

Informal Remarks

of

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Chairman, Board of Governors of the Federal Reserve System

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Thank you very much, David, those were really very kind remarks.

As I think I mentioned to a number of you who were at the Council on Foreign Relations meeting a few weeks ago, since I became a central banker I have learned to mumble with great incoherence. That's something which I learned from Paul who did that in a manner which was approaching a work of art. I might add that on the issues of foreign exchange and interest rates this evening, if you think what I said was clear and unmistakable, I can assure you you've probably misunderstood me.

At that Council on Foreign Relations meeting the other week, I spent a good deal of time discussing what central bankers usually talk about -- focuses on short-term movements in output, interest rates, inflation, foreign exchange, trade balances, international trade adjustment. On this occasion, however, I think it would be useful to step back and try to discern the more deep-seated, longer-term forces that are driving the world economy. I'd like specifically to focus on two of them this evening -- first, the economic forces which have shaped and are shaping the structure of activity in the industrial world and in recent years the developing world as well. Secondly, I'd like to touch on the political forces which have governed and will govern the outcome of the economic forces.

During the 20th century and in fact I suspect probably all the way back to the beginning of the industrial revolution, we have experienced increasingly, impressively, a rise in the part of the value of economic output which, for want of a better term, I would designate as conceptual, as distinct from the physical. A half century ago, for example, our radios were bulky and activated by large vacuum tubes while today the same function is served by pocket-sized transistor packs with a small fraction of the weight. The insights that developed into modern electronics are of course at the base of the dramatic change. We also used to construct office buildings with excess bulk. In fact I remember reading once that a building that had originally been built at the turn of the century or shortly before had been tagged for demolition and it had been so over-engineered and built that they had great difficulty knocking it down. Obviously, with advances in engineering and the development of lighter but stronger materials we now get the same working space in newly constructed buildings with a lot less concrete, steel and glass.

Modern aircraft and the extension of new insights into the behavior of nature have sharply improved the speed and the convenience of long distance travel. And medical breakthroughs that have revolutionized the provision of health care are illustrative of a long list of examples underscoring the rise in the ratio of ideas to physical effort and bulk as the source of economic value creation.

Once the bushels of grain and tons of iron ore, coal and steel, cement, were added up, I suspect that we would find that the growth in the physical components of the GNP, measured strictly in terms of their bulk, would probably represent a relatively flat trend in recent decades. In fact, I would suspect that we, on a tonnage basis, have got very much the same volume of output as we did at the turn of the century in the United States, in Europe and elsewhere. This means that the conceptual components of GNP -- that is, those elements in economic output which are ideas and advancing ideas -- have essentially accounted for virtually the entire rise in the industrial world's GNP since the turn of the century.

Even the concepts of manufacturing are being altered by the structural changes that are going on in the way we add value. At the turn of the century, I would suspect in a typical steel rolling mill one would find that the rolls that would come off, the coils that would come off the rolling mills, would be moved by four or five journeymen hefting the coil over to the next set of rolls and continue from there. Today's mills probably are run by some young clerk weighing 150 pounds with no muscles, working on a computer and clearly being capable of doing very much the same physical brawn effort that was accomplished 50 to 100 years ago. In short, what we are seeing is ideas substituting for bulk and for the structure of the type of production which we used to be so much enamored with.

It's no longer clear what in fact is the distinction between manufacturing and service and trade. Historically, those are very clear distinctions, but in today's environment what is a production worker is in fact the person working on the computer off a rolling mill and that is scarcely our view of what blue collar employment used to be a couple of generations ago. What we are essentially beginning to see is a concept of manufacturing which was so thing- or physical-volume oriented that it is gradually dissolving into impalpable conceptual issues.

In recent years the intellectual contribution largely has reflected the explosive growth in information gathering and processing techniques, which have greatly extended our analytical capabilities and had enormous consequences for virtually all facets of our economic lives. These trends almost surely are irreversible and will continue into the 21st century. Once knowledge is gained, it is never lost. Perhaps the dark ages may be the one exception to that proposition.

In the years and the decades ahead, telecommunications and advance computing will take on an increasingly greater role. By facilitating the transfer of ideas, they create value by changing the location of intellectual property, much like the railroads at the turn of this century created value by transferring physical goods to geographic locations where they were of greater worth. At the turn of the century we created economic value by moving ore from the Mesabi range over the lakes down to the Pittsburgh district where we joined it with

coking coal from that area and produced steel. The value that was produced essentially reflected the changing of the location of the physical volume of things.

