in East Asia, financial problems emerged in Russia in August, and concerns increased that difficulties would spread to Brazil and other Latin American countries.

- All of these developments made our economic outlook more uncertain, and raised the risks that growth would slow more than was appropriate.

F. One indication of the dramatic developments in the global economy was the change in the world economic outlook by the International Monetary Fund during a four-month period.

1. Last May, the IMF forecast 3.1 percent world GDP growth during 1998. On September 30, the IMF revised its forecast to 2 percent.

2. The downward revision for world growth during 1999 was also dramatic—from 3.7 percent to 2.5 percent.

3. And frankly, this 1999 projection is a bit optimistic compared to other business analysts' more recent forecasts.

G. The full extent of the after-shocks to our domestic economy was, and continues to be, hard to gauge.

1. Financial developments in September and October quickly turned investors away from additional risk-taking investments. Investors' appetite for risk clearly declined.

2. Market volatility increased as managers of financial funds re-weighted their portfolios towards less risky assets.

3. A world-wide financial flight to quality increased spreads between private bonds relative to U.S. Treasury securities, which are considered a safe haven.

H. In this environment, there were growing concerns that credit-worthy borrowers would find it difficult to obtain credit for productive investment opportunities in the coming months.

1. Some companies had cut back on their borrowing in the capital markets.

2. And Federal Reserve surveys and other sources indicated that some banks had tightened their lending standards.

3. The most recent Fed survey of senior bank loan officials indicated that one-third of domestic banks tightened their standards on commercial and industrial loans to large- and middle-market business during the past three months.

4. We have seen some signs of a return to calmer market conditions in the past month. The financial markets have become more settled, with credit-risk spreads narrowing since their peak in mid-October, although some of these spreads still remain at relatively high levels.

I. The international situation continues to pose risks to U.S. exports and the world economy in general.

1. The IMF recently announced a program supporting Brazil's economic adjustment measures. This financial support should allow Brazil to defend its exchange rate system, and foster greater economic stability in Latin America next year.

2. In Japan, continued economic weakness is likely in 1999. The fiscal stimulus measures and bank reform plans announced to date are unlikely to boost economic growth appreciably in the near-term.

3. Putting this all together, the outlook for U.S. exports continues to be held back by a weak global economy.

J. For these reasons, the FOMC moved to ease monetary policy, stating on September 29 that the action was taken in response to increasing weakness overseas and less accommodative financial conditions domestically.

1. I should stress that the Fed acted to cushion the effects of international and financial developments on prospective economic growth.

2. Monetary policy works like a time-release capsule, with a lag of a year or even longer. So it's necessary to anticipate developments rather than wait until after the fact.

3. As the Federal Reserve stated on November 17th, with the three policy actions taken since late September "financial conditions can be reasonably expected to be consistent with fostering sustained economic expansion while keeping inflationary pressures subdued."

K. Looking forward to 1999, the Chicago Fed is anticipating that U.S. real GDP growth won't be as high as the growth we've experienced over the past few years.

1. We are still working on our forecast for 1999, but based on early indications we expect real GDP growth in the neighborhood of 2 percent. That's similar to the expectations of many private forecasters.

2. We expect that inflation as measured by the Consumer Price Index will remain low, although not quite as low as in 1998; and that the unemployment rate at the end of 1999 will be only slightly higher than it is now.

L. We forecast the national economy on a regular basis, and we'll be refining our thinking on 1999 in the coming weeks as we prepare for the Fed System's monetary policy report to Congress in February.

   1. By the way, as part of our information gathering process the Chicago Fed holds an economic outlook symposium, which brings together analysts and economists from across the Seventh District.

   2. We'll be releasing the consensus 1999 forecast of that group on Friday.

III. Midwest & Manufacturing

A. That brings me to my second topic tonight-the revival of the Midwest economy.

   1. Today, we're wondering how the domestic economy will be affected by problems overseas.

   2. In the case of the Midwest twenty years ago, the question was how quickly the region could bounce back in the face of stiff competition from overseas.

   3. The answer to that question is indicated by the title for this annual meeting-"Quest for Excellence."

B. That title is especially appropriate, as it was the manufacturing industry's quest for excellence that played a major role in the revitalization of the Midwest.

   1. As most of you remember well, the manufacturing industry in the Midwest experienced an extreme downturn during the 1970s and 1980s.

   2. Between 1967 and 1987, the Midwest went from a national share of 26.7% of manufacturing production to 22.1%.

   3. The 1979-83 period was especially severe. The Midwest lost over one-fifth on its manufacturing work force.

C. One explanation for the severity of the downturns for the Midwest was the regions technology and stock of physical capital.

   1. They tended to be older and less efficient in comparison to the rest of the U.S. and abroad. It's no wonder the Midwest was referred to as the "Rust Belt" during this time.

   2. However, during these rough times, manufacturing was re-invented. The industry understood that it had to change or perish.

   3. So it changed its management techniques, reduced its workforce, and reinvented its productive processes. These changes took time. It wasn't until the late 1980s that these efforts finally began to pay off.

D. The turnaround can be seen by looking at the auto industry, which has reconcentrated in the Midwest.

1. In past years, assembly plants were spread out across the country closer to population centers to reduce distribution costs.

2. Now the proliferation of car and truck models makes it more efficient to produce the entire output of a specific model at one plant.

3. The Midwest and its south-central extension into Kentucky and Tennessee have become the most efficient location for those plants.

4. As a result, more than 50 percent of the auto plants in the US. are located here in the Midwest.

E. Looking more broadly across all manufacturing industries, the Midwest's share of employment and production have been on the upswing since the mid-1980s.

1. Each industry-autos, farm equipment, trucks, construction equipment, machinery, steel—has found its own route to competitive success.

