

# Cato's Letter

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## Deregulation and the Global Market Revolution

FREDERICK W. SMITH

**F**edEx has become a very large enterprise. It now produces almost \$30 billion in revenue and employs a quarter of a million people. When I am asked how FedEx has become such a big enterprise, I wish I could say it was prescient management and clear-eyed strategic direction, but the fact is that FedEx has benefited from several strong macroeconomic trends. We set our sails and followed those very strong winds to the size and scope that we are today.

In recent decades we have seen dramatic growth in high-tech and high-value-added products as a percentage of all economic activity. Today, high technology in this country represents about 15 percent of GDP. It represented about 1 percent in 1970. That has big implications when you consider its effects on related economic activities.



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The growth in trade in high-value-added and high-tech items is really the story of globalization. There are certainly lots of commodities being traded today, but lots of commodities were traded in 1890, too. The real secret of the expansion in global trade has been high-value-added products. Whether it is Chilean wine or Louis Vuitton bags or surgical kits from Germany or airplanes from Brazil or semiconductors or auto parts or aircraft avionics or something else, the global market in high-value-added products has created the standard of living of the industrialized world over the last 40 or 50 years.

Unlike commodities such as agricultural and petroleum products, high-value-added items do not weigh very much. As Alan Greenspan often says, the aggregate output of the United States of America today is five times greater in real terms than it was in 1950. But that output weighs the same. It has not gained one pound in the last half century. As a consequence, high-value goods are easily transported. They are easily moved across borders. And they are easily traded. So as trade in high-value-added items has grown, the knitting together of the world as a single economy—with some notable and tragic exceptions—has become almost inexorable.

### The Internet Afterburner

And then in 1994 something happened that really turbocharged

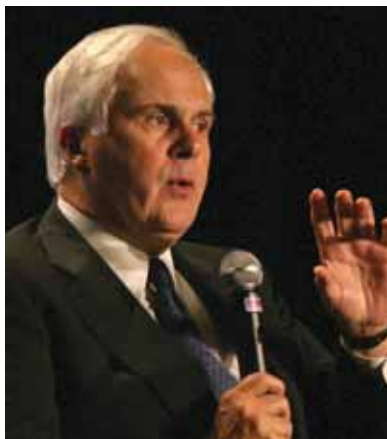
international trade—the development of the World Wide Web. For the first time in human history there was a low-cost, standardized protocol, with a visual medium, where people could offer their wares for sale without regard to time and place. For the first time it allowed almost anyone to access a worldwide market. No requirement for infrastructure. No requirement to deal with the bureaucrats. No requirement to have a man in Havana, so to speak.

Today, that system is producing about seven million pages of new

product on the Web every single day. The number of people who are online and able to buy your product is going up by an exponent every couple of years. You can see the results if you visit the FedEx Inter-

continental Network—far and away the biggest transportation system ever built in history. It is remarkable to see these completely eclectic trading patterns: things coming from Argentina going to Budapest and things coming from Kiev going to some remote part of China and things coming from Chubu Airport in Japan going down to Brazil. International trade is being propelled by the growth in high-tech and high-value-added goods displayed on the Internet and now available to people with very little hassle.

The Internet allows us to intermediate and simplify the complex customs clearance and paperwork



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requirements of various countries. Today about 25 percent of U.S. GDP is related to international trade—about 13 percent in imports and about 12 percent in exports. And that is continuing to grow two to three times faster than GDP.

I will never forget reading a book by Walton Wriston some years ago titled *The End of Sovereignty*. Wriston talked about the fact that governments everywhere are now under the discipline of the marketplace. Currency traders at terminals around the world are holding a daily referendum on the viability of any individual country's fiscal policies. Well, now that is happening for the goods-producing sector of society. That is very important and not very well understood.

When you see a commentary about international trade on CNN, they will invariably show a container ship. You will see big containers being lifted on and off ships. Malcolm McLean, a trucker from North Carolina, figured out that if you moved a truckload of containers on and off a ship, it would be a lot better than having to load the uncontainerized cargo on and off the ship. That revolutionized trade. To this day, the movement of goods by sea accounts for 98 percent of all of the tons moved in international trade.

### The Power of High-Valued Goods

The sector we are in at FedEx, which is far and away the largest transporter of goods by air, is a little tiny thing. It is only 1.5 to 2 percent of the tons moved in international trade. But guess what? That 1.5 to 2 percent of the tonnage moved in

intercontinental trade is about 40 percent of the entire value of all international trade. And if you take out petroleum and agricultural products, probably over 50 percent.

So FedEx airplanes are the clipper ships of the computer age. And as the Internet becomes a more familiar appliance for businesses everywhere and the ability to move things door to door in 24 or 36 hours becomes more and more accepted, you will see the continued integration of the global trading system.

Another very important macroeconomic trend is often misunderstood by policymakers. If you go all the way back to the end of World War II, most of the economic corrections in the industrialized world were inventory corrections. When inventory supply lines were very long, it was difficult to see the economic activity required in any stage in the production cycle and adjust output accordingly.

Because of the information revolution, the growth in high-tech and high-value-added items, and the development of the Internet, intermediate stages in production have become highly visible to companies. Wal-Mart and Dell are fantastic examples of businesses built around their logistics and supply chains. They used the improved visibility and the responsiveness of transportation and logistics available in the last couple of decades to completely revolutionize their sectors.

The economies of the world, absent big political corrections, currency issues, and problems with energy supplies, are highly flexible. As long as people are permitted to be entrepreneurial and allowed to deal with markets on a commercial basis, the economy is highly flexible and able to correct itself.

### Why I'm a Cato Supporter

We at FedEx have to play the game in Washington and London and Tokyo, just like any other big commercial enterprise. We have our lobbyists—although few in number and highly effective, I hope—and we tend to let our arguments speak for us much more than our political engagement. But I want to tell you about the three things that brought me to be a supporter of Cato.

