HOUSTON BUSINESS BRIEFS

The 1990 Texas Gulf Coast Economic Conference

During the Economic Summit of Industrialized Nations held in Houston in July 1990, descriptions of Houston's role as an international city were commonplace. Frequently cited were the city's 600 foreign businesses, the 60 foreign banks and representative offices, the largest consular corps in the South and Southwest and the Port of Houston's ranking as sixth largest in the world. The multinational corporations based in Houston with worldwide operations in oil, engineering and construction and high technology also illustrate the Texas Gulf Coast's global reach.

On Sept. 6, the Houston Branch of the Federal Reserve Bank of Dallas sponsored the first Texas Gulf Coast Economic Conference, titled Changing Tides in the International Economy, which focused on this region's role in the world economy.

During the conference, three panels of experts discussed economic change under way throughout the world, how these changes affect the Gulf Coast and how the Texas business community must adapt to the international challenge. This article summarizes the remarks made by the members of the three panels and distills some conclusions about Houston's role in the world economy.

Economic Trends Developing in the International Arena

The members of this first panel represented developed or emerging regions of the world economy—Mexico, Europe, the Pacific Rim and Japan. Panelists explained that the pace and extent of change in these areas are remarkable. The Japanese appear firmly established as an economic superpower. Pacific Rim countries are emerging as newly developed nations, and sweeping institutional change is favoring free markets in both Mexico and Eastern Europe. Panelists also discussed the reality of a single European market by 1992 and proposals to form a common North American market that includes Mexico and Canada.

Ricardo Ampudia, consul general of Mexico, described the new and successful economic policies of President Carlos Salinas. In the 1980s, Mexico was beset by economic problems—falling oil prices, a low savings rate, a protectionist policy of import substitution, oppressive policies in industry and an enormous foreign debt. In seven years, real per capita income fell 22 percent. Real wages were cut in half, and inflation accelerated to an annual rate of 180 percent. The Salinas government has now renegotiated and reduced foreign debt, slowed inflation to 20 percent and put growth on a positive track. The Mexican government privatized, liquidated, merged or transferred 900 of 1,200 state-owned businesses. In addition, it proposed the privatization of Mexico's commercial banks, and it moved strongly to encourage foreign investment.

In June 1990, President Salinas and President George Bush signed an agreement to begin negotiations to implement a free trade agreement between Mexico and the United States. The implications for Texas and Houston are enormous. Today, with trade between the two countries at $52 billion annually, Mexico supports 450,000 Texas jobs. The Port of Houston handles more Mexican cargo (exports and imports) than any Mexican port. Under a single North American market, Mexican trade with the United States could grow to $300 billion annually.

Yhi-Min Ho, dean of the Cameron School of Business at the University of St. Thomas, briefed conference participants on the "Four

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Dragons of the Pacific Rim"—Taiwan, South Korea, Singapore and Hong Kong. The success of these newly developed nations lies in several shared common characteristics: a shared belief that trade is the heart of economic success, a shared colonial history, a shared enemy in Communist insurgence and shared values such as hard work, family ties and high respect for education. Regional success continues to spread as Taiwan, for example, moves capital into Southeast Asia in search of cheaper labor.

Economic development has not brought regional political stability to these countries. China remains the regional political giant, and differences with Taiwan and the pending merger of China and Hong Kong highlight the political conflict. One result is a continued drain of capital and highly skilled labor out of the region and into the rest of the world. The large Asian population along the Texas Gulf Coast is the most visible sign of the movement out of Asia. Less obvious is the capital flowing into Houston real estate and petrochemical facilities.

Yoshiyuki Kawashima, representing Mitsui & Co., discussed the Japanese economic success that in 1989 raised Japan's gross national product per capita above that of the United States. He described this success as being rooted in the Japanese work ethic, the heritage of Confucianism and the land reforms and educational system left by the United States after World War II. Kawashima expressed some sympathy with American frustration at Japan's nontariff barriers to trade, however, he also expressed some concern as a Japanese consumer about whether it is America's place to revamp the Japanese distribution system.

