The Southern States in a Globalized Economy

Remarks before the Southern Governors' Association
73rd Annual Meeting

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Biloxi, Mississippi
August 25, 2007

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Thank you, Governor Barbour. I was rather enjoying your introduction until you mentioned the 1994 Senate race, a misguided adventure from a previous life. We at the Fed are sticklers for accurate data, so I need to issue a correction: I received 1,639,615 votes in 1994, which computes to 38.309 percent—roughly. About the only thing I was able to accomplish in that race was eating a dipped cone in every Dairy Queen in the Lone Star State—all 700-plus of them. Texas ended up with a fine senator in Kay Hutchison and, despite all those ice cream cones and Hunger-Busters, I managed to shed 20 pounds. It was a win–win experience. At least that's my story and I'm sticking to it.

You all know that we at the Fed are nonpartisan. Once you enter the "Temple," as some call it, you check your politics at the door. I joined up a couple of years ago and, like all Fed presidents, have refrained from political commentary since crossing that threshold. But I think it right and proper to say that what you have done here, Governor, in Biloxi and throughout Mississippi in the aftermath of Katrina's fury is impressive. I am honored to have been introduced by you and to meet with the Southern Governors' Association.

My district covers Texas, 26 parishes in Governor Blanco's state and 18 counties in New Mexico. It is a productive district, just like those covered by the Atlanta Fed and the St. Louis Fed—by Dennis's [Lockhart] and Bill's [Poole] banks—and the Richmond, Cleveland and Kansas City Feds, all of which have portions of the Greater South in their districts but are not represented here today. The governors of the Southern states, along with Dennis and Bill and me, with Jeff Lacker in Richmond, Sandy Pianalto in Cleveland and Tom Hoenig in Kansas City, serve a mighty swath of the U.S. economy. The American public reads almost daily about the great economic power rising on the far side of the Pacific. Well, you might remind your constituents and the press every now and then that the 16 states that you govern and that my colleagues and I serve, all told, produce a combined output that is 76 percent greater than China's. Let me do the calculation in a different way: For every dollar's worth of output that China produces, the hardworking constituents of your states produce $1.76. The South is an economic juggernaut.

How do we keep growing this mighty economic force? How does the South stay ahead of China and India and all the others who are knocking at the door, wanting economic prosperity?

First, we must acknowledge that we live in a cyber-enhanced, interconnected, inextricably interdependent global economy. The Southern economy is no longer confined by lines drawn on a map; it is no more removed from countries and markets at the far ends of the Earth than it is from the rest of the United States. We live in a globalized economy, knitted together by Knowledge Age technologies. Until the Industrial Revolution, economies were largely local, confined mostly to cities and towns. The butcher, the baker and the candlestick maker were within a day's walk or horseback ride. Then came railroads, industry, telephones, cars, highways, television and the Internet. With each successive technological innovation, our economic activities expanded beyond our towns and states and regions, allowing us more choices in determining our destinies and bringing more difficulties in devising local and regional

government economic policies. Sir Anthony Eden, the prime minister who succeeded Winston Churchill, said to the House of Commons in 1945, “Every succeeding scientific discovery makes greater nonsense of old-time conceptions of sovereignty.” He was dead-on.

What happens around the world affects us in the Southern states, just as what happens in each of your states influences investment decisions and economic activity around the world. We all know how devastating a fierce hurricane can be at the local level, destroying homes and businesses and disrupting millions of lives. Dislocations caused by a storm in the U.S. ripple around the globe: The Gulf’s vast oil and gas activity shuts down, causing world energy prices to rise and leaving drivers in Boston, Bulgaria and Brazil with less money in their pockets.

When a Mississippi manufacturing company closes its Gulfport factory and moves it to Guangdong, China, in pursuit of lowering its costs, it hurts. The press, with its local emphasis, focuses on the downside. And you, as governors, feel the brunt of your citizens’ anger. And yet you know and I know that Chinese workers at that new factory many thousands of miles from here now make more money than they did before. As they grow more prosperous, the Chinese can afford to consume more, and so they start spending their hard-earned yuan at the neighborhood Wal-Mart—good news for Governor Beebe—or on bottles of Jack Daniel’s—good news for Governor Bredesen—or perhaps on once-in-a-lifetime vacations to Disney World—good news for Governor Crist—or on soybeans grown in Texas—good news for my friend Governor Perry, who is well aware that China is one of the fastest-growing destinations for shipments leaving Houston’s port. So intertwined are the world’s economies that disentangling the web would be, as Bill Poole just pointed out, disastrously expensive, counterproductive and entirely fruitless. It takes extraordinary political leadership to accommodate globalization.