As we move into the 1990's and into the 21st Century, the equivalent of the creation of value through location is going to clearly be telecommunications where what has moved is not the ore or the coal, but data and concepts and impalpable elements in our system through communication satellites and a variety of other elements which are at the moment probably not even foreseen. But the concept of the production of economic value and wealth for the purposes of human survival and human life, that process will significantly change but it will remain what it always has been, namely those material elements which enhance the capability of the human race to function, to live, to achieve values, to embark upon many of the things which they could not do in earlier ages.

This is extraordinarily important when one views the international economy because one of the things which we are acutely aware of in the data is the extraordinary continued rise in the amount of goods and, increasingly recently, services which move across international boundaries. In fact, what we are all aware of obviously is that trade per se has been rising at a much faster pace than has domestic demand, and clearly that has been even more so the case in the movement of services and, increasingly recently, intellectual property. This means necessarily, algebraically in fact, that the average ratio of

imports to domestic demand must be rising. And indeed when we talk about the necessity of coordination in the international economy, and in fact coordination in a mechanism that is developing in many different forms, what we are doing is trying to coordinate this economic phenomenon which is creating more and more exchange of goods amongst countries. And since goods are increasingly impalpable, then the capability of moving them has become, obviously, substantially easier than at any time in human history. And what that has obviously meant is that the facility of moving goods, moving economic values and their associated services, has necessitated almost inevitably a rise in trade as a proportion of aggregate world output. And it's fairly apparent, I would think, that when one looks at the economic internationalization of the world, what we are looking at is this process, this irreversible process of an increasing conceptualization of the physical output of what it is we produce.

However, while knowledge and conceptual advances are irreversible, it is nonetheless possible to place barriers to trade to prevent expansion. Fundamental to the 1980's is a quiet revolution to market-oriented policies throughout the world and this is the second issue which I would like to address this evening. In effect, it requires a political framework to adjust to this ever-changing environment of the production of economic value. When one looks at the movement toward market economics and market policies -- free market policies as

distinct from the collectivist, socialist forms of economic production which prevailed for so long a period and to such an extraordinary extent in the world after World War II -- it really is extraordinary how far we have come in the last decade.

I say it is a quiet revolution because very little has been made of it. We do in peripheral conversations discuss the changes in the United States. I mean it's obvious that the Reagan years, whatever one may think of them in a number of respects, are years in the United States in which there has been a very dramatic shift toward market-oriented open-trade concepts. It's not President Reagan only. It is essentially the fact that he represents a fundamental change that has been occurring in the international political environment, necessitated by the change in economics. One can find the change merely by looking at the democratic Congress, because it's not that many years ago that I recall, as David pointed out, having earlier stints here and subjected to Congressional hearings on very similar economic matters as I would be subjected to today. And the one thing that I find utterly fascinating is that the democrats in today's Congress, or more specifically in those committees related to economic affairs, both domestic and international, are more market-oriented than the average republican was back in the mid 1970's.

The shift has occurred largely because the technology in the world is forcing it. Margaret Thatcher would not have been in the position she has been in Britain 20 years ago and

accomplished what she has done in the United Kingdom because there was no political way in which anything she did was even remotely feasible in the political philosophy of earlier in the post-World War II period. One can say much the same for Canada and when one looks onto the continent there is an extraordinary change that occurs as one goes from Willi Brandt to Helmut Schmidt and then onto Helmut Kohl. The changes are not fractious. There is not a confrontation of great moment that grabs the headlines. It's an inevitable shift that seems to be going on.

The one time the confrontation has happened in recent years is when President Mitterand, when coming into office in 1981, endeavored to place into position some of the old economics in an environment of dramatically changing international trade and freedom of markets. He rapidly changed and joined, in effect, the total swing that has been occurring in recent years. The same is true in Italy and one can argue in the Iberian Peninsula.

