The Federal Reserve Board

Remarks by Vice Chairman Roger W. Ferguson, Jr.

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Economic Policy for Our Era: The Florida Experience

Today, I would like to offer some observations, from the perspective of a policymaker, on the events that have already transformed much of the national and regional economies and that are continuing to reshape business around the globe. Specifically, I want to reflect on the changing role of economic policy in our current environment of rapidly improving communications and expanding markets. In order to sustain the gains that Florida and other regions have made in the past decade, and to best ensure our continued global competitiveness, we need to fashion economic policy that, above all else, helps to facilitate communication through efficient and effective markets.

Recent Growth Trends
The national economy is enjoying an impressive period of economic prosperity. National income, after adjusting for inflation, has grown about one-third since 1991--or about 3½ percent per year. The rate of U.S. joblessness has fallen to a level not seen in thirty years, and wealth is being created at a pace rarely seen.

Growth in Florida has been even more impressive. Florida has always had a large service sector because of the tourism and medical industries. The recession associated with the Gulf War had a disproportionate impact on Florida's growth, and your state started the decade with a slightly deeper recession than the rest of the Southeast and the nation as a whole. In early 1992, the state began to systematically outperform the nation overall, and that has continued to the present. Year-over-year employment growth in Florida has outstripped that of the rest of both the Southeast and the United States since 1992.

The recent job growth and prosperity of the state has been powered by two components of services, tourism and back-office type business services. There was a dramatic surge in service-sector growth beginning in 1997 that was associated with expansions of capacity in Orlando and, to a lesser extent, Miami. The more recent surge has been mainly the movement of back-office corporate functions, such as call centers, into the state, which have relocated mostly to the northern metropolitan areas of Tampa, Jacksonville, and Tallahassee. These service industries depend importantly on modern communications, a theme to which I will return shortly.

Florida also has significant international exposure, with approximately one-half of Florida's exports going to Latin America. Brazil and Mexico are two major trading partners. The export mix from Florida includes computer and communications equipment as well as industrial chemicals and fertilizers. In the service sector, south Florida, as the gateway to Latin America, continues to attract the interest of banking organizations from around the world. In the state, foreign banks from twenty-three countries compete with domestic banks in the areas of international private banking, trade finance, and correspondent banking.

What accounts for this remarkable reversal in economic fortune? As I have said recently, on the national level, and possibly in Florida as well, the dominant force of late appears to have been a significant upshift in the rate of productivity growth. Having increased 1.6 percent per year from 1990 to 1995, output per hour in the nonfarm business sector--a conventional measure of productivity--has risen at an annual pace of about 2.6 percent since 1995. Cyclical forces--such as the inability of businesses to add to their payrolls as rapidly as they would have liked in response to the rise in demand--have probably played some role in these efficiency gains. But I suspect that longer-term, structural changes, reflecting the boom in capital spending and the revolution in information technology, probably have been more important. Through this increase in productivity, our national economy has successfully prepared itself to take advantage of the rapid globalization that has characterized the current economic expansion.

Although private decisions rightly deserve primacy in any discussion of the current economic climate, they were taken against the backdrop of important policy decisions. I believe that this productivity increase might not have occurred were it not for the policy adjustments that were started in the late 1970s and are continuing even today. Furthermore, the opening of many nations' economies to our goods and services reflects, in my judgment, the fact that the world's policymakers have, in general, abandoned the economic policies that were found to be counterproductive. In the end, free trade, deregulation, sound fiscal policy, and sound monetary policy have all played a role in the strength of the U.S. economy. These same factors are emerging as equally important in other economies.

Economic Prosperity, Trade, and Global Integration

In economics, nothing is more fundamental than trade. Trade allows us individually, and as a nation, to devote our scarce resources to their most advantageous uses and then exchange our products with others to satisfy our diverse preferences. This process allows specialization, and it is what gives rise to the existence of markets. The lifeblood of trade is communication. Communication allows us to find the most profitable outlets for our products and suppliers for our needs and wants. The greater our capacity to communicate, the greater our ability to specialize, the broader our expanse of markets, and the more prosperous we become. These are not new ideas. They have been our understanding of how nations become wealthy since being described by Adam Smith more than two hundred years ago.

Today, we are experiencing a great technological revolution--a communications revolution. The proliferation of microprocessors and other innovations of the past several decades has dramatically lowered the costs of getting and transmitting information. Predictably, the new communications technology has brought with it a growth of new markets. This great expansion of markets has allowed the U.S. economy to improve its allocation of resources by shifting them to their most internationally competitive uses. It also seems probable that these new communications technologies have brought greater openness in global markets by helping us to break down the complex and unproductive network of artificial trade barriers that characterized much of the previous century.

