

MAPS Anniversary Luncheon Speech  
W. Lee Hoskins  
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## I. Introduction

It's a great pleasure to be part of the MAPS Anniversary lunch. What I would like to do today is take a look at where our economic region is and where it is going. I think you will agree that we are living in a time of rapid change and competitiveness and the continued globalization of markets will only intensify the situation. Some people welcome change and use it to their advantage. But, far too many people resist change and spend their time trying to stymie it. On this point, permit me to read from a letter written over 150 years ago.

'Dear President Andrew Jackson:

'The canal system of this country is being threatened by the spread of a new form of transportation known as railroads. The federal government must preserve the canals for the following reasons:

'One - If canal boats are supplanted by railroads, serious unemployment will result. Captains, cooks, drivers, repairmen and lock tenders will be left without means of livelihood, not to mention the numerous farmers now employed in growing hay for horses.

'Two - Boat builders would suffer and tow-line, whip and harness makers would be left destitute.

'Three - Canal boats are absolutely essential to the defense of the United States. In the event of the expected trouble with England, the Erie Canal would be the only means by which we would move the supplies so vital to waging modern war.

'As you may well know, Mr. President, railroad carriages are pulled at the enormous speed of 15 miles per hour by engines which in addition to endangering life and limb of passengers, roar and snort their way through the countryside setting fire to crops, scaring the livestock and frightening women and children. The almighty certainly never intended that people should move at such breakneck speed.'

Signed - Martin Van Buren, Governor of New York, April 1829

There will always exist pressures to favor the status quo. As an aside (if desired), railroads had a similar myopic-induced viewpoint as the canal operators. They did not really accept autos and aircrafts as competition.

My **message** to you is that

- a) In an ever more competitive world, organizations must adopt new strategies and business practices that not only concentrate on production or service for our own markets, but also deal with global markets. Employing technology will be critical.
- b) Policymakers need to remove impediments, particularly in the financial services industry, that stand in the way of market forces and ultimately reduce the competitiveness of our firms.

A look at Ohio and the rest of the Fourth District over the past decade presents us with a good example of the positive results of technological applications and unbridled market forces.

## II. The Changing Nature of the Fourth District Economy

- A. This region has come a long way from the recession years early in the previous decade. The catch-word for Ohio and the Midwest over the last decade has been "restructuring."
- B. Our regional economy still remains highly dependent on manufacturing.
  - 1. Manufacturing sector in Ohio is dominated by durable goods industries such as industrial machinery and equipment, transportation equipment, and fabricated metals.
  - 2. At the end of the 1970s, some of our industrial base was obsolete in a number of ways that became quite apparent when national markets began to open up
    - a. Although growth in employment has been stagnant or declining throughout the 1980's, manufacturers continue to produce goods at a faster pace than the expansion of the state economy. We have experienced significant productivity gains...producing more with fewer workers. The result is a leaner, more competitive manufacturing sector.
    - b. application of technological developments has aided productivity growth enormously
    - c. Investment and export boom during 1988 and into the first part of 1989 was very beneficial.
  - 3. We have seen a Phoenix-like rise by some industries out of the ashes to become more vibrant and competitive in the local and national economy.
  - 4. Newspapers and magazine articles have heralded this resurgence as the Renaissance of manufacturing. The rust belt had begun to regain some of its old luster.
- C. Growth rate of services has been primary source of new jobs in Ohio and the nation.
  - 1. Services (primarily personal, health, and business services) have contributed two-thirds of the half-million new jobs in Ohio since 1980.
  - 2. The two fastest growing sectors are business services and computer data processing services -- both have capitalized on technological breakthroughs. Yet, it should be noted that these sectors are closely linked to manufacturing.
- D. We have come a long way in rebounding from the twin recessions that greeted the 1980s. However, for us to continue our success into this decade, we cannot rest on our laurels. The norms of the past do not necessarily apply to the way we must conduct business today and in the future.
  - 1. business strategies must be revised to take a more global approach
  - 2. technology will continue to play a big role in competitiveness

### III. Financial Services Industry

- A. Today, the financial services industry is facing many of the same challenges that many other businesses have faced since the early 1980s
- B. Technology and internationalization of business has and will continue to globalize the financial services arena
- C. As our financial markets become more global, policymakers and bankers realize that our banking laws and system of regulation put our domestic financial services industry at a competitive disadvantage
  - 1. international differences in bank structure can have important implications for the competitiveness of U.S. institutions here and around the world
  - 2. disadvantages will widen as
    - a. Europe 1992 approaches
    - b. Japanese banks continue to look for profitable opportunities
    - c. technology develops and is applied to the financial services industry

### IV. What Role Should Governments Play?

- A. Must create an environment in which market forces are free to operate
- B. Government still has an important role to play
  - 1. protection of individual property rights
  - 2. but, must be careful to preserve market fundamentals

### V. What Actions Should Policymakers Take in Reforming the Financial Services Industry? Before we can expand banking powers, regulatory reform is imperative. Any set of reforms must be based on market principles.

