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Remarks by
Alan Greenspan
Chairman
Board of Governors of the Federal Reserve System
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I am pleased to be able to contribute to this conference's discussion of the challenges and opportunities associated with achieving diversity throughout the ranks of the American business and financial community

The decades since World War II have increasingly underscored the superiority of market capitalism. First, the head-to-head competition with the centrally planned economies of eastern Europe came to an abrupt end with the freeing of walled-off eastern Europe in 1989. The results of that experiment in social systems marked an unequivocal victory for the market capitalism of the West. This past year has exhibited a more modest replay of 1989 with the dismantling in many Asian countries of the model of so-called mercantilist capitalism, which involved a good deal of state intervention. Again, the less fettered capitalism that is most prevalent in the West demonstrated its superiority in sensitivity to consumer preferences and market forces.

Yet, although the image of free market capitalism has been elevated throughout the world from its sorry state at the end of World War II, the application of it within the United States, its largest adherent, is regrettably incomplete. Too many barriers still prevent the free flow of capital and people to their most productive employment. This conference is addressing one result of those barriers, the underemployment of a significant segment of our population. I trust that from yesterday's workshops and in subsequent discussions you will be able to identify ways to utilize more fully the talents of our increasingly diverse workforce to meet the challenges of a dynamic, global, financial services industry.

I would like to address two aspects of the issue of underemployment of minorities: first, the implications of ignoring the potential that already exists and, second, the need to encourage young people to seek the types of education and training that will meet the demands of work in the twenty-first century.

Regrettably, when faced with choices among otherwise similarly educated or experienced job candidates, some may simply select those with whom they are more comfortable by dint of familiarity--those who come from the same schools, who belong to the same clubs, or who are recommended by their colleagues--rather than look deeper into the unfamiliar for untapped talent. A similar tendency may explain at least some of the large disparity in mortgage application acceptances between whites and minorities that was investigated by the Federal Reserve System and others in recent years. After accounting for the obvious differences in income, assets, and previous credit histories, a significant gap remained. Upon detailed examination, the data showed that those clearly qualified for a loan, or clearly not qualified, were accepted, or rejected, independent of race. The gap may have stemmed at least partly from the extent to which those reviewing loan applications, mainly whites, were prone to give more assistance to whites than to minorities in correcting application deficiencies in marginal applications. I believe it is reasonable to surmise that, if minorities had had the same advantages of application enhancement, the banks would have uncovered many additional, profitable lending opportunities.

I was reminded during a recent visit with Jesse Jackson of a related episode half a century ago: the confrontation just after World War II of the decades-old racial discrimination in major league baseball. At that time, the leagues were somewhat less than "major" in that a significant segment of baseball talent was excluded. I suspect that many league owners realized that hiring black ballplayers could enhance their teams' competitive skills, an improvement that would eventually show up at the box office and on their financial bottom line. Of course, in the late 1940s, aside from those prone to prejudice, most owners were simply more comfortable with the

status quo, taking the path of least resistance, that is, doing nothing. Almost as bad, were the procrastinators, who saw what needed to be done but were dilatory. Fortunately, Branch Rickey was neither. He had the courage of his convictions and was smart enough to know that, in bringing Jackie Robinson into the major leagues, he was moving ahead of his fellow owners and could thereby gain an advantage. It also was the right thing to do.

I do not want to argue that minorities today are being excluded systematically from our business and financial major leagues in the same way that black ballplayers were blocked from baseball half a century ago. However, I believe that, like the major league owners, business and financial industry decisionmakers are subject to some inertia in expanding their vision to seek talent wherever it lies. Our experience with mortgage applications is one that underscores the role that free market competitive pressures can play in undermining discrimination and improving the profitability of business activity. Discrimination is patently immoral, but it is now increasingly being seen as unprofitable.

Prices, interest rates, stock prices, and other signals produced by market economies to encourage the distribution of productive resources have no inherent moral content. However, to the extent that market participants discriminate--consciously or, more likely, unconsciously--the setting of wages and prices and the distribution of output are distorted. In the end, costs are higher, less real output is produced, and national wealth accumulation is slowed. If markets were fully efficient--that is, if all resources were allocated optimally and fully employed without discrimination--profit maximizers would arbitrage away such non-economic differences in the returns to human capital and other productive resources.

I do not doubt that most participants in business and finance have the same aversion to the misuse of human talents that they have to the misallocation of capital resources. Thus, efforts such as those at this conference to demonstrate the potential gains from broader approaches to hiring and to the choice of business counterparties seem wholly appropriate. It is in these areas that I believe sustained progress in diversifying the marketplace of business and finance is feasible.

We need also to make further progress in establishing business relationships between the financial services sector and the rapidly expanding number of minority-owned businesses. Indeed, the growth of minority-owned small businesses is truly impressive. The number of black-owned firms increased nearly 50 percent and the number of Hispanic-owned firms jumped 80 percent between 1987 and 1992--between two and three times the rate of growth of non-minority-owned firms. More recent data are not available, but I suspect that trend has continued since 1992 as the strong performance of the economy, coupled with generally ample availability of credit, has created an environment conducive to the birth and growth of innovative enterprises of all ownership types.

