Speeches

A Decade of Difference: The Newly Improved U.S. Economy

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Thank you, David, for the nice introduction, and thanks to the membership of the Gwinnett County Chamber for inviting me to be part of your program today. I appreciate the opportunity to be here.

As our record-breaking expansion heads toward the halfway mark of its tenth year, you'd be hard-pressed to think of a better place to consider what's gone right with the economy than right here in Gwinnett County. Everything that distinguishes the U.S. economy from the rest of the world—high technology, labor mobility, entrepreneurship—is on display here, in abundance.

I'm going to resist the urge to recite Gwinnett's awesome growth figures this afternoon, but because I'm a policymaker, I would like to begin with a show-of-hands survey.

How many of you lived outside the Southeast in 1990?
How many of you lived outside the state of Georgia, but still in the Southeast, in 1990?
How many of you lived in Georgia in 1990, but not in Gwinnett County?
And how many of you lived in Gwinnett County in 1990?
Now let me ask you this: Do you live in a "new" Gwinnett County? The answer, I suppose, is "new compared to what?" or "it depends,"—and I leave it to you to decide. But reasonable people can disagree about the answer without disputing one central fact: there are a lot more of you in Gwinnett County today than there were 10 years ago: 524,000 today versus around 353,000 in 1990. Or to put it another way, more people have moved to Gwinnett since 1990—171,000—than *lived* here just two decades ago (167,000 in 1980).

The debate I've just suggested—is Gwinnett new or not?—resembles one that's been raging among economic policymakers lately. No one disputes that we've witnessed some profound changes in the U.S. economy since 1990 (although, since this is economics we're talking about, few agree about what those changes are). The question is whether they add up to a fundamentally "new" economy.

I've got some thoughts of my own to share with you on that question. But I'd like to begin this afternoon by looking at how things have improved for the U.S. economy, circa 2000, through the lens of what has changed since 1990.

Faster, smarter and more productive

Let me start with productivity. Ten years ago last month, on August 2, Iraq invaded Kuwait after Kuwait spurned an old-fashioned shakedown by Saddam Hussein. Now, if tomorrow you heard that Iraq was once again preparing to invade Kuwait, how would you get more information on developments there? You could turn on your radio and wait for a wire report, of course. Or you could tune into CNN, or wait for your morning paper. You might have done any of those things 10 years ago, too.

Today, though, you could gather as much information as any newsroom by simply firing up your computer and checking out dispatches from the *Kuwait Times*, or the *Jerusalem Post*, or Egypt's *Middle East Times*. This is the very definition of productivity improvement, and you can do it because you've got access to the Internet. And you can use the Internet because in 1990, British engineer Tim Berners-Lee invented the World Wide Web at CERN, the European Particle Physics Laboratory in Geneva, Switzerland.

It's easy to forget sometimes, but the Internet isn't new. It actually dates to 1969, when the U.S. Department of Defense created a decentralized computer network called ARPAnet to facilitate communications during a nuclear attack. ARPAnet, of course, evolved into the Internet as other networks connected to it. But until Tim Berners-Lee set out those first World Wide Web specifications to help CERN's physicists work together, the Internet's productivity-enhancing potential remained mostly unfulfilled.

I don't mean to suggest that the Internet is responsible for all or most of the productivity gains we've seen in the current expansion. (And I'll have more to say on this later.) But as an analogue for the sheer neck-snapping speed with which telecommunications, data processing and personal computers improved productivity in the current expansion—from Tim Berners-Lee's PC to every single one of ours in less than 10 years!—I like the Web just fine.

The Napsterization of finance

The second distinguishing factor of the current expansion is a transformation of the financial system. Think back again to 1990: It was the first full year of operations for the Resolution Trust Corporation, which was established in 1989 to liquidate the assets of thousands of failed savings and loans. There are, of course, lots of reasons why the S&L industry failed. But they all have their roots in post-Depression era legislation that divided the financial services industry into rigid sectors, while prohibiting competition between and among them.