One hundred twenty Japanese firms operate in the Houston area, including 12 manufacturing units. A few Japanese chemical companies have built grass roots facilities in the area, including Kaneka Texas, Nippon Pigment, Nippon Zeon, Nippon Petrochemicals and Mitsubishi Rayon. Houston and the Gulf Coast suffer an image problem from the downturn in oil and the failure of local real estate and financial markets. In addition, the continued lack of direct air links to Japan remains a serious problem.

Mario de Luca of the Banco di Roma described the sweeping economic change under way in Europe. In 1987, the European Economic Community ratified the Single European Act. The act does not refer to a common European currency or central bank, although these ideas have been the source of much debate. The act, however, creates a single market "without internal frontiers, in which the free movement of goods, persons, services and capital is ensured."

Topping the priority list for reform in Europe is financial services. Exchange controls and discriminating fiscal rules made cross-border provision of financial services impossible. Minimum harmonization of prudential standards, mutual recognition and home-country control of financial institutions will lead the reform process. In effect, a banking license issued by the home country will be valid throughout Europe.

In Eastern Europe, euphoria over political change may be difficult to match with economic gains. De Luca warned that the region only partially shares a European heritage. Forty years of Communist rule destroyed Eastern Europe's industrial infrastructure. In addition, the work force is slack and unqualified. Opportunities in this area are least risky in Germany and Czechoslovakia and most risky in Romania and Bulgaria.

Internationalization of the Texas Gulf Coast Economy

In some ways, this panel was the most important one because it focused on the Texas Gulf Coast region itself. Certainly, the area is being reshaped by events in the rest of the world. As a result, how must the Texas business community respond to this challenge?

F. Ray Marshall, professor at the LBJ School of Public Affairs at the University of Texas and a former U.S. Secretary of Labor, discussed how many of the competitive advantages enjoyed by the United States until the late 1960s are now lost and how Americans must reorganize the workplace to remain competitive. Before 1970, abundant natural resources were important to the industrial base. Today, industry can often substitute human capital, technology and superior organization for natural resources. In addition, the United States previously had huge internal markets that were isolated from the rest of the world but still large enough to achieve economies of scale. Now, this country is part of the world economy, and a workplace narrowly designed to capture scale economies is no longer sufficient.

Marshall described the new competitive organization as the "high performance work unit." It is quality-driven. It seeks efficiency by cutting waste, not through scale. It forces lean and participative management. It develops *positive* incentives to compel workers to pay attention. It provides job security. It must remain at the cutting edge of technology, and it requires a commitment to training and retraining the work force. In the high performance work unit, workers must learn to pay attention to quality, and managers must learn to diagnose their organization, rather than dictate.

Perry Adkisson, chancellor of the Texas A&M University System, had a similar message. As natural resources recede as a determinant of competitiveness, the fertile and oil-rich Texas Gulf Coast is among those regions that lose most. Adkisson discussed technology transfer and the need to commercialize the kinds and quality of technology the market demands. The region needs to build on its scientific strengths, link those strengths to market demands and provide the infrastructure and support necessary for successful commercialization.

Texas A&M, as well as other state and private universities along the Texas Gulf Coast, has moved to strengthen technology transfer by increasing university equity participation in new companies, expanding participation in trade shows, conducting symposia and workshops, establishing regional data bases, forming seed-capital funds, developing or expanding high-tech incubators and expanding networks and matchmaking services. These programs to move information from the laboratory to the factory floor are crucial to maintain the region's research investment in oil, gas, water and agriculture. Such programs are a prerequisite to increased industrial benefits from research in biotechnology, telecommunications, microelectronics and other high-technology fields.

Tom Kornegay, managing director of the Port of Houston, discussed progress at the port. Kornegay outlined the growth and progress of the port over the past 75 years, as well as progress to expect in the years ahead. The Barbours Cut Container Terminal was constructed in the 1970s to take advantage of the then new concept of shipping via containers that could be transferred directly from ship to truck or rail without unpacking and repacking cargo. The terminal has grown from one dock to four container berths, and by 1993, new berths will almost double its capacity once more.

