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Murray L. Weidenbaum
Washington University in St Louis

Center for the Study of American Business

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Contact:
Robert Batterson
Communications Director
(314) 935-5676

Washington University Campus Box 1208 One Brookings Drive St. Louis, Missouri 63130-4899

American Isolationism Versus The Global Economy

by Murray Weidenbaum

A growing paradox faces the United States. It is the simultaneous rise of a new spirit of isolationism amid the increasing globalization of business and economic activity. Viewed independently, each of the two trends possesses a certain logic. In juxtaposition, however, isolationism amid globalization is simply unachievable. Some explanation may help.

The end of the Cold War brought on a widespread expectation that the United States could safely and substantially cut back its military establishment. The threat from a powerful Soviet Union was a fear of the past. Moreover, government leaders could shift their attention from foreign policy to the host of domestic problems that face the American people. Surely, there is no shortage of urgent national issues to occupy our attention, and they are all inwardly oriented — welfare reform, health care, immigration, environmental cleanup, crime control, deficit reduction, and tax reform. The isolationist tendency is visible and apparent.

But, in a far less dramatic way, it is also becoming clear that the rest of the world is not content with going its separate way. Overseas forces, institutions, and people increasingly affect the workers and managers of America's business and their families. The global marketplace has rapidly shifted from just being a simpleminded buzzword to complex reality. International trade is growing far more rapidly than domestic production. That's true all around the globe. It is hardly a matter of a company or an investor deciding to participate or not. The days of agonizing over whether to go global are over. Eight basic points illustrate the changing external environment for public sector and private sector decisionmakers.

1. *Americans do not have to do anything or change anything to be part of the global marketplace.* Even if a business does not export a thing and has no overseas locations, its

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Murray Weidenbaum is Mallinckrodt Distinguished University Professor and chairman of the Center for the Study of American Business at Washington University in St. Louis. This speech was delivered at the Fourteenth International Monetary and Trade Conference in Philadelphia, Pennsylvania on November 13, 1995.

owners, managers, and employees are still part of the world economy. The same goes for the many companies and individuals that supply it with goods and services. The issue has been decided by technology. The combination of fax machines, universal telephone service (including cellular), low-cost, high-speed copiers and computers, and speedy jet airline service enables money, goods, services, and people to cross most borders rapidly and often instantly. And that goes especially for what is the most strategic resource — information.

A dramatic example of the ease of business crossing national borders occurred during the Gulf War. On the first day of the Iraqi attack on Kuwait, a savvy Kuwaiti bank manager began faxing his key records to his subsidiary in Bahrain. Every once in a while the shooting got close and transmission was interrupted. By the end of the day, however, all of the key records had been transferred out of Kuwait. The next morning, the bank opened as a Bahraini institution, beyond the reach of the Iraqis — and also not subject to the U.S. freeze on Kuwaiti assets. Literally, a bank was moved from one country to another via a fax machine.

No American business of any consequence remains insulated from foreign producers because of vast distances. Every American is subject to competition from overseas. If that force has not hit a region yet, it probably is on its way.

2. *Employees, customers, suppliers, and investors in U.S. companies are increasingly participating in the international economy.* That is not just a matter of sales or even earnings originating from foreign operations. Increasingly, U.S. firms are establishing factories, warehouses, laboratories, and offices in other countries. As a result, one-half of Xerox's employees work on foreign soil. The pharmaceutical firm Pfizer is exceedingly blunt on this subject:

> Pfizer does not have a choice about whether to manufacture in the EC or not. If we are going to sell to Europe, we have to manufacture there.

Surprisingly large numbers of American companies have already deployed a majority of their assets overseas. Here are a few important examples: Citicorp (51 percent), Bankers Trust (52 percent), Chevron (55 percent), Exxon (56 percent), Digital Equipment (61 percent), Mobil (63 percent), Gillette (66 percent), and Manpower Inc. (72 percent). To underscore the point, a recent Conference Board survey of American manufacturing companies shows that becoming an internationally oriented company usually pays off. Sales by firms with foreign activities grow at twice the rate of those with no foreign operations. Firms with international activities grow faster in every industry — and profits are higher. Geographic diversification is especially important for profitability. Companies with factories in North America, Europe, and the Asian rim outperform companies that stay in one region.