2. Although some of these industries face short-term challenges due to developments overseas, the manufacturing sector is well positioned to compete on a global basis over the long term.

F. Given the success of Midwest manufacturers, it's clear that I don't have to lecture you about the importance of management in the productive process. If I did, more than likely, you wouldn't be sitting where you are today , among a group of the best decision-makers in Illinois.

G. There are many examples of Midwest companies that are incorporating new technologies and manufacturing practices into their productive process—many are represented in this room tonight.

1. Rather than single out one Illinois company as an example of best practices, I'd like to briefly describe the efforts of a company in our neighboring state of Wisconsin—Milwaukee Electric Tool Company.

2. Milwaukee Electric Tool produces professional quality power tools and accessories.

3. They are headquartered in Brookfield, Wisconsin and operate 5 plants with approximately 1,100 employees in North America.

H. Until 1990, Milwaukee Electric's plants were organized on the traditional batch or mass production techniques.

1. These techniques, as you well know, require excessive material handling and the need for large amounts of floor space.

2. The completion of the entire manufacturing process could take weeks or months.

I. In the early ’90s, Milwaukee Electric Tool began to reorganize its plants to implement cellular manufacturing.

1. Cell manufacturing is a team-based approach to production.

2. Under this system, a plant consists of several cells that each produce specific products or components.

3. Each cell has between 20 and 40 members and operates like an independent business with total responsibility for the quality, manufacturing and delivery of the product to the consumer.

J. Why did Milwaukee Electric Tool make the switch? It wasn’t because they were suffering financially, but because they anticipated increased competition from Europe and Asia.

- Now all their plants utilize a flexible cell approach with dramatic results: inventories have been cut in half; sales have more than tripled; both quality and productivity have increased; and incoming orders are largely filled within a day.

K. Looking back at these achievements of Midwest manufacturers, we can see that foreign competition was a common element in their success.

1. It was competitive pressure from foreign companies, which forced the painful restructuring within the industry. The emergence of foreign competition can pose a threat, but for those that survive there are direct benefits as well.

2. Their presence in the domestic and overseas markets where we compete has allowed us to learn from the interaction. Worthy competitors compel us to rethink our old practices and adopt new management strategies and productive techniques.

3. For example, lean manufacturing practices in the auto industry, which emphasizes teamwork, low inventory, flexible production equipment, and close relationships with suppliers, were originally developed by Honda and Toyota.

L. Increasingly, foreign competitors are also becoming foreign customers. Foreign auto producers purchase parts from domestically owned auto suppliers. This beneficial interaction illustrates the growing interdependence of our global economy.

1. The financial turmoil in Asia not only threatens the prosperity of foreign countries, but our own prosperity as well.

2. We can no longer think of foreign and domestic competition as a zero sum game. Their losses are not our gains.

3. The economic revival of Asia will be crucial to our future prosperity. It’s our natural affinity for competition—not isolation from other countries-that allows us to thrive.

IV. Future of Manufacturing

A. What challenges and opportunities are facing the manufacturing industry in the future?

1. One challenge is the changing dynamics of the labor force. The graying of the labor force coupled with population migration in the Midwest will affect the number of workers available to work in manufacturing.

2. Currently, the Midwest is experiencing net internal out-migration. In other words, there are more residents leaving for other regions than there are coming in.

3. According to the Census Bureau, we lost 154,000 residents to other states between 1996 and 1997.

B. Tightening labor markets and favorable climates in the South and West have drawn Midwestern residents away.

1. Immigration and natural increases have helped offset these losses and has kept Midwest population growing in absolute terms, but at a slower rate than the rest of the nation.

2. Population growth in the Midwest is 0.5 percent per year—half the national rate of 1 percent. While these numbers are relatively small, over time they can have an adverse effect on our labor markets.

C. The public and private sector must develop new strategies to retain people or run the risk of running short of workers at competitive wages.

- One approach is working to make the Midwest a better place to live by improving the quality of life through low crime rates, a clean environment, open space, outdoor recreation, and cultural entertainment.

D. Even more important is enhancing educational opportunities to expand the existing labor pool, either by attracting new workers or re-training previously unemployable individuals.

- I know that education and training is an area that IMA has focused on.

E. Offering opportunities for retraining and education for the labor force is simply good business. Improved education will be necessary in the future to remain competitive.

1. Our strength in the future will be our ability to compete on quality rather than on price. Competitors from abroad will have natural cost advantages due to their plentiful labor supply.

2. By focusing our efforts on education and training, we enable our workers to add higher value to the production process.

F. The growth of the national economy also presents a potential challenge for Midwest manufacturing.

  1. As a nation, we've enjoyed a period of strong economic growth. In recent years, economic growth has been above trend, but we'll experience slower growth at some point.

  2. Manufacturing will not always have the luxury of above-trend growth it has had in recent times.

  3. While the slowing of growth will present new challenges, the industry is well positioned to meet any adversity in the future.

  4. The previous successes of manufacturing have clearly demonstrated that the industry can rise to the challenge.

G. On the horizon, there don't seem to be any discernible natural advantages or external trends that will necessarily sustain U.S. manufacturing.

  1. We can't just sit back and hope that things work out. Increasing competition from abroad with a slowing of economic growth will add to the challenges facing the industry.

  2. We cannot become complacent with our progress so far. Success is a continually moving target.

  3. We must continue to innovate and push our competitiveness to new heights if we are to hit the mark.

H. In John F. Kennedy's words, we do these things not because they are easy but because they are hard. Effective management and team excellence captures the spirit of these words. It will be the future winners of the Team excellence awards who will show us the way to meet the challenges of tomorrow.

I. Thank you.