I spent almost five years in the U.S. Marine Corps. I had the great privilege and honor in the Marine Corps of being a platoon leader and a company commander, and later on a forward air controller. I spent two years in Vietnam. And so I was one of the guys in Vietnam who were like the guys that George Bush has sent to Iraq today. We had a very different complement of people. We did not have an all-volunteer military. We had a draft-based military. You were in there either because they were after you or they soon would be.

One of my most profound experiences was the time I had to court martial a man. After I gave him a

speech that I thought was the equivalent of something Dwight Eisenhower said, I finally asked the question that I should have asked in the first place: "Why did you join the Marine Corps anyway?" He said, "Well, the judge told me it was five years or join the Corps." I saw up close and personal, to use a term we used in Vietnam, the consequences of a not very well thought out foreign policy and the hubris of the political classes, unfamiliar with what goes on on the ground when you have young men engaged in mortal combat, and I became exceedingly

suspicious of that process.

### Deregulation Works

The second reason I became interested in Cato is because everything that we did at FedEx was possible only because we systematically dismantled

government regulations. When we first got started in the early 1970s, it was possible only because of a loophole in the aviation law, which never envisioned anything like FedEx. Prior to that time, aviation had been a highly regulated gentlemen's club. But they changed the law to permit little jitney operations so people could fly planes between smaller cities. Then they completely deregulated air transportation in 1977 and 1978. Then came the deregulation of interstate surface transportation in 1980. And finally, in 1993, Congress recognized that there really wasn't intrastate transportation anymore.



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It was just interstate and international transportation, and regulation at the state level was in violation of the Commerce Clause, and they forbade it.

One of the biggest parts of my job is to tear down all of the protectionist schemes designed to protect national airlines and prevent us from moving high-tech and high-value-added items around the world.

Again, I saw up close and personal the destructive effect of well-intentioned but completely atavistic types of regulation. The great cost is always that one can never foresee what might have been. And if there was ever an example of the dramatic effects of deregulation, I think it is FedEx and the people who have followed in our footsteps. Wal-Mart and Dell would have been impossible without those regulatory revolutions.

### Central Planning Doesn't Work

My experience as a manager and participant at the board level in a number of large enterprises has taught me the flaw in the mindset that holds that large bureaucratic systems like the federal government can manage virtually anything they want to. It is impossible to manage the health care requirements of tens of millions of American citizens at the federal level. It is impossible to manage all of the permutations of people's economic aspirations and lives through a complex tax code. It is impossible to try to second-guess the market. It is impossible, from a managerial standpoint, for the federal government to do the things it is trying to do today.

In the 20th century, we had some of the most dramatic examples in

the history of mankind of the horrors of central planning. How much more real-life experience do we have to have with the fallacy of central planning than the tragedies of untold magnitudes that beset the Soviet Union, China, Cambodia, and other countries?

So all three of those things came together to make me a market liberal. I became convinced that the only solution to most of the issues that human beings have to deal with is to go back to fundamental principles, which were developed by a very smart group of people in the 17th and 18th centuries. In the Bill of Rights, the Declaration of Independence, and the Constitution is the requisite wisdom of the millennia, which today is time and time again forgotten by the political classes.

There is no institution that, person for person, dollar for dollar, idea for idea, has been even close to the Cato Institute in advancing those fundamental principles. There are a handful of people who have really made a difference: Friedrich Hayek, Milton Friedman, and Ronald Reagan—and I always include Ed Crane and José Piñera on the list. Two hundred years from now, those will be the people that we will be talking about, if this thing gets turned around, like we talk about Madison and Jefferson today.

Cato's is an important effort.

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And it is an effort that I think is remarkable in terms of what has been achieved to date. I think that if you had told people of my age 20 years ago that there would be a serious national debate on privatizing Social Security, they would have said it was impossible. If you had said that there would be a serious national debate on empowering individuals to buy their own health care and to give them incentives to save for their own care in their old age and so forth, they would have said that was impossible too.

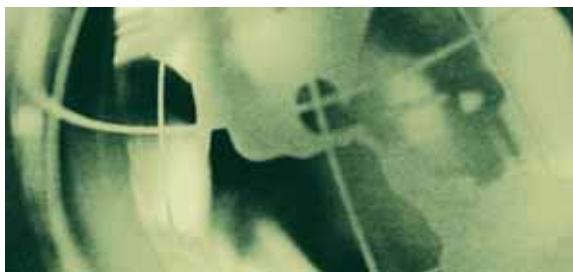
Yet if you search the *New England Journal of Medicine* for “Bill Frist,” you will see the majority leader of the

Senate basically espousing things that the Cato Institute has stood for since it published *Patient Power*, which introduced the idea of health savings accounts, in 1992.

So that is why I have been involved with Cato. I know that oftentimes,

when I talk to other businesspeople, Cato is not part of the mainstream thinking of a business class that is embroiled in political combat every day. But thank goodness for Cato, because it has made a difference. And I am very proud to have played a very minor role in trying to keep these very important lessons in the public mind.

I am reminded often of Edmund Burke’s famous comment that the only thing that is necessary for evil to prevail is for good men to stand aside and do nothing. And I can promise you that the Cato Institute has not stood aside and is doing something.



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## Federal Reserve Policy in the Face of Crises

November 16, 2006

WASHINGTON, D.C.

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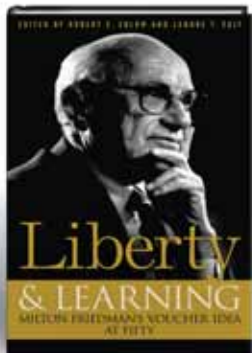
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