3. *The transnational enterprise is on the rise.* It is far more than merely a matter of which country to choose to locate a manufacturing or marketing operation. For the dominant companies, the locus of executive decision-making is shifting. "Think global but act local" is not just a slogan. It is a competitive necessity. The larger business firms operating in several regions of the world have been setting up multiple locations for decision-making. For those domestic firms that sell goods or services to other American companies, increasingly their customers are located in one or more decentralized divisions, some of which are now based overseas. That works two ways for Americans. DuPont has shifted the headquarters of its electronic operation to Japan. Germany's Siemens has moved its ultrasound equipment division to the United States.

Moreover, cross-border alliances have become commonplace. It is the rare business of any considerable size that has not entered into some form of cooperative arrangement with one or more companies located overseas — companies that they still often compete against in many markets. The concept of strategic alliances has moved from the classroom to the boardroom. A new set of international business relationships has arisen: joint ventures, production sharing, cross-licensing agreements, technology swaps, and joint research projects.

Increasingly, the successful business looks upon its entire operation in a global context. It hires people, buys inputs, and locates production, marketing, and decision-making centers worldwide. An example helps to convert theory to reality. Here is a shipping label used by an American electronics company:

Made in one or more of the following countries: Korea, Hong Kong, Malaysia, Singapore, Taiwan, Mauritius, Thailand, Indonesia, Mexico, Philippines. The exact country of origin is unknown.

Any comprehensive and balanced analysis also tells us that not every aspect of the international economy has a positive impact on Americans. Of course, a similar warning applies to the business environment here at home.

4. *Some overseas markets are more profitable than domestic sales, but high risk and high rewards tend to go together.* The attraction of overseas locations is increasing. Southeast Asia is the faster growing part of the world. Any observant visitor to Hong Kong, Singapore, Malaysia, or Thailand will see that the 8 percent real growth they have been reporting is no statistical mirage. Each of those economies is booming. Mainland China has been experiencing double-digit expansion year after year. Only the most modest slowdown is in sight. Of course, starting off from a small base makes it easier to achieve large percentage gains than is the case for an advanced industrialized country like the United States. But far more than that is involved.

Government policy in each of those countries welcomes foreign investment. With the inevitable exceptions, they encourage the formation of new private enterprises. The contrast with the United States is striking — and ironic. While these present or former communist and totalitarian countries are moving toward capitalism and trying to reduce the role of the public sector, we have been moving in the opposite direction. Despite efforts by the House of Representatives, the United States is still expanding government regulation of business. The result is to make it more difficult and certainly more costly for private enterprise to prosper. Under these circumstances, it is not surprising that so many American companies are doing their expansion overseas.

Take the energy company that explores in faraway Kazakhstan, or the mining enterprise that moves to Bolivia, or the medical devices firm that sets up a laboratory in the Netherlands, or the manufacturing corporation that builds a new factory in Guangdong. To a very considerable extent, these companies are responding to adverse domestic policies as much as to the attractions of overseas markets. The villains of the piece are the government officials in the United States who lock up much of the nation's natural and labor resources in fear that somebody somewhere may make a profit.

Nevertheless, the risks overseas may be great. Over the years, many companies have suffered the expropriation of their foreign assets. You do not have to go farther than Mexico to recall a vivid, although not recent, instance. Iran furnishes a more current and dramatic example. The dangers are not just political. Wars and insurrections are more likely in the regions of the world with less strongly established political institutions. There is no shortage of examples — Croatia, Bosnia, Armenia, Azerbaijan and Chechnya currently make the headlines. Civil wars and large scale violence occurred in recent decades in Indonesia, Malaysia, Thailand, Sri Lanka (Ceylon), and Myanmar (Burma).

Less dramatic but still noteworthy are the difficulties experienced by some Western enterprises in collecting on their debts in China. Moreover, many companies operating in that region report that the special expenses of doing business there make it difficult to convert sales into profits. One large American law firm expects to show its first profit only after six years of doing business on the mainland.

The special risks are numerous. Differences in language, culture, and business practices are pervasive. Our notions of personal honesty are not exactly universal. My purpose is not to scare anyone away from foreign markets, but to emphasize the often painfully close relationship between high profits and high risk. But there is a new positive side to all this.