The Omniport, completed last year at the Port of Houston, is a sophisticated system of spiral conveyors to move bagged and boxed cargo. It is the first automated cargo system of its kind in the United States. A 236,000 square-foot warehouse is being privately developed adjacent to the Omniport to accommodate refrigerated and frozen foods. Because of seasonal differences between North America and South America, this warehouse will position Houston as a major port for seasonal produce.

Harris County recently approved a bond issue to widen and deepen Houston's ship channel, and government agencies are reviewing federal funds for this project. The project cost is $130 million in local tax revenue, $120 million in federal money and $68 million in utility relocations and other costs borne by industry. The port is convinced the improvements will benefit the community, but a diverse range of environmental issues remain to be resolved.

William M. Arnold of First City Bancorporation of Texas told the audience about his bank's extensive commitment to international finance. The First City strategy has been to seek investors around the world who want to invest in Texas factories and jobs, to finance trade, mitigate risk and leverage country limits with help from the Commodity Credit Corp. and the Export–Import Banks and to work through a network of international correspondent banks to maximize access to investment referral and export-import transactions.

Arnold said that First City's commitment to international banking leaves it leaning against the wind. Many banks, both regional and money-center, have dropped international lending because of continued rescheduling of debt on Third World loans and domestic problems in real estate, energy and agriculture. To some extent, foreign banks have replaced U.S. banks at home and abroad and are quite active on the Texas Gulf Coast as a whole.

International Operations of Texas Gulf Coast Industry

C. Robert Palmer of Rowan Co. Inc. described the oil-service industry as a global industry, no longer able to operate only domestically. For example, Rowan Co. Inc. operates rigs in the North Sea and

Indonesia, as well as the Gulf of Mexico. Although most people think of oil services as an American industry, this perception is changing as exploration moves worldwide. Increasingly, host countries require that local companies be used as suppliers in the development of their reserves, or host countries give these local companies significant competitive advantage.

In addition, Palmer suggested that current government policy accepting the decline of U.S. domestic reserves as inevitable might be short-sighted. At a minimum, there is a need to remove positive barriers to domestic development that are driving production away from the United States. Responsible tax and regulatory policy must consider the cost of dependence on foreign supplies.

Richard A. Corbett of the *Oil & Gas Journal* suggested the following rule of thumb for downstream operations: Refiners buy feed stock globally and market domestically; petrochemical producers reverse this rule. Thus, an international oil-*supply* crisis, such as the current Iraqi invasion of Kuwait, has more impact on refiners. Putting aside the crisis as something that will either fade away or be coped with, Corbett focused his remarks on the environmental challenges the industry will face in the 1990s. Like the Middle East crisis, the environmental proposals are tougher on refiners.

Reformulated gasoline and alternative fuels are key elements in the latest congressional work to reauthorize the Clean Air Act. Several companies are already offering reformulated gasoline and other products to reduce air pollution. These products add new operating costs of only 1 cent to 3 cents per gallon, but as rules stiffen, costs rise further as refinery processes are extensively reworked. Operating costs could easily rise 20 cents per gallon.

One effect of the Iraqi–Kuwait crisis may be to delay the environmental work that must be done to upgrade refineries. Construction has peaked for the petrochemical expansion boom that began in Houston in 1987, so the lag may hurt local construction and engineering firms. Downstream construction is a key part of Houston's current expansion, and short-run upstream gains from the Middle East crisis must be balanced against downstream losses.

William A. Pearce of M.W. Kellogg Co. described financing of worldwide construction of refineries, petrochemical facilities and fertilizer plants. In particular, for at least the past eight years, many less-developed countries have been in a financial crisis because of debts owed to banks worldwide. Few of the world's banks are interested in international commercial lending other than to the safest, most secure developed nations. For a company like Kellogg, which often builds projects in less-developed countries, the solution is to turn to various government-supported financing agencies, such as the Export–Import Bank in the United States and to work with an international commercial bank that picks up the unguaranteed part of the loan.