- A. Federal deposit insurance
  - 1. one method is to at least enforce the current limit (\$100,000) or reduce the limit near the original amount (\$25,000)
  - 2. if greater coverage were desired, a co-insurance system could be instituted
    - a. 100% up to 25,000
    - b. 90% between 25,000 and 50,000
    - c. 80% between 50,000 and 100,000
    - d. 70% above
- B. Do away with the "Too Big To Fail" doctrine
  - 1. allow banks to be subject to market discipline of failure
  - 2. reduce long-term exposure to both insured and uninsured claims

### V. Technology Must Also Play A Role (as I have already alluded to)

- A. Today's seminar represents one step in the endless journey of technological development and implementation in the financial services industry
- B. Introduce my colleague, Ned Richardson, who heads up our marketing and product and business development areas for the Fourth Federal Reserve District
  - 1. Ned will talk about some of the developments in electronic transfer of funds
  - 2. and discuss some of these developments applications

- B. Negative Effects of Deposit Insurance
  - 1. intricate system of rules and regulations to protect the insurance fund (taxpayers) and to guard against unfair subsidies to poorly managed banks
  - 2. proved to be operational handicaps in a fast-paced world
    - a. technology allowed unregulated interlopers to unfairly compete
    - b. fluctuations in inflation highlighted the inflexibility of a rigid system of rules and regulations

### III. Price Stability and Sound Banking

- A. Credit analysis
  - 1. decisions to limit bank risk are based on
    - a. the value of collateral in secured loans
    - b. and on projections of the ratio of a borrower's current assets to current liabilities in unsecured loans of working capital
  - 2. unexpected price changes can invalidate assumptions underlying the loan; the standards of loan evaluation can be preserved under conditions of price stability
- B. Price instability
  - 1. accounts for many of the problems of financial institutions here and abroad, but also for the plight of U.S. deposit insurance agencies
  - 2. price fluctuations of the late 1970s and early 1980s coupled with the regulatory environment and deposit insurance limits of \$100,000 per account encouraged the system to undertake greater risks
    - a. bank managers and shareholders are not penalized for poor management since depositors are all but unconcerned with risk
    - b. insurance is not priced for risk (flat fee)
    - c. the manner in which deposit insurance agencies settle failures, guaranteeing non-insured parties not included under the deposit insurance system, tends to worsen already apathetic market pressures
    - d. problems are compounded by the incentives of managers, once an institution is in trouble, to take greater and greater risks

- II. On the surface it appears that we have weathered the storm, and there is clear sailing ahead. It seems that we need only to continue to do whatever it was that brought about the recent resurgence of manufacturing and growth in services. However, the dramatic restructuring of our region has occurred at the same time as the U.S. economy has become more open to world trade.
- A. Industries face a more global economy than at any time since the turn of the century. What does a global economy mean for the U.S.?
1. Recent events have broadened world markets, including opening of China and perestroika in the Soviet Union
  2. Upcoming unification of European markets in 1992 will create even more opportunities for competition and participation
  3. Opening of European economy doesn't imply an automatically level playing field or more important an increase in overall efficiency.
  4. The trading world lacks a commitment to the principles of free trade. Environment is "neo-mercantilist" -- market access is often a function of negotiating skills rather than competitive strength
  5. Can America Compete? Trade deficits we have accumulated since the 1980s are primarily the fault of poor economic policies. These policies, especially high inflation rates of the 1970's, made our firms less competitive. We can do better, and policymakers can help.
- B. What role should governments play in a global economy?
1. Simple: Create environment consistent with good allocation of limited resources. Government policies should not strive to supplant markets and limit their discipline.
  2. Inflation: Control it because it leads to misallocated resources, socially inefficient institutions, and erosion of long-term growth
  3. Exchange rates: Avoid foreign exchange market intervention. In a system of floating exchange rates and free trade, resources will find their best use.
  4. Trade Restrictions: Stifle the healthy flow of resources and are ultimately damaging to trade and growth for all parties
  5. Regulation: Has adverse effects on long-term decisionmaking; the U.S. experience with its own steel industry illustrates this
- C. Regulatory Reform is necessary to allow the financial industry to be more responsive to the rapidly-changing needs of the marketplace.
1. For years, banks treated as a publicly controlled utility in U.S.
  2. Legislated changes have resulted in increased competition, also spurred by rapid technological changes
  3. Interstate banking has also increased competition
  4. More needs to be done: Banks in other nations compete globally and offer much more support to the export power of their native countries
  5. If we expect to compete, our financial resources must be mobile as those of foreign nations are

- III. Just as policymakers can take steps to improve American competitiveness, American firms can also take steps to improve their competitiveness in this growing global economy.
  - A. American industries must adapt to new world marketplace. World view must be revised.
    - 1. Strategies and resources must be updated vigilantly and institutions must become more flexible and responsive
    - 2. Increasing use of automation adds to output capability and efficiency but still workers are the heart of any process.
    - 3. Employee involvement and proper organizational structure are important aspects of this efficient use of the means at hand
    - 4. Business strategies and practices, and use of technology, must be constantly reassessed and updated; such technology will make the business world even more dynamic. In the case of financial transactions, technology to increase efficiency is growing, and America must stay on top of it
  - B. CONCLUSION: This responsibility falls to everyone in this room and to the Fed as well.
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