One of the most interesting aspects in recent weeks is something I must say to you I would never have imagined and that is the acceleration that is going on in the Economic Community toward the 1992 deadline. They have clearly created a critical mass on the European continent to move toward the full notions of a free-trade Economic Community. Once they agreed to eliminating capital controls, very recently, in a sense the dye was cast because if you eliminate controls that maintain the

sovereign economic structures of the various different continental European economies, then you find that unless monetary policies are closely coordinated you will have -- as I think the London Economist indicated this week -- the currency of the week or the currency of the month. Under those conditions, you would have cross-border movements of capital which would be utterly devastating to the stability of the system. Once you fit into place a requirement that capital flows, you have essentially first locked in a coordination of monetary policy as a necessity, and eventually perhaps even that will require the European Central Bank which I had originally thought was just somebody's vague view of something that would be nice in the 23rd Century.

But what's happening at the moment is a combination of the telecommunications and computer structure. We are driving the underlying politics of our societies and not only democratic societies. It's inconceivable -- but it is, I guess, possible -- that the Soviet Union is going to move in this direction. I know they are obviously trying. In fact I seriously expect that, on the basis of having spoken to several Soviet economists of recent date, some of them talk in terms of market economics, something that they subscribe to, and one merely waits for the time in which the Soviets will announce that they have invented capitalism. But when you look at the People's Republic and the extraordinary endeavors that are being pushed there, you come to

the conclusion that this is a phenomenon which crosses political ideologies and is being driven by far more extraordinary forces.

One final fallout from this is what is happening to the LDCs. One extraordinary set of experiences I had when I was here as Chairman of the Council of Economic Advisers in the mid-1970's, was meetings of the G-77 or its equivalent and listening to the north-south debate which was essentially a debate of capitalism versus socialism and never the twain shall meet. Today's environment in the same countries are really quite extraordinarily different. One finds through sub-Saharan Africa an endeavor to move toward a good deal of market economics strictly as a practical question being forced by the practicality of necessity of constructing economic environments which function.

This phenomenon may well be the economic and political force which ultimately solves the LDC problem. One obvious characteristic, which is a fallout from the overall political shift that one is perceiving, is that we no longer see the type of populist economics in Latin America one would ordinarily have expected under the politics of the 1960's and even the 1970's that under conditions of debt which confronted much of the Latin American major-country group that it would have been politically so easy to move toward debt repudiation striking out at the imperialist bankers of the north.

The fact is that has not happened. Even Alan Garcia who moved slightly in that direction has not moved very far.

The fact that when we look at somebody like Alfonsín -- who one would presume would have been upended by the Peronista victory a number of months ago and still functions -- or say Nelson Obregón -- the Finance Minister of Brazil who talks market economics in a way in which American economists would never even approach 20-30 years ago -- what one senses is an acute awareness that the only way to fundamentally resolve the debt problem is for the debtor countries to create an economic environment which is adequate growth to move them out from under the burdensome debt service.

This is the reason why I am not, I shouldn't say optimistic about a solution to the debt problem, but I am a good deal more optimistic than I sense the overall gloom that seems to cover this issue. And I am because the debtor nations have chosen not to succumb to really powerful pressures that would seemingly make it so easy for them to cave in and take the road of least resistance and listen to the siren songs of a number of the debt facility issues. They have chosen not to because I think they recognize that if we are ultimately forced to go in that direction -- and I certainly hope we do not -- that we are presumably looking at the end of private financing of these major, these very large and very potentially productive countries. We're looking at the elimination of private financing for a generation. No one is going to go back into those markets under those conditions. It will also create a large schism between the commercial banking system of the

international community and what is potentially some very important customers who would, if they can resolve this particular issue, move into an effective growth advance in the 21st Century.

I don't know how to come out of this. It's the most difficult problem of which I am aware. It's a very tough one. It's one that is involved in debtor fatigue, creditor fatigue, general fatigue. There is no really fundamental alternative when you look at all of these various, different schemes that come up. The payoff is so terrific if in fact we manage to pull this off, and I don't know what the probabilities are that we will succeed. But I certainly know in this context that it is worth the effort that we're all putting in and hopefully we will continue.

So let me say in ending that we who are involved in international economy either on the private sector basis or public basis have got an extraordinary complex set of economic, social, financial problems ahead of us. But what I think is increasingly becoming clear is that these two basic forces, one the economic and the other the political, are both working in a way which is shedding a lot of potential problems and at least creates the environment where one can look toward the future with some degree of optimism, even though one necessarily sees an extraordinarily large amount of short-term problems that basically will confront us for the months ahead, probably the years ahead. But there is nothing fundamental to the evolution

of the world's economy which in any way suggests that we are at some point where the expansion in economic growth and human standards of living are about to come to a halt.

Thank you very much.