Finally, as a representative of new high-technology firms in Houston, David Eller of the Granada Corp. discussed biotechnology. The concentration of intellectual capital at Houston-area research centers and universities makes the city a world center for agricultural biotechnology. The opening of Texas A&M's Institute of Biosciences and Technology at the Texas Medical Center will establish formal collaboration between a renowned medical center and biotechnology research. Such a collaboration has already produced significant improvements in beef cattle at the Granada Corp. This new technology enhances the traditional role of the Texas Gulf Coast as a gateway for agricultural products throughout the world. Now, biotechnology generates added value to the economy and allows the region to compete more effectively.

Conclusion

Great international centers, such as London, Paris, Tokyo or Mexico City, are the seats of political power and centers for those who do business with foreign governments. Houston shares some attributes with these cities, such as a great port, roads and railways that focus on the city, a medical quarter, great universities, international finance and a concentration of wealth. However, Houston is built on business rather than government. Its international role is based squarely on the region's legacy of oil and agriculture, therefore, its future increasingly depends on its ability to navigate the changing tides of the international economy. ❖

Texas Gulf Coast
Economic Conference Program

Sept. 6, 1990
Houston, Texas

Welcome
Robert H. Boykin
President and
Chief Executive Officer
Federal Reserve Bank of Dallas
and
Robert Smith, III
Senior Vice President in Charge
Houston Branch, Federal Reserve
Bank of Dallas

Keynote Address
Wayne D. Angell
Member, Board of Governors
of the Federal Reserve System
Washington, D.C.

Economic Trends Developing in the International Arena
Moderator
W. Michael Cox
Vice President and
Economic Advisor
Federal Reserve Bank of Dallas

Panelists
Ricardo Ampudia
Consul General of Mexico
Houston, Texas
Yhi-Min Ho
Dean, Cameron School of Business
University of St. Thomas, Houston,
Texas
Yoshiyuki Kawashima
Senior Vice President,
Regional Officer and
Chief Operating Officer of Chemicals
Mitsui and Company (USA) Inc.
Houston, Texas
Mario de Luca
Senior Executive Vice President and
General Manager (International)
Banco di Roma, Rome, Italy

Internationalization of the Texas Gulf Coast Economy
Moderator
William H. Wallace
First Vice President and
Chief Operating Officer
Federal Reserve Bank of Dallas

Panelists
Perry L. Adkisson
Chancellor, Texas A&M University
College Station, Texas
William M. Arnold
Executive Vice President and
Manager of the
International Division
First City Bancorporation of Texas
Houston, Texas
Thomas Kornegay
Managing Director
Port of Houston, Houston, Texas
F. Ray Marshall
Rapoport Centennial
Chairman of Economics
Lyndon Baines Johnson
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Luncheon
Remarks
Andrew L. Jefferson, Jr.
Chairman, Board of Directors
Houston Branch
Federal Reserve Bank of Dallas
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Introduction of Speaker
Judy Ley Allen
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Federal Reserve Bank of Dallas
Owner, Allen Investments
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Speaker
Geza Feketekuty
Senior Policy Advisor to the United
States Trade Representative
Resident Scholar at the International
Trade Commission
United States Representative to the
Organization for Economic
Cooperation and Development
Trade Committee
Washington, D.C.

International Operations of Texas Gulf Coast Industry
Moderator
Harvey Rosenblum
Senior Vice President and
Director of Research
Federal Reserve Bank of Dallas

Panelists
Richard A. Corbett
Refining/Petrochemical Editor
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David G. Eller
Chairman and
Chief Executive Officer
Granada Corporation
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C. Robert Palmer
Chairman and
Chief Executive Officer
Rowan Company, Inc.
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William Pearce
Director of Project Finance for
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The M.W. Kellogg Company
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Houston Beige Book
September 1990

The Iraqi invasion of Kuwait injected a strong dose of uncertainty into the Houston economy, but September brought no indication that this uncertainty threatens the strong recovery under way in Houston. All the Texas Gulf Coast's extensive operations in oil and petrochemicals suddenly were forced to reassess their position in the market after the Iraqi invation of Kuwait. The result has been a mixture of good and bad news for different segments of the industry. The crisis led local consumers to postpone or cancel some large purchases, but the problem does not seem to be widespread enough to threaten the local economy's forward momentum.