Last year, Congress passed the so-called Gramm-Leach-Bliley Act. Among Gramm-Leach-Bliley's most important provisions was a repeal of the centerpiece of those 1930s-era statutes, the Glass-Steagall Act. With the passage of Gramm-Leach-Bliley, banks are now (officially) permitted to own insurance companies, and brokerage

houses are able to operate banks. And while the financial services industry has evolved much more quickly than the law, Gramm-Leach-Bliley nevertheless signaled that old era—the one that was still very much with us 10 years ago—had officially ended.

What we're witnessing in the new era, I think, is what my Atlanta Fed colleague Bob Eisenbeis calls the Napsterization of finance. If you've got a teenager at home, you know what I'm talking about. Napster is a so-called peer-to-peer distribution service, meaning that it allows me to download onto my computer a digital recording from someone else who already has it. The recording industry, of course, calls this "stealing" (and they may or may not be right) but I think Napster is a fascinating example of what economists call disintermediation: the elimination of the middle man.

And it's increasingly happening in finance. Consider this: Two years ago, more than a third of all small business loans in Georgia were originated by banks with no presence here at all. In Florida last year, not a single Florida-based bank ranked in the top 10 in terms of market share. And throughout the 1990s one of the nation's leading industrial and consumer lenders has been General Electric, maker of jet engines, dishwashers and situation comedies.

Obviously, disintermediation has not been an entirely positive development for the old intermediaries—although I think there will always be a place for traditional community bankers to help customers find their way in an increasingly complicated financial world. But for the economy, disintermediation has been absolutely essential: Today, investors and entrepreneurs can find each other with greater ease and at lower cost than at any time in history. Without question, this has been one of the most important reasons for the economy's record-breaking performance these last nine years.

Embracing the one sure thing

The expansion's third distinguishing factor is a willingness by the American people to embrace uncertainty. Ten years ago, you may recall, Americans were in awe of the so-called Asian miracle. The success of Japan in particular had launched an epidemic of envy, worry and even fear across the United States. In less than half a century, Japan had transformed itself from one of the world's most wretched countries into one of its richest; it seemed to be doing something right. That something was industrial policy, and many Americans thought we should pursue one, too.

With hindsight, of course, it's obvious that the Japanese approach had some problems. Above all, Japan's experience over the last 10 years demonstrates that markets make much better decisions about the allocation of resources than policymakers. And while it's true that American-style layoffs remain mostly unheard of in Japan, it's also the case that Japan's reliance on industrial policy led it into a recession that has lasted most of the last decade.

The willingness of Americans to accept the dictates of global markets, good and bad, distinguishes the United States not just from Japan, but from much of the rest of the world as well. In Europe, for example, the objective of labor practices remains (as it has for decades) to provide workers with *certainty*: with the assurance that their jobs and their paychecks will be there tomorrow, no matter what. The problem is that global markets make no such assurances. As a result, some of Europe's leading companies—despite chronic double-digit unemployment in their own home countries—are sending some of the best jobs overseas.

Here in the United States, transfers, layoffs, plant closings and worse have been with us a long time. As recently as 10 years ago, though, we took them as a sign that we had been outsmarted and out-hustled by our international competitors. Now we know otherwise. Now we understand that as capital has become quicksilver mobile and international markets merge into one, the American tolerance for uncertainty is a crucial competitive advantage.

Who wants to be an entrepreneur?

A fourth, related change from a decade ago is an increased capacity for entrepreneurial risk. Think back again to 1990. Quite apart from concerns about hostilities in the Gulf, there was, I recall, a fairly severe case of economy-induced anxiety gripping the country. The title of a 1992 bestseller perhaps best captured the mood: *America: What Went Wrong*. There was, of course, absolutely nothing wrong, but in the early 1990s, a great many people thought there was.