The role of international trade and finance in bringing renewed prosperity to our economy in the past decade is hard to overemphasize. Total trade with foreigners now accounts for about one-quarter of the total U.S. national output--more than twice the share of the period between 1920 and 1970 and the largest trade share of the U.S. economy in more than a century.

The Cost of Growth
Economic transformation has not come without cost. Between 1977 and 1987, U.S. industry reduced production jobs in manufacturing by 1.4 million workers. Is economic progress possible that does not make obsolete the methods and practices of the earlier, less efficient economy? In his 1950 book *Capitalism, Socialism, and Democracy,* economist Joseph Schumpeter described capitalism as a system "that incessantly revolutionizes the economic structure from within, incessantly destroying the old one, incessantly creating a new one." Schumpeter saw that economies continually bounce from one growth path to another, all the time remaking themselves. He coined the phrase "creative destruction" to describe this process.

Simply put, economies are constantly under competitive pressure to re-invent themselves. As they move toward higher levels of productivity, they necessarily make other production technologies obsolete. Schumpeter cautioned that economic policymakers who fail to appreciate the relationship between the relentless churning of the competitive environment and wealth creation will end up focusing their efforts on the methods and skills that are in decline. In so doing, they establish policies that are aimed at protecting weak, outdated technologies, and in the end, they slow the economy's march forward.

In retrospect, we can tell that some economic policies of the past century have inadvertently, or in some cases intentionally, done just that. They have had the effect of directing or misdirecting economic growth by either substituting policymakers' judgment regarding the distribution of an economy's assets for the combined wisdom of individuals or allowing markets to send false signals. In the long run, such policies were destined to fail.

The Economic Policies of the Last Century
A very broad reading of economic history reveals that policymakers in many countries during the last century attempted to manipulate trade and other forms of economic activity by altering, artificially, the *measures* of value, that is, prices. One such policy followed by some countries during the last century was known as the "beggar thy neighbor" policy, the manipulation of the exchange rate in order to boost a country's exports. Trade restrictions were also often used to protect domestic industries from imports. A final example from the international sphere is the system of global fixed exchange rates that emerged following the Second World War. To blunt market forces, fixed exchange rates were usually accompanied by capital controls that tried to manage the inflows--and more importantly the outflows--of a nation's investment funds. Ultimately, this system of global fixed exchange rates worked poorly and could not withstand the market forces that emerged in the 1970s.

In a similar spirit, some economies used taxes or other incentives to promote one industrial activity or discourage another. Obviously, the most egregious form of this policy was in planned economies. But many democratic economies, as they recovered from various wars and other national traumas, nationalized entire industries. In our society, we never found that degree of government intervention appropriate, but we did regulate some business decisions for certain industries, such as electric power distribution and airlines, attempting to overcome the "natural monopoly" or "excessive competition" characteristics perceived in these industries.

Finally, some central banks in the past engaged in policies that artificially altered the path of domestic prices in their effort to regulate their business cycles. If the monetary authority wanted more growth above trend, it lowered money-market interest rates by expanding the stock of money. Such policies were expected to bolster demand and encourage an acceleration of growth. There was the misunderstanding that somehow a long-run tradeoff existed between inflation and unemployment. But it gradually became understood that inflation eroded investor and consumer confidence and distorted behavior, both because the average of prices gave a constantly depreciating reading of the values it was supposed to represent and because relative prices provided an inaccurate reflection of comparative worth. Monetary policies that intended to create growth through the inflation of prices ended up impeding markets and reducing economic prosperity. We now know that there is no long-run tradeoff between inflation and unemployment. The U.S. experience of the last several years has also taught us that low and stable inflation is the underpinning for sustainable growth and that sustainable growth fosters the maximum creation of jobs over time.

Emergence of the Communications Era

In recent decades, trade restrictions, "beggar thy neighbor" policies, and the pursuit of a supposed long-run tradeoff between inflation and unemployment have all been called into question and generally rejected. In part because of the communications revolution and the substantially reduced costs of transacting from great distances, businesses have sought more globally integrated production processes, and investors have required the development of financial instruments to facilitate their demand for international portfolio diversification. Such developments have put enormous pressure on policymakers to loosen their grip or abandon policies that led to the misallocation of resources. Tariffs have been reduced, and restrictions on the flow of goods have been eased. Controls on the flow of investment capital have been eliminated in most industrialized countries, and they are rapidly coming down in many developing nations as well. In some cases, these changes were more or less forced upon the nations that adopted them. But in many instances the policies have been liberalized because of the realization that markets allocate resources more effectively than governments.

