

## 2001 WISCONSIN BUSINESS LEADER OF THE YEAR AWARD

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### **The Impact of Open Markets and Expanded Trade on Economic Development**

It's a pleasure to be here tonight and to have the honor of speaking at this dinner in honor of the 2001 Wisconsin Business Leader of the Year. Looking at your past recipients, it's clear that your current honoree is in excellent company.

I'm particularly proud to say that three past recipients have served as directors of the Chicago Fed: Don Schneider from Schneider National, Chuck McNeer from Wisconsin Energy and Jim Keyes from Johnson Controls. Chuck served as chairman of the Chicago Fed in 1991, and Jim is currently a valued member of the board.

Providing us with excellent directors is just one reason I'm partial to Wisconsin. I always love coming here, particularly to visit Milwaukee:

- You've beautifully revitalized your lakefront and downtown.
- You've opened a world-class addition to the art museum — the Quadracci Pavilion designed by Santiago Calatrava. My wife and I visited the museum this afternoon and were given a wonderful tour by Libby Wigdale. It's truly spectacular.
- You've developed Miller Park and planned a new Harley-Davidson Museum, further showcasing the civic leadership of Milwaukee businesses.
- Overall, you've created a diverse corporate base that includes manufacturing, health care, consumer products, insurance, retailing and financial services.

- If you keep this up, it won't be long before Chicago seems like a suburb of Milwaukee...

But, most important tonight, you're the home of Marshall & Ilsley Corporation. M&I has grown to become the largest independent bank in the state under the astute leadership of its chairman, Jim Wigdale.

Most of you know about Jim's background. How he grew up in Milwaukee, and after earning a degree from Stanford, returned to his home town and joined M&I Bank in 1962. He married his lovely wife, Libby, and started a family that grew to include five children.

He rose steadily through the ranks at M&I in positions of increasing responsibility. In 1988, Jim was elected vice chairman and director of Marshall & Ilsley Corporation, and in 1992 he became chairman and chief executive officer.

Let me relate some statistics:

- Over the last 10 years, under Jim's guidance, M&I assets have grown from \$7 billion to \$27 billion, an increase of almost 375 percent.
- Employees have doubled, from 6,000 to 12,000.
- Revenue and net income have quadrupled.
- And the stock price has risen nearly 350 percent.
- And, on top of all that, he has achieved a 500 percent increase in the number of his grandchildren — from 3 to 16.

Lest you think all the trend lines point up, thanks to a particularly accommodative monetary policy from the Federal Reserve, he and his growing family will be able to refinance their mortgages and lower their payments significantly.

But seriously, we all know Jim is a hard working, self-effacing family-man, with wholesome Midwestern values.

And isn't that refreshing, given the recent exposure of excesses in some sectors of the business community?

Jim's solid values and strong management of M&I — while not seeking or making headlines — have truly benefited shareholders, employees and the communities in which M&I is located.

What stands out to me, is how carefully Jim has guided M&I in an era of increasing consolidation in the banking industry. Bankers who know their communities and customers can expand their reach, as Jim has done, and continue to be major players.

For example, M&I has demonstrated the financial strength and vision to expand beyond Wisconsin into other areas of the country. And, as we look at the nation, our ability to look beyond traditional borders has contributed greatly to the economic prosperity of our country, and the world.

And that's what I'd like to talk to you about tonight: the importance of free trade to economic prosperity.

But first, you're probably wondering why, as a Fed president, I'm not discussing the short-term outlook for the U.S. economy and monetary policy. That's because the FOMC meeting is Tuesday. As you know, the Federal Open Market Committee, chaired by Alan Greenspan, determines monetary policy by setting the target short-term federal funds rate. And in the week before and after the meeting we observe a blackout period, during which the committee's statement serves as the public voice of the Fed in these areas.

I can, though, tell you a little bit about the process we go through to prepare for the meeting.

About two weeks in advance, each of the 12 Federal Reserve Banks releases a report called the Beige Book, due to the color of its cover. The Beige Book summarizes economic conditions in the 12 districts based on anecdotal information. The Beige Book complements the in-depth analyses of published data with current information gathered from business leaders such as yourselves.

In addition to the Beige Book, the Fed staff in Washington prepares a Green Book. The Green Book is their economic forecast, and is made available to us five days in advance of the FOMC meeting.

Then, a day after the Green Book, we receive a Blue Book. The Blue Book outlines options for monetary policy to be discussed at the upcoming FOMC meeting.

Beige Book, Green Book, Blue Book. I'll bet you didn't know central bankers could be so colorful.

After evaluating all these materials, we vote on two issues. The first is whether to change the federal funds rate. Should we raise it, lower it, or keep it the same? The second is whether to alter the balance of risk statement. This statement indicates whether we believe the risks going forward are tilted towards rising inflation, or tilted towards weaker economic growth, or are balanced.

That's what I'll be up to this coming week. So if you want to see the short version of what my speech would have been, you can find it in the news on Tuesday...

But let me turn now to a subject that I can talk about — one that's important to our long-term prosperity. It's an area I've been involved with in the past and which has been much in the news lately. And that's open markets and expanded trade. A key factor in economic growth both here and abroad is the long-term process of opening our borders to trade and investment.

In recent weeks, advances in free trade have been overshadowed by increases in tariffs. The United States has increased tariffs for steel and lumber. The European Union and Canada have threatened to increase tariffs on a variety of products, including steel, motorcycles and tomatoes.

Some commentators have questioned which way the world trading system is moving. Is it towards more openness or less? As part of this dialog, it is appropriate to take a step back and consider how open markets and expanded trade affect economic growth in general. Let me turn to that subject.

