Challenges

VOL. 1 NO. 7 COUNCIL ON COMPETITIVENESS MAY 1988

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SPECIAL REPORT

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INTERVIEW Expert Looks at New World of Global Finance

"I can think of few subjects more important for political debate than how the United States copes in a complicated new financial world," concluded Eugene H. Rotberg at the end of an illuminating hour-long interview with *Challenges*.

From his vantage point as Executive Vice President of Merrill Lynch & Co., Inc. for the past year, as Vice President and Treasurer of the World Bank for the previous 19 years, and for 11 before that at the Securities and Exchange Commission, Mr. Rotberg has been in a unique position to witness the sweeping global changes that have fundamentally altered the competitive landscape.

Volatility and Stress

In the past decade alone, the world's financial markets have become inextricably linked to each other and increasingly volatile. Significantly contributing to the volatility has been the deregulation of equity and debt markets. "For the first

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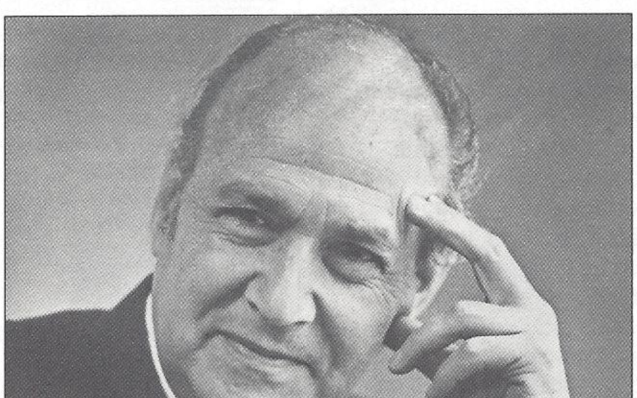

NESHAN H. NALTCHAYAN PHOTO

Eugene H. Rotberg

New Consensus For U.S. Labor And Industry

Workers should think more about the bottom line; management should think more about workers' needs. That's the centerpiece of what has been billed as the Collective Bargaining Forum's "landmark advance" in labor-management cooperation.

The joint approach for improving U.S. productivity and competitiveness is detailed in *New Directions for Labor and Management*, recently published by the Department of Labor for the Forum, a group of 20 leading U.S. business executives and labor leaders, which was founded in 1984.

New Directions recommends that management treat employment security as a basic policy, ranked with capital deployment, product lines and other business strategies. For their part, workers must join with management to "improve the economic performance of American enterprises and help firms adapt to changes in technology, market conditions, and worker values and expectations," the report said. The agreement came after three years of study and discussion by Forum members.

The group cited several specific steps toward better labor-management cooperation: recognition of unions as legitimate representatives of workers; increased employee workplace participation; improved information-sharing; innovative compensation plans that reward workers who help improve productivity; and joint efforts on quality improvement, training, work redesign and cost containment.

"Landmark Advance"

Forum Co-Chairman Lynn Williams (President, United Steelworkers of America) called the consensus "a landmark advance in labor-management relations." Acknowledging fundamental differences between workers and executives, Mr. Williams cited such innovations as profit-sharing as evidence that workers are already enjoying some aspects of what he called "industrial democracy."

Co-Chairman William L. Weiss (Chairman and CEO, Ameritech) said the report was part of the "intellectual foundation" that will "challenge traditional attitudes of labor and

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PUBLISHED IN ASSOCIATION WITH *MANAGING AUTOMATION / INDUSTRIAL EQUIPMENT NEWS*

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time since the early 1900s, there are few constraints on what citizens can do with their savings," Mr. Rotberg observed. Facilitating the globalization of markets have been the new communications and computer links that give investors from Topeka to Taiwan instant access to the identical worldwide buy/sell information. This new mobility of money has led to volatile interest and exchange rates.

Further adding to the mix have been the new instruments created by the financial community to allow investors either to hedge or leverage their investments, plus the sheer size of the markets: 20 years ago, an average of 5 million shares were traded daily on the New York Stock Exchange, compared to 200 million today.