Today, I'd say the mood is captured not by any particular book, but by a television show: "Who Wants to be a Millionaire?" If 10 years ago, everyone you encountered knew at least somebody who'd been laid off, today everyone knows somebody who's gone to work for a start-up. Yes, it's true that the current mood is as overdone as it was 10 years ago. And it's also true that many—maybe even most—high-tech start-ups won't amount to much in the long run. But the point is not that 999 start-ups fail for every one that succeeds. The point is that 1,000 try something completely new, completely different—and that in terms of innovation and value creation, the successes redeem the failures thousands of times over. These folks are making venture capitalists of us all—and the United States the envy of the world.

Productivity improvements, financial innovation, a willingness to embrace global uncertainty and a newfound spirit of entrepreneurialism: All four developments distinguish the current expansion from previous periods of growth, and all four are very much on display here in Gwinnett County. But public policy has been an important factor, also, and here, too, there's been one more change for the better over the last decade.

Fiscal and monetary policy: pulling in the same direction

In 1990, the U.S. government ran a deficit of 221 billion dollars. That fall, some of you may remember, President George Bush and congressional leaders cloistered themselves at Andrews Air Force Base, where they hammered out legislation that began to bring spending in line with revenue through a combination of spending cuts and tax increases. In 1993 and 1997, President Clinton signed legislation that continued the job.

As we approach the end of fiscal year 2000, the federal government is going on three consecutive years of budget surpluses. And while the good old U.S. economy deserves most of the credit for the budgetary heavy lifting, fiscal restraint (such as it is) has also played an important role in the economy's performance. Businesses no longer have to compete against the federal government for financial resources. And the so-called inflation premium has largely disappeared from interest rates now that fiscal and monetary policies are pulling in the same direction. As election season approaches and you begin to hear lots of rhetoric about fiscal policy, I hope you'll keep in mind that the budget surplus is already providing dividends.

Now let me mention one thing that hasn't changed since 1990. I'm talking, of course, about monetary policy. I know: On the face of it, any claim that monetary policy hasn't changed seems a little incongruous. The FOMC has, after all, increased the fed funds target rate 175 basis points since June of 1999; "unchanging" hardly seems to describe our disposition. But the FOMC's actions over the last 15 months—indeed, over the last two decades—have been in service to a principle that truly has become immutable: the principle that low inflation, if sustained over time, will be followed by strong economic growth and low unemployment. For too long, though, this ideal was an exercise in academic conjecture, usually because monetary policymakers made a mistake and allowed inflation into the economy.

The extraordinary expansion is evidence that low inflation *works*. Since 1990, it has encouraged businesses to invest in productivity enhancing innovations, and allowed financial resources to flow to their most efficient uses. It has ensured that Americans' willingness to live uncertainty accrued to our benefit, and guaranteed

that the budding entrepreneur has something to fall back on if things don't work out. Low inflation has, in short, been the difference in the economy's four distinguishing factors.

Productivity gains: How much longer? (And how significant?)

All of this takes me back to the question I led off with: Do we have a new economy? I suggested earlier that the answer is "it depends" or "new compared to what?" Let me explain what I mean.

The new economy debate is fundamentally about productivity, which is generally defined as output per worker per unit hour. Productivity matters because, along with the size of the labor pool, it determines how much an economy can produce. The issue is particularly important now, with labor markets as tight as they are: If the economy is going to continue to meet surging demand, then productivity is going to have to grow, too.

And in the current expansion, as I suggested earlier, it has. From 1972 to 1995, annual productivity growth averaged an anemic 1.4 percent. From 1996 to 1999, though, it doubled, to 2.8 percent, and from the second quarter of 1999 to the second quarter of 2000 it grew a staggering 5.3 percent. So what, exactly, do I mean by "it depends"? Well, to be precise, it depends on whether the recent upshift in productivity growth is truly *permanent*.