Over the decades, the inexorable march of capitalist evolution has shifted our economy’s base from agriculture to manufacturing and now to services. This is important to understand as we contemplate the South’s future. As people get richer, they shift their spending away from goods and toward services. For every dollar Americans spend on goods, we spend $1.70 on services. Ours is not a goods-based economy anymore—we grow and ship to the world a veritable cornucopia of crops, but agriculture represents only 1.5 percent of our economy. We build at a furious pace and mine our rich store of natural resources, but construction and mining represent only 5.5 percent of our economy. We are a manufacturing powerhouse, and yet factory output represents only around 11 percent of our economy. Services account for 82 percent of our economic output. Let me repeat that: 82 percent of our economic output comes from the service sector.

Given your professional background, Mr. Chairman, you may be interested in one fact that illustrates the importance of the service sector: At the end of 2005, the U.S. auto and auto parts manufacturing industry employed about 1.1 million workers and added 0.8 percent to our GDP. The legal services sector had nearly the same workforce—a little over a million lawyers inhabit America—but they contributed 1.5 percent to GDP. Lawyers produce twice as much as automobile workers. So much for lawyer jokes.

Obviously, services differ from goods in the job skills they require. Physical strength and manual dexterity, workers’ primary input for so much of what was produced in the agricultural and manufacturing eras, have been replaced by creativity, reasoning and emotional intelligence. We

prosper by the work of our brow, not the labor of our muscle. The capital stock of our modern economy is not our buildings or our factories or our farms. It is our brains. It is our ability to think of new ideas, inventions and solutions. It is our commitment to customer service at this fine resort and millions of other places. It is our designs for new buildings, new computers or a space module. It manifests itself in new financing products or medical breakthroughs or the entertainment industry.

The great economist Joseph Schumpeter coined the term *creative destruction*. This seemingly contradictory phrase comes, by the way, from an economist who had a knack for the clever quip. One of our former Fed governors, Dewey Daane, is a constituent of Governor Bredesen. He lives up there in Nashville. As a Harvard student back in the 1940s, he was taught by Schumpeter. He reports that the first day of class, Schumpeter walked in the room and said: "When I was young, I wanted to be the greatest economist in the world, the world's greatest lover and the best horseman on earth. I have not done well with the horses."

In his pursuit of the first of those three grand goals, Professor Schumpeter wrote that "stabilized capitalism is a contradiction in terms." He was right: Capitalism is far from stable, and it is never dull. It is constantly transforming the economic landscape. And the American genius has time and again mastered that transformation—rather than be victimized by it.

The destructive side of capitalism's creative destruction is evident in lost jobs. Let me share a few numbers for the states you govern. The number of workers in apparel manufacturing in your states decreased 80 percent between 1990 and 2005. In the same 15-year period, payrolls fell 18 percent at paper manufacturers and 15 percent for furniture makers. The number of farm workers decreased 6 percent, and the number of mine workers declined 5 percent. That is pretty painful stuff. And it is not ancient history. It all occurred within a time frame that is fresh in the memory of everyone in this room—between 1990 and 2005.

And yet, despite these employment losses, each state in the Southern region now has a *larger* job base than it did in 1990. North Carolina, for example, has created 1 million *net* new jobs since 1990. Texas' employment has risen by more than 3 million since 1990.

Why? Because the creative side of creative destruction outpaced the destructive side. Your economies replaced lost jobs in declining sectors with new ones in emerging, higher-value-added sectors. Between 1990 and 2005, the number of data processing and Internet service provider workers in Southern states increased 65 percent. Professional services workers grew 63 percent. Financial services employees increased 31 percent. Retail employment grew 23 percent. By 2005, the financial and real estate services sectors employed as many Southern workers as the manufacturing sector. Lodging and food services accounted for the same share of the Southern workforce as construction.

Health care sector employment in the South alone grew by 2.3 million from 1990 to 2005. Let me put that in perspective: For every manufacturing job lost in the Southern states between 1990 and 2005, the health care sector created 2.4 new jobs.

Yes, we are losing jobs in the goods-producing parts of the economy to faraway lands. But we are gaining them in the service sector and net—*net*—we are creating more jobs than we are losing.