5. *The rise of the global marketplace provides vast new opportunity for Americans to diversify their investments and — of course — to broaden business risk.* The last half dozen years provide a cogent example in terms of the global business cycle. At first, the Anglo-Saxon economies lost momentum. Remember when our friends in continental Europe needled us about the odd phenomenon of an English-speaking recession? That was the time when the

economies of the United States, the United Kingdom, Canada, Australia, and New Zealand all were in decline simultaneously.

But, as we were coming out of recession, Japan and most of Western Europe started to experience slowdowns and then downturns in their economies. The American economy has been coming off a cyclical peak and is now slowing down. At the same time, Western Europe has turned the corner and is on an expansion path once again.

In the case of the developing countries, it is hazardous to forecast which one of them will get unglued. There is no certainty that any of them will. But the odds are that at least one of those rapidly growing nations will be derailed from the path of continued progress. Military coups and domestic insurrections do occur. The biggest uncertainties are what will happen to China after Deng Xiaoping dies and how well will the integration of Hong Kong go.

6. *The rise of China and Southeast Asia is a new and durable force in the world economy that Americans will have to recognize.* Depending how you measure national economies, China is in the top 10 — or top three, or top two. That is an interesting range of variation.

Even the most experienced Asia experts candidly tell you that they do not know what will happen after Deng. There is already considerable pressure in China to reverse course, to move back to a more authoritarian society with less opportunity for private ownership. China also has a history of internal dissension, of splitting up into several regions each of which is the size of several major Western European countries. So far, the ability of the economic reforms to create tremendous amounts of income and wealth is the best guarantee of their being continued. But, the many misunderstandings between China and the United States constitute a very real dark cloud on the political as well as economic horizon.

The economies of several other countries in Southeast Asia are also growing rapidly — at about 8 percent a year, compared to China's 10-12 percent. They seem to be welcoming American and other Western businesses with more enthusiasm than the Chinese.

Malaysia is a good example of a fairly stable nation with a sound economic policy — notably a balanced budget — and an 8 percent overall growth rate. Other opportunities for geographic diversification exist in Thailand, Indonesia, and now the Philippines, whose economy has turned around. To the surprise of some, Vietnam welcomes American businesses as well as tourists.

A decade from now, Southeast Asia will be one of the major economic regions of the globe — along with Japan, North America, and Western Europe. Americans must face the fact that the economies of Southeast Asia are potentially both customers and competitors for our companies. To think of that area as just low-cost labor is misleading. The level of technology is high in Taiwan, Singapore, and Malaysia. The amount of education is also impressive. Intelligent and productive work forces are available in substantial quantities — and they also constitute a substantial and rapidly rising consumer base.

The 1½ billion people in Southeast Asia constitute the major new market area of the world. A noteworthy although not particularly welcome trend is for the nations of Southeast Asia increasingly to trade with each other. That is not surprising when you examine the investment patterns. Who are the major investors in China, Malaysia, Indonesia, Thailand, and Vietnam? The answer is neither the United States nor Western Europe. It is Hong Kong, Taiwan, South Korea, and Japan.

As a result, the major sources of imports into Southeast Asia are Hong Kong, Taiwan, South Korea, and Japan. Likewise, those same four nations are the major markets for Southeast Asia's products. As Southeast Asia continues to grow rapidly, it will be a major challenge to Western businesses to participate in that key market.

7. *Despite the military and political issues that divide Western Europe, the economic unification is continuing full bore.* With a minimum of fanfare, Sweden, Finland, and Austria are entering the European Union. Note the successive changes in terminology as the nations of Western Europe move closer together while increasing their membership. The six-nation

European Common Market became the 12-nation European Community. Now we have the 15-member European Union.

As in every major change, there are winners and losers — for Americans as well as for Europeans. With the elimination of internal trade barriers, the stronger European companies can now compete in a continent-wide market. They enjoy considerable economies of scale. American companies well established in Western Europe — such as Ford — are included in that category. The losers are the high-cost European producers who were accustomed to the protections afforded by a restricted national market. The loser category also contains those American producers who have been taken by surprise by the reinvigorated European competition.

Fifteen member nations are not going to be the end of the line for the European Union. The entrance of Austria is a strategic move because Vienna is a major gateway to Eastern Europe. Hungary, Poland, and the Czech Republic are anxious to develop closer economic and business relations with Western Europe. They can become low-cost suppliers or low-cost competitors — likely both.