Productivity growth generally results from two developments. The first is capital deepening, which is just what it sounds like: giving workers more resources—deeper capital—to do their jobs with. The second development is the arrival of some new technology that truly, permanently changes the way things are done.

A few minutes ago I said that the Internet, telecommunications, data processing and other information technologies are driving the productivity surge we've witnessed in the second half of the current expansion. True enough. But it's also quite likely that a good portion of the increase resulted from old-fashioned capital deepening. Because, in fact, several years before productivity broke out of its slump, investment (or what economists call fixed private non-residential investment) exploded, too: from 2.5 percent between 1980 and 1991 to 10.3 percent from 1992 to 1999. You would expect to see some productivity improvement after an investment surge like that.

But the critical issue is not whether technology has fundamentally improved the way things are done (as I believe it has), but *whether it will continue to improve at the same rate in the future*. In some ways it reminds me of the debate over the so-called "Asian miracle" a few years ago, when GDP across much of Asia was growing at annual double-digit rates: On the surface, it looked like Asia had come up with a new and fundamentally better way to do things. What really happened, though, was that hundreds of millions workers transitioned from subsistence agricultural production to basic manufacturing. No wonder those economies grew so quickly!

I'm not suggesting that the pre-Internet age in the United States was comparable to subsistence agriculture. Of course not. But the bounce we've received from information technologies may in some ways be comparable to the basic and fundamental shift in productivity we witnessed in Asia. Again, though, the essential question is not whether this shift has taken place, but whether it can continue. It didn't in Asia, where the transition was a lot more fundamental, and I'm not sure it will here, either. The World Wide Web, remember, went from one scientist's personal computer to ubiquity in a decade. But if the productivity shift is permanent, then the information technology revolution cannot be a once-in-a-lifetime development. It will have to happen again, and be even more profound, in the next 10 years. As much as I believe in American ingenuity, that seems a bit much to ask.

On the other hand, though, maybe the productivity shift hasn't been so profound here, after all. That's what I mean by "new compared to what?" For hundreds of millions of Asians, the economy really was new (and truly miraculous) in the sense that basic manufacturing—the move from the fields to the assembly line—permanently improved the human condition. Has the Internet really been *that* profound?

Profound as it has been, the IT revolution probably doesn't compare to productivity developments in our own history, either. It's easy enough to think of some obvious candidates—electrification, the invention of the automobile, the telephone or television—but I'd like to think one more time about Gwinnett County. If, 50 years ago, you could have asked the ancestors of many recent arrivals whether they would consider moving to Gwinnett County (or anywhere else in the South, for that matter), the answer would surely have been "never." There are lots of reasons why the South trailed the rest of the country in economic development, but two of the most important were that it was too hot and too remote.

Let me ask you this: Which is more essential on a smoldering August day—your PC or your AC? Which is more vital to your business: the Interstate or the electronic highway? Maybe it's a close call. Nevertheless, there's no arguing with the fact that Gwinnett County and the rest of the South would not be what they are today without air conditioning and the Interstate highway system. They transformed the region in ways that information technology simply cannot.

So I conclude that we do *not* have a fundamentally new economy. Yes, much of it is new and improved, and more productive, too. And that means we can probably grow faster than previously thought. Even so, there are still limits. Economic shocks can still happen. And policymakers can still make mistakes. As long as those three remain, the possibility of inflation remains, too.

Throughout the almost 10-year-long economic expansion, the Fed has avoided rigidly applying all the old economic rules, and has allowed the economy room to take account of recent developments. The Fed has also been vigilant in defending the principle that low inflation is an indispensable element in the pursuit of our other objectives of strong growth and low unemployment. And while it's true that inflation remains relatively low, I believe that overall demand growth remains sufficiently close to productive capacity to warrant a cautious monetary policy stance. Consumers and businesses have had no problem generating momentum, but inflation is the one thing that could stop them. With our actions over the last 15 months, the Fed is determined to help keep that from happening, and to keep the current expansion on track well into the new century.

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