### Open markets foster prosperity

Despite recent economic uncertainty, the United States and much of the rest of the world have never before been as affluent as they are today. For example, per capita output in the United States in 2001 was about twice the 1966 level and more than four times the 1940 level.

We also have seen a dramatic rise in economic openness among nations. For the United States, total trade, measured as exports plus imports, has increased from less than 10 percent of GDP in 1940 to nearly 25 percent today. The parallel rise in openness and affluence is no coincidence.

Economic studies have repeatedly found that openness promotes prosperity. Looking across the countries of the world, you find that the economies most open to trade and investment are those with higher per capita income. That is because cross-border investment fosters an efficient reallocation of resources that leads to productivity improvements and higher economic growth.

Moreover, economies benefit from the real efficiency gains brought about by freer trade. When firms can purchase the highest quality and lowest cost materials from anywhere in the world, their production costs fall. These lower costs lead to lower prices and better choices, which spread broadly throughout entire societies.

But, it's important to note that the benefits of lower prices are largest for those with low and moderate incomes. Because free trade lowers the price of everything from food and clothing to automobiles, those who spend the largest fraction of their income on these goods reap the largest gains.

#### Domestic and international benefits of openness

U.S. firms and workers benefit from producing and selling goods globally, but countries on both sides of the transaction stand to gain — particularly in developing countries. Countries that lack capital can develop more quickly because capital inflows allow them to increase their productive capital stock without foregoing current consumption. When the capital inflow takes the form of foreign direct investment, it improves access to international best practices in accounting, banking, legal and other important standards.

As a result, developing countries that have opened their borders to trade and investment are better off. In its examination of 84 developing countries, the World Bank reported that those with the largest tariff reductions in the 1990s also had the most rapid growth in GDP and exports. And American multinationals pay workers in developing nations double the local manufacturing wage. Thus, open markets, from a purely economic perspective, benefit the consumer, the producer and economic development at home and abroad.

#### Dealing with arguments against open markets

Despite these benefits, there are a number of groups, both here and abroad, who oppose free trade and open markets. Especially in cases regarding displaced workers, their concerns are serious and deserve our attention. I'd like to discuss some of their concerns and what role, if any, the government can play in addressing these issues.

As trade barriers fall, some industries and their workers find themselves facing sharp competition from imports. This is because increased trade redirects resources toward their most productive uses. In the United States, the result is that production shifts to higher value-added products as production of lower value-added goods shifts overseas.

It is indeed true, then, that inefficient industries will suffer from increased competition. Nevertheless, economic studies suggest that worker dislocation caused by trade accounts for no more than 10 percent of all

displaced workers in the U.S. Moreover, the adjustments that arise from expanded trade do not reduce the total number of jobs in the United States. In fact, expanded trade is, overall, good for workers.

While competitive pressures may cause some to reduce their work forces, other firms will find themselves with new opportunities and will increase hiring. The evidence suggests that the expanded opportunities are likely to be in high productivity industries such as aircraft and pharmaceuticals that pay wages substantially above the U.S. average.

For instance, throughout the Midwest, there have been shifts away from manufacturing employment towards service sector occupations. This is true here in Milwaukee. During the past 25 years, Milwaukee has seen a decline of 30,000 manufacturing jobs. At the same time, you've added more jobs in financial services, insurance, and professional services such as accounting and management — many of them high paying.

Even within manufacturing — which still retains a higher concentration here — domestic and international market forces are a constant source of industry changes. Local jobs in beer production, certain machinery lines and apparel manufacturing have declined, even while jobs in printing, chemicals, plastics and medical equipment have grown.

Thus expanded trade and competition tend to reallocate jobs and resources to higher value-added sectors. Conversely, high tariff barriers can reduce employment in relatively efficient industries by directly increasing costs of production. Here's just one example. Trade protection in the U.S. sugar industry has pushed the domestic price of sugar well above the world price. In 1999, we paid almost five times the world price. That is a huge difference, and one of the unintended consequences is that Midwestern candy factories are relocating to countries such as Canada, where the price of sugar is not artificially increased.

Thus from a broader perspective, society at large suffers if we choose not to open our borders. Although a small number of industries benefit greatly from barriers, a larger number of firms, workers and consumers suffer the costs.

## Policy options

While the long-term benefits of free trade are clear, we cannot ignore the short-term disruptions that occur as barriers come down. So in my view, the crux of the free trade debate is, "How can we cushion short-term dislocations so that we can more quickly achieve the long-term benefits of open markets and expanded trade?"

One way this can be done is to lower barriers and increase openness gradually, in a process that more closely mirrors natural innovations in the economy. Technological innovation, for example, usually takes place in incremental steps without creating large amounts of unemployment.

Workers and businesses have come to expect technological innovation to change the nature of their enterprises. And, because it takes place incrementally, this allows workers and firms time to find new uses for their skills and equipment.

Lowering trade barriers — while positive over the long term — can occur suddenly, dislocate major industries and cause significant and rapid unemployment in concentrated regions.

Thus it behooves us to look at policies that can ease these short-term disruptions. For instance,

- Trade reforms can be designed to phase in gradually to allow businesses and workers more time to transition;
- Training programs could be improved to provide dislocated workers with the skills they need to be re-employed;
- And the government could directly compensate the losers for their losses on a one-time basis that would incent them to become re-employed in a different industry.

Time does not permit a more detailed discussion of the advantages and disadvantages of these policy choices. But, in my opinion, they are the types of policies that are important to consider as we move forward to open markets and expand trade.

## Conclusion

In closing, I'd like to thank you for inviting me to share my thoughts on open markets and expanded trade. While some remain opposed to free trade, I continue to believe that openness is essential to long-term prosperity in both the developed and developing worlds.

It's been a great pleasure to be with you tonight, and especially to have a chance to honor Jim Wigdale.