Oil and Petrochemicals

According to local analysts, oil prices at $30 per barrel or more are driven by the threat to Saudi Arabian oil production. As of late September, market fundamentals do not support prices much above $25 per barrel. But, if the situation in the Middle East reaches an impasse, prices will settle at $25 per barrel. If Iraqi and Kuwaiti oil production returns to the market, prices will fall below that level, according to the survey.

The rig count continues to rise in both Texas and the United States, but it primarily seems to reflect a continuation of recent positive rig count trends and some normal seasonal expansion. The downside risk to current oil prices means the prevailing high prices do not offer the kind of incentives that invite extensive investments in oil exploration. However, the high prices have improved the financial position of many oil operators who based plans for 1990 on oil priced at $18 to $20 per barrel.

The refining and petrochemical operations along the Texas Gulf Coast were hurt by the increase in the price of oil and, in some cases, by the loss of normal Iraqi and Kuwaiti supplies. The switch to new, heavier oil supplies has imposed numerous technical difficulties and, in some cases, changed the slate of available products for refiners. Refineries are operating at maximum capacity to meet demand for product.

Petrochemical facilities similarly are operating at high levels, but their margins are being squeezed by both high oil prices and soft product prices. As of late September, the effects of reduced margins on many planned petrochemical construction projects were still not clear. But even before the invasion of Kuwait, many projects were being scaled down or delayed.

Natural gas prices have not followed the oil market upward. The domestic oversupply of natural gas continues, and the only effect of higher oil prices is that natural gas prices may increase more than usual during the winter months.

Retail Sales

The Iraqi invasion of Kuwait suddenly halted auto sales in Houston, but a week later the sales pace returned to normal. Sales for August were off 11 percent from the previous year, but much of the loss was attributable to one bad week. Apart from the Middle East crisis, Houston-area auto dealers were very positive about the near-term outlook.

Back-to-school sales were very strong, but August retail sales among larger stores in Houston were slowing. The very strong month-to-month increases seen in every previous month of 1990 failed to materialize in August.

Wood and Paper Products

One large East Texas lumber operation said the bottom had simply fallen out of the demand for construction materials, and orders had stopped coming from big homebuilders throughout the country. Inventories are rising quickly, and layoffs are a near-term possibility.

The demand for paper, on the other hand, is very strong with good sales volumes. Merchant pulp, which has had weak prices since last spring, has not seen any price improvement. Weak prices developed over the summer, and these prices have now begun to strengthen once more.

Real Estate

All indicators remain positive for Houston real estate, as recent data show strong gains in apartments, commercial property, existing housing and housing starts. August was the second-best month in Houston history for new home sales. Calls to builders in the Houston area yielded mixed results, but many indicated that traffic through model homes and the pace of commitments to buy had slowed very recently. Respondents blamed uncertainty generated by the crisis in the Middle East.

Inflation

One manufacturer indicated that the company operated three salary scales that varied from city to city. Houston was recently moved from the middle scale to the highest one to forestall rising turnover. Unskilled and blue collar labor, however, continue to be in adequate supply in Houston, with no upward pressure on wages.

The increase in oil prices had immediate and noticeable effects on the cost of doing business. Representatives from chemical plants said that oil-based feedstock had jumped immediately. One manufacturer said that surcharges on shipping costs into the plant had jumped immediately by an annual rate of more than $1 million and that increased shipping costs out of the plant would probably be comparable. Soft national markets left most manufacturers pessimistic about the prospects for passing these costs in the form of higher prices over the remainder of this year. ❖

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