The information that we have on the financial behavior and characteristics of minority-owned firms is still fairly sparse. However, the Federal Reserve's 1993 National Survey of Small Business Finances provides a snapshot of the small business community and the types of financial services used by these firms. Minority-owned businesses accounted for about 12 percent of the business population covered by the survey. They shared many of the characteristics of non-minority firms, but they also reported some important differences. Minority firms, for example, were somewhat smaller and younger and were more concentrated in

the business services industry Black, Hispanic, and Asian-owned firms, like their non-minority counterparts, tended to rely heavily on depository institutions as a source of funds, but the percentage that borrowed at all was lower for minorities, reflecting in part their younger age, smaller average size, and relative lack of equity capital A survey of this type cannot yield a full picture of trends in small business finance for minority firms, but as we continue to analyze these data, we hope to learn more Nonetheless, the data suggest that a solid base of business relationships between the financial services sector and minority-owned firms already exists, a base on which we should be able to build as the number of minority businesses continues to expand and as the existing ones grow

Several other recent developments hold the promise of improving links between financial institutions and minority businesses First, major banks and finance companies are trying mass-market approaches to small business finance, similar to approaches in the consumer area, and this effort has greatly expanded the competition for loans In addition, new innovative intermediaries--such as community development corporations and multi-bank and investor loan pools--are seeking to develop expertise in specific segments of the small and minority business marketplace These innovators, working with traditional lenders, are helping to develop new approaches to managing costs and evaluating the risks associated with providing financing for very small and young firms

But credit alone is not the answer Minorities must be assisted in finding sources of equity finance This is an essential part of the financial foundation for the dynamic young enterprises that are so central to our wealth-creating process Unless minorities can have access

to all forms of capital from which to create wealth, they will be denied the full benefits of our vibrant economy, in which all should be able to participate

Looking ahead, more generally we must find ways to prepare the more racially and culturally diverse pool of young people who will be flowing into jobs and operating businesses in the twenty-first century. The fast-paced technological change of recent years and the growth of the conceptual component of our nation's output has brought with it increased demands for workers who are equipped not simply with technical know-how but with the ability to create, analyze, and transform information and to interact effectively with others. The evidence suggests that, across a wide range of industries, including financial services, employers have been upgrading their skill mix. Importantly, these changes represent not only a shift in the occupational mix, but also, to a larger degree, an upgrading of skill requirements of individual jobs, for which the range and complexity of tasks and the scope for problem-solving and decisionmaking has expanded.

Our future entrepreneurs, too, must be prepared to compete in an environment in which the largest part of the growth in output is the result of new insights. Breakthroughs in technology are continually adding to the ever-longer list of wholly conceptual elements in our economic output. The success of our future business leaders will depend greatly on their capacity to develop and apply new technology and to rearrange physical reality to achieve products and services more highly valued by consumers. To do this will demand not only greater specialized knowledge, but also an ability to deal with risk and uncertainty. Unfortunately, we have found that we never can predict with any precision which particular technology or synergies of technologies will add significantly to our knowledge and our ability to gain from that knowledge.

Traditionally, broader human capital skills have been associated with higher education, and, accordingly, the demand for college-trained workers has been increasing rapidly. While the higher demand has induced more people to enroll in college, the supply of college graduates has lagged behind the growing demand. As a result, over the past fifteen years, a wide gap has opened between the earnings of college graduates and those of workers who stopped their formal schooling with a high school diploma or less. Higher proportions of both black and white high school graduates have been going on to college over the past 15 years, and minorities now constitute a higher proportion of the B.A.s, M.A.s, and professional degrees awarded each year. Nonetheless, black and Hispanic college enrollment rates still lag, and the number of college-trained minority workers, while expanding, remains relatively small. Moreover, while the proportion of blacks in professional and managerial jobs has increased, it remains lower for blacks than for whites.

To begin to close these gaps will require attention on a number of fronts. A very fundamental need is to look for ways to begin the learning process as early as possible. In the long run, better basic education at the elementary and secondary school level is essential to providing a foundation that will position students to move on to higher education. The statistics on the proportion of our youth who are high school dropouts remain discouraging.

Another trend that is gaining a great deal of attention is the growing propensity of private employers to provide training and education to their workers. The development of human capital is increasingly perceived by many corporations as adding to shareholder value. With this incentive, private industry, I believe, can succeed where government programs have, at best, had limited payoffs in training and upgrading workers with deficient or outdated skills. Moreover,

corporate sponsorship of in-house universities and external formal education can be a resource for furthering the development of talented minority professionals

Clearly, we still have a long way to go in overcoming the economic consequences of discrimination. Despite the progress that has occurred in educational attainment and occupational upgrading among minorities, the available information on whether there has been an improvement in the earnings differentials between minority and white workers in recent years is ambiguous. More conclusive data are available on trends in capital asset accumulation. The Federal Reserve's Surveys of Consumer Finance indicates that the median real net worth of minority families more than doubled between 1989 and 1995. That said, a sizable gap still exists between the net worth of the two groups.

I have no illusions that the task of breaking down barriers that have produced the gaps in income, wealth, and employment will be simple. I applaud the efforts that Jesse Jackson has undertaken to arrange this two-day seminar. I trust these discussions will raise the level of consciousness in our community about choices involving hiring and developing business relationships with minorities and their businesses and will encourage our business and financial leaders to work harder to identify opportunities to put underutilized talent to work productively and profitably. It is good for business. It is good for our society. And--it is the right thing to do.