"Unprecedented Stress"

"This combination of trends has placed the world's financial system under unprecedented stress," observed Mr. Rotberg. Sometimes the system gives way, as during the October 19th stock market collapse and subsequent aftershocks. "As we saw, trouble occurred when everyone tried to go through the same door at the same time," he noted. "The shifts are worldwide and instantaneous."

"The issue is not the amount of dollars . . . . The real question is what will it cost us to keep attracting that foreign investment."

Mr. Rotberg doubts, however, that governments will try to stabilize markets through regulation or intervention. "There's no mechanism in place — nor can there be — to withstand that kind of pressure," he said. "The stress was caused by fundamental economic, social and political factors," which are not subject to additional regulatory or legislative control beyond increased oversight, licensing, disclosure and perhaps expanded margin requirements. When everyone is selling, however, government regulation cannot produce buyers — or even confidence — given the magnitude of the flows.

"That much investment from outside . . . puts tremendous pressure on interest rates and exchange rates."

But governments will try to protect their power and sovereignty. As a means of exercising more control, for instance, he speculates that governments at some point, during a period of stress, may seek to limit the freedom of citizens and institutions to shift savings from their own country and invest in another. That would have significant adverse consequences.

Impact of Foreign Funds

Such a crackdown on the cross-border flow of funds, if it occurs, could harm the United States, which has benefitted significantly from the unprecedented level of recent foreign investment. Non-residents have used their new financial freedom to invest in the United States, buying everything from U.S. Treasury bills to real estate and common stock. "The issue is not the amount of dollars flowing into the United States. Dollars, by definition, are always invested here. The real questions are what it will cost us to keep attracting that foreign investment, and the nature and character of that investment," Mr. Rotberg pointed out.

In other words, how high will interest rates have to rise or the dollar have to fall to continue to attract foreign funds? Mr. Rotberg estimates that the dollar's drop has caused Japanese financial investments in the United States to be devalued by up to 50 percent in the past two years. Clearly, they would have been better taking the dollars earned from selling Toyotas in Denver and converting them into Deutschmarks, he noted. He speculated that several factors — including lethargy, the anticipation of replicating their gains of the early 1980s (a period of a strong dollar) and a political wish "not to rock the boat anymore" — led them to reinvest their dollars directly in America.

"Certainly I'm concerned that it might not continue," Mr. Rotberg said. "But it's also unwise to be hostage to that much investment from outside. It puts tremendous pressure on interest rates and exchange rates."

He is less concerned about the cost of capital, which some claim has contributed significantly to declining U.S. competitiveness. Mr. Rotberg guesses that the after-tax cost of short-term debt financing in Japan and the United States has been about the same over the past five years and that the marginal differences are

"There's something structually defective about a system that encourages borrowing for consumption rather than investment."

"dwarfed" by Japan's other competitive advantages — particularly their long-term focus and marketing efforts.

The savings and investment gap extends to the entire society. Indeed, America's high levels of consumption are so troubling that Mr. Rotberg would like to see them addressed at the upcoming international economic summit. "There's something structurally defective about a system that encourages borrowing for consumption rather than investment," he said. Other topics he'd like to see on the Toronto agenda at the end of June: greater attention to economic development in the developing nations, plus efforts to tackle growing protectionist pressures. "We need much more awareness about the importance of economic growth in Asia and Latin America to expanded U.S. exports and their increased political stability," he said.

Lack of Understanding

Just as he is uncertain that these issues can be readily handled by the economic leaders at a summit, Mr. Rotberg fears that many of the more basic competitiveness issues are not sufficiently understood by Middle America. "Awareness is there, but acceptance is not," he said. "American business, academic and public leaders do think globally, are more aware of the interrelationships and are more conscious of the uncertain power they have over their own destinies," Mr. Rotberg said.

"But many running for political office are not willing to share that wisdom. It implies that something has changed, that our dominion has diminished .... And those who make that point are subject to a political backlash."

Mr. Rotberg believes a key to America's ability to compete and to attract foreign investment rests with the education and skills of the labor force. He is concerned, however, over the trend of U.S. companies to build plants overseas. "The corporation's stockholders may benefit (from such offshore expansion), but the labor force is left to fend for itself," Mr. Rotberg pointed out. How America copes with that complicated new reality is an issue he hopes is a focus of the upcoming presidential and congressional elections. ■