Perhaps the most important positive development in that continent in the coming decade will be the new economic strength of the largest member, Germany. It is taking more time than expected to fully consummate the integration of the "new provinces" (neuer länder), as East Germany is now referred to. Any visitor is struck by the substantial amount of physical investment that the national government is making in the East. That is bound to result in a strong and newly competitive region. All in all, we should not forget Europe in our attention to the Orient.

Let us end on an upbeat and realistic note.

8. *The American economy is still the strongest in the world and our prospects are impressive.* We are not a weak or declining nation in the world marketplace. Legislation and political pressures to "buy local" may be popular, but they fly in the face of economic reality.

Our concern for the losers in the domestic marketplace requires a constructive response; make the United States a more attractive place to hire people and to do business.

After all, in a great many important industries, American firms are still the leaders. U.S. firms rank number one (in sales volume in 13 major industries — aerospace, apparel, beverages, chemicals, computers, food products, motor vehicles, paper products, petroleum, pharmaceuticals, photographic and scientific equipment, soap and cosmetics, and tobacco.

What about the future? Recall that the first of these eight points began with an illustration of the awesome power of technology. Nobody can forecast which specific technologies will succeed in the coming decade. But the prospects for American companies being in the lead are very bright. There is a special reason for optimism.

Although in the 1990s, America will be benefiting from the upsurge of industrial research and development (R&D) during the 1980s. A key but undramatic crossover occurred in the early 1980s. For the first time in over a half century, the magnitude of company-sponsored R&D exceeded the total of government-financed R&D. That primary reliance on private R&D continues to this day.

Few people appreciate the long-term impact of that strategic crossover. The new and continued dominance of the private sector in the choice of investments in advanced technology makes it more likely that there will be an accelerated flow of new and improved civilian products and production processes in the years ahead. A progression of innovation may be forthcoming comparable to the advent of missiles and space vehicles following the massive growth of military R&D in the 1950s and 1960s. Just consider how the fax machine has altered our customary work practices.

There is a positive macroeconomic aspect to continued technological progress. When the persistent trade deficit of the United States is disaggregated, we find some surprisingly good news: our exports of high-tech products steadily exceed our high-tech imports. We more than hold our own. This country does indeed enjoy a comparative advantage in the production and sales of goods and services that embody large proportions of new technology.

Of course, these are not laurels to rest on. The point is that there is no need to take the low road of economic isolationism — which is protectionism — to deal with foreign competition. We should take the necessary actions, in both the public and private sectors, which make American business and labor more productive and hence more competitive in what is increasingly a globalized marketplace. The ingredients are well known — tax reform, regulatory reform, and a modern labor policy.

Perhaps the most basic development since the end of the Cold War has been missed by all observers and analysts because it is so subtle. During the Cold War, the two military superpowers dominated the world stage. It is currently fashionable to say that in the post-Cold War period, three economic superpowers have taken their place — the United States, Japan, and Germany. That is technically accurate but very misleading.

During the Cold War, government was the pace-setting player on the global stage. Governments made the strategic decisions. Businesses were important, but they were responding to government orders, supplying armaments to the superpowers. In the process, of course, business created substantial economic wealth. But the shift from military to economic competition is fundamental. It means that the business firm is now the key to global economic competition. Governments, to be sure, can help or hinder, and in a major way. But they are supporting players, at best.

The basic initiative in the global marketplace has shifted to private enterprise. Individual entrepreneurs and individual business firms now make the key decisions that will determine the size, composition, and growth of the international economy. That makes for an extremely challenging external environment for the competitive American enterprise of the 1990s. It also requires greater degrees of understanding and forebearance on the part of U.S. public policymakers.

The rapidly growing business-oriented global marketplace is a source of great actual and potential benefit to American entrepreneurs, workers, and consumers. Because the international economy is changing so rapidly, Americans face both threats and opportunities.

Those who identify with the change are likely to be the winners; those who resist will be among the losers.

History tells us that trying to shut ourselves off from these "foreign" influences just does not work. When imperial China tried to do that some 500 years ago, it fairly quickly went from being the world's most advanced and powerful nation to becoming a very poor backwater of the globe.

One thing is certain; it is futile to say, "Stop the world, I want to get off!"