

INTERNATIONAL ECONOMIC TREND ANALYSIS

Howard G. Schaefer

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For my mother
Evelyn Schaefer



Preface

International economics is a complex subject made almost incomprehensible by the vast amounts of data and other information now available in quantities, accuracy, and real time unprecedented in human history. One of the most successful means of dealing with complex information is by using a systematic approach for accumulating and evaluating data. This approach is at the heart of most management information systems. Unfortunately, available systems for international economics were expensive and time consuming. Consequently, I began developing my own system utilizing the readily available data published in *The Economist*. It has proven remarkably helpful.

A successful analytical system also requires a basic analytical model. Law school had taught me that an important reason for written judicial opinions was as a discipline to force judges to reason logically about the facts and issues before them. Applying the same concept to the subject of international economics and finance, I found that writing this book forced me to think deeply about the subject matter and develop an overall understanding of the existing international economic system.

Although the subject matter may be laborious, patient attention to the material will make the diligent reader fully conversant with the complex ebbs and flows of international economic and financial events. We are entering an unprecedented period in international economic growth; yet there remain vast differences in economic theory, government policy, and data, causing national economies to move in divergent directions threatening to capsize trade and financial markets. The international matrix system presented here will improve the understanding of international economic events leading to better business and investment decisions.

This book could never have been accomplished without the love and support of my wife Debra and daughter Nicole whom I deeply love, and I appreciate the sacrifices they have made. I wish to give special thanks to Frank Thomas Murphy, C.P.A., of counsel to Coopers & Lybrand, for his diligent review of the manuscript and bringing to bear his long and active experience in international business affairs. I wish to also thank the wonderful people at John Beck Editing and Production Service for professional editorial guidance in bringing the manuscript to book form and Eric Valentine at Greenwood Publishing Group, Inc., for supporting this project. Appreciation is also given to *The Economist* and the International Monetary Fund for permission to use their published data and to Carol Howard, head of research (*The Economist*) for her patience in answering my questions.



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CHAPTER 1

Perspective

Throughout history, those alert to international trade have considerably enhanced their individual and national wealth. In antiquity, the Egyptians, Greeks, and Phoenicians derived much of their wealth from flourishing Mediterranean trade; while in the Middle Ages, Arab traders exchanged European precious metals for the spices and silk of China. During the Industrial Revolution, Britain built its overseas empire on the international trade of its manufactured goods while following the Meiji restoration in 1868; Japan pursued cultural independence by commencing international trade to obtain natural resources and foreign technology to strengthen its domestic economy.

While increasing wealth has been the primary motivating force in international trade, astute leaders have recognized other important advantages. Companies that successfully compete in the international marketplace are less vulnerable to enterprising competitors invading the domestic market encouraged by consumers seeking better and cheaper replacements. Likewise, nations successfully competing in the international marketplace derive efficiencies and technologies that enhance their domestic economies, advance their citizens' standard of living, and enhance their ability to sustain the financial drain of a national defense apparatus.

International trade and investment is also a treacherous arena to the unwary, however. Extending beyond one's border is not a simple extension of existing business and investment practices. International commerce has its own unique characteristics increasing the risks of cross-border commerce. Cultural and religious differences, poor communications, incompatible business practices,

different legal systems, different financial systems, variations in utility infrastructure, and a political establishment anxious to protect domestic residents are only some of the many differences facing the international venturer.

Overcoming these differences offers great rewards to those nimble and skillful in navigating these unique characteristics. Europeans, Japanese, Chinese, and many other peoples who have accepted these additional difficulties have also worked to reduce the risk by assiduously developing unique business practices and accumulating extensive experience dealing with these uncertain conditions.

Thus, for many people the term *global economy* means opportunity and adventure. Yet for others, the term means uncertainty and depravation. Americans in the 1990s seem particularly distraught about this term as evidenced by the public debate on adoption of the North American Free Trade Agreement (NAFTA). NAFTA eliminates many barriers to cross-border trade between Mexico and the United States which should be mutually beneficial. But the decline in U.S. global economic hegemony and the rise of major global competitors had created an uneasy feeling of impending decline in the national standard of living which threatened to block NAFTA's passage.

The term *global economy* signifies some massive economic transformation that is profoundly altering the economies of all nations to the detriment of the United States as large multinational corporations redistribute resources around the globe to maximize profits, escape government regulation, and minimize taxes. This transformation is said to cause vast capital flows to regions offering the highest return or stable financial conditions, thereby starving many nations of needed expansion capital while, in the meantime, low-cost countries entice hard-pressed and overregulated manufacturing concerns with irresistible opportunities to relocate as employees of multinational firms become a new class of stateless people developing their own cultural values independent of local cultural values.

U.S. INTERNATIONAL ECONOMIC HERITAGE

Underlying American concern about global competition is a surprising lack of understanding and sophistication in international commerce. It is surprising because American businesses have been formidable global competitors skillfully exploiting the unique characteristics of the international marketplace. Americans traditionally demonstrated a keen knowledge of international business affairs. In fact, for most of American history, international business has been an integral factor in economic growth and in the forefront of American business and political strategy.

American global competitive skills and awareness of global economic opportunities began well before the founding of the great nation. During the colonial period the colonists needed manufactured goods, and Britain was the greatest and most advanced manufacturer in its day. However, the American

colonies had an unfavorable balance of trade and little specie or precious metals by which to pay for the trade deficit. A complex system of triangular trade was developed by the enterprising colonists. The agricultural products of the colonies were shipped to southern Europe and the West Indies in exchange for various products that were shipped to Britain and traded for the manufactured goods that could then be brought back to the Americas.¹

After independence in 1789, the former colonists worked to reduce their dependence on foreign manufactured goods by developing their own manufacturing capability. To encourage domestic manufacturing, Alexander Hamilton spearheaded the drive for high tariffs on imported manufactured products.² In the early 1800s, this high-tariff policy triggered a national debate that highlighted not only the growing sectional disparity among the states eventually culminating in the Civil War but also the continuing impact of international commerce.³

Under tariff protection, the northern states built a flourishing and highly productive manufacturing sector that directed its output primarily to the growing domestic economy. The southern states, on the other hand, developed a thriving business exporting cotton to European textile mills. High tariffs not only made both imported and domestically produced manufactured goods expensive for the southern economy but also caused serious friction with foreign trading partners who threatened retaliatory tariffs on cotton exports.

An early demonstration of America's shrewd appreciation of global economic opportunity was Perry's opening of Japan in 1853 as its importance to economic growth became apparent. Whale oil was a principal source of illuminating oil, constituting at the time a major American industry. One of the principal whaling grounds was in the northern Pacific area where shipwrecked sailors occasionally washed upon the coast of Japan, whose government xenophobia impeded recovery of these unfortunate men. More important was the unfolding opportunity in international trade. The commercial success of ocean-going steamships indicated strong growth in Pacific shipping between the United States and the consumer market of China's vast population. However, successful steamship operation required coaling stations to supply coal for the passing steamships. Japan had commercially accessible coal deposits and controlled the Ryukyu Islands which offered an ideal location for a mid-ocean coaling station.⁴

Following the end of the Civil War in 1865, new opportunities in international commerce presented themselves. Enterprising commodity traders and banking houses built upon their overseas trading network to raise foreign capital for American railroad expansion. As the United States developed its intercontinental railroad system, the cheap transportation opened new opportunities for exploiting the vast natural resources and agricultural products of the interior for the expanding export business.⁵ America's increased international trade and vibrant domestic economy led to an extensive expansion of international financial activity.