Trade is flourishing, gaining great momentum in the ten years since the fall of the Berlin Wall. Total trade with foreigners now accounts for about one-quarter of total U.S. national output--more than twice the share of the period between 1920 and 1970 and the largest trade share for the U.S. economy in more than a century. Not coincidentally, the economy has been expanding at a strong and steady rate.

In addition, our economy has benefited from past actions by the government to deregulate industries. The removal of unnecessary government regulation started more than twenty years ago, during the administration of President Ford, and gathered momentum during the Carter years. It has altered the business landscape. Deregulation allowed, indeed forced, businesses to focus more clearly on a marketplace that has become more competitive, with fewer constraints and increased flexibility.

If economic policy is to play a constructive role in building a new world economy, policymakers must increasingly focus on policies that eliminate barriers to communication and allow the market to work most efficiently and effectively. They must develop approaches that do not hinder "creative destruction" but appropriately cushion its impact on workers and communities. They can encourage the information revolution by fostering policies and approaches conducive to giving investors and consumers the information they require to make informed decisions. For example, the Federal Reserve and the Basel Committee on Banking Supervision have strongly supported initiatives to improve the quality of national and international disclosure practices. Credible financial statements and other disclosures are key means for communicating a company's operating results and its overall health, as well as for making more transparent various operating activities.

Regarding monetary policy, central banks around the world are now endeavoring to provide stability to their domestic price levels. In some cases, this focus on price stability was undertaken in order to return credibility to the central bank after a period of unacceptable inflationary pressures.

The Federal Reserve, with our mandate, must also seek to facilitate the transmission of the information that the price level is meant to convey. By maintaining a stable purchasing power for money, workers and firms will more clearly see the values being attached to their opportunities and more effectively make judgments about the allocation of their resources. This is a monetary policy that does not attempt to alter the information being transmitted by the marketplace but to increase its clarity and consistency.

The increased openness of Federal Reserve decisions--reflected in announcement policies aimed at more rapid and transparent dissemination of Federal Open Market Committee decisions--also needs to be appreciated as a way to facilitate the communication to and within the marketplace in order to promote the most effective policy possible.

Policies for a Communications Era--A Local Perspective

This perspective on economic policy extends beyond the establishment of the national monetary policy that occupies much of my time. A popular bumper sticker says, "Think Globally, Act Locally." Good advice. Indeed, this simple maxim describes one of the great strengths of the Federal Reserve System. Although we tend to think of the Federal Reserve as a Washington-centric institution, it is, in fact, a structure of twelve independent regional Reserve Banks, teamed in harness with the Board of Governors in Washington. Florida is in the Sixth Federal Reserve District, which is headquartered in Atlanta but has two Branches in Florida. Reserve Banks have always had an important role in channeling regional economic information into the deliberations of national economic policy. Today, they take those responsibilities a step further.

In closing, let me give a few examples of some of the local programs that are conceived in this spirit. The Atlanta Reserve Bank and the Board of Governors, along with nine other federal agencies and regulators, earlier this year hosted a conference to discuss rural housing and economic development activities. The conference, entitled "Bridging the Gap: Financing Affordable Housing in Rural Florida, Georgia and Alabama," was held in Maitland, Florida, and was attended by seventy-five community development practitioners. The conference focused on rural economic development opportunities, particularly those housing programs designed to serve low- and moderate-income families, and on the ways to identify program and administrative funding sources necessary to take advantage of these opportunities.

In addition, the Atlanta Reserve Bank last year hosted a conference for financial institutions, local community development corporations, local municipalities, and others to roll out the community profiles that the Reserve Bank had prepared and to discuss programs and opportunities to address local needs. The profiles included demographic and statistical information about these communities. Currently, the staff of the Atlanta Reserve Bank are conducting extensive outreach to the same communities to assess the program and to identify current needs and emerging issues.

Conclusion

As an economic policymaker, I believe that building a world-class economy isn't at all about trying to manufacture various economic outcomes. Fortunately, most policymakers have come to recognize that their role in building world-class economies is to help develop the infrastructure through which people communicate. We need to provide the public with the tools that allow them to judge value accurately and to see opportunities with the greatest clarity. Economic policy, including monetary policy, has to be an integral part of the communications revolution that is sweeping the world. These are the policies appropriate for our era.

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