A good friend of mine, Dr. Jonathan Weissler, is chief of medicine and holds the chair in pulmonary research at the University of Texas Southwestern University Hospitals in my hometown of Dallas. We have coffee together in the mornings at our local Starbucks—come to think of it, another globalized service provider.

After we have our coffee, Dr. Weissler goes to his office where, like most doctors, he examines patients and then dictates notes into a recorder. The recording is transcribed into the patient's file. There is nothing startling there; this has been standard medical practice for decades. What is new—and what is fast becoming a hallmark of the globalizing economy—is that he no longer pays an on-site employee in Dallas to transcribe his dictation. Instead, Dr. Weissler simply clicks a mouse and sends the recording to a company that farms the transcribing work out to English speakers around the world. While Dr. Weissler sleeps, the notes are typed up overnight in Bangalore for a fraction of the cost and arrive on the good doctor's desktop by morning.

Incidentally, Dr. Weissler says he can tell when the transcripts are produced in India because the English is perfect and even the most complex medical terms are spelled correctly—a testimony to India's teaching of proper English in their schools.

By reducing costs and streamlining his recordkeeping in this way, Dr. Weissler's practice runs more efficiently and his staff can devote more time to serving patients and growing his practice. The real payoff is that money saved in offshoring transcription can be reinvested into researching new ways to save and improve American lives.

Dr. Weissler is harnessing and harvesting globalization. What makes this possible? Cyberspace and globalization. The Net and fiber-optic cable give him the ability to access, coordinate, manage and control resources around the world without regard to distance, borders or time zones.

There are counterparts to Dr. Weissler in every one of your states. As globalization continues and the world economy evolves, more creative destruction will impact your states. That is the bad news because job destruction creates political pressures for transition programs at best and protectionist or retaliatory responses at worst. The good news is that the creative side of this inexorable phenomenon, properly managed, results in better jobs, higher living standards, lower prices and increased prosperity.

I echo Bill Poole's message: The answer is not protectionism. Rather than labor fruitlessly to protect your constituents from foreign competition, you and your legislatures must prepare them for it. Use your extraordinary talents as leaders to provide the transition mechanisms that will enable them to retool and move up the value-added ladder into higher-paying jobs.

There is no great secret about how to lay the groundwork for Southern states' success in harvesting and harnessing—in mastering—globalization. The key to adapting to and profiting from globalization lies in education. Texas boomed on the discovery of oil. Now we thrive on the output of the human mind. If you look around Dallas and Houston, you see office buildings, not oil wells or factories. Those buildings warehouse the capital plant of the modern era: human brains. Brains that research and provide services in medicine, marketing, finance and myriad other services. Oil wells eventually run dry. An educated mind never does.

Just as farming and oil and gas and manufacturing once propelled the development of the Southern states, an educated workforce with high earning potential will propel the future of your states, our great nation and the world. The ultimate source of competitive advantage for Texas is not oil and gas or the chemical industry or this widget or that or even the Dallas Cowboys or the San Antonio Spurs (even if they are the good Lord's favorite teams)—it is our elementary and secondary schools, and the University of Texas at Austin, Texas A&M in College Station, Rice University in Houston, Southwestern Medical and Southern Methodist University in Dallas, and our law and engineering schools and research centers. Each of you could say that for your states. The development of human capacity through education should be the highest policy priority of any government in the South or anywhere else.

When I ran for the Senate, I was told to make every effort to condense complex thoughts and ideas into simple catchall phrases. I obviously wasn't very good at it. And, as politicians yourselves, you know meaningful brevity is not an easy task. Nor one that everyone appreciates. Pundits deride the catchy line as "bumper sticker" politics. I am not running for anything, so I'll risk offering a bumper sticker for our times, one delivering this simple message: "You earn what you learn."

As I said at the outset, the South is a mighty economic machine. To remain powerful and prosperous, we need to move faster and farther up the educational ladder. The Chinese and the Indians and the Vietnamese and Eastern Europeans and Latin Americans are taking possession of the lower rungs of the world economy. There are 3 billion or more fervent wannabe capitalists among them who want to be rich like us. We cannot stop them, nor should we bother trying. But we must stay ahead of them. The key to doing so lies in developing our citizens' brainpower. The human brain is the capital plant of the Knowledge Age. Education is the fuel for that plant. The living standards of your constituents will be determined by what they learn. So my best advice for you as governors is to throw your weight and your budget dollars behind education. It is an investment that provides unlimited returns. It is an investment that will secure our economic future.

Thank you.