

The *Boston Herald's*
"Ninety-Six in '96" Forum

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I'd like to thank Pat Purcell for asking me to participate in this celebration of Massachusetts' vitality and resilience. Looking down the list of companies being honored today and seeing their strong performance after such difficult times in the early 1990s, I am struck by this evidence of dynamism, ingenuity and persistence. In some cases, the road here has been bumpy; a number of companies in this room have undergone very painful restructurings and layoffs. But because you--and others like you--have not only survived but flourished, Massachusetts has made an impressive recovery.

It being January, I'd like to take both a look back, at 1995, and a look forward, to '96. I am reminded of the famous opening of Dickens' *A Tale of Two Cities*--"It was the best of times, it was the worst of times, it was the age of wisdom, it was the age of foolishness it was the season of Light, it was the season of Darkness, it was the spring of hope, it was the winter of despair." While this quote may conjure up some level of gloominess, I don't want to alarm you regarding the economic prospects for 1996. These, I believe, are good. However, there are some major issues clouding the horizon that we as business leaders and policymakers must address, and I'd like to discuss them as well.

First, let's begin with the best of times. By all the standards traditionally used to evaluate economic policy, 1995 has to be seen that way. While we're hampered a bit by the lack of current economic data due to the Government shutdown, through the third quarter of 1995 real GDP had grown 3.5 percent over 1994. We're fairly sure that pace will slow when the results for the fourth quarter are known, but 1995 will still be seen as a year of healthy growth. Inflation was well contained, with the CPI rising only 3 percent from the end of 1994 to the end of 1995, representing the fourth consecutive year in which inflation was 3 percent or less. One has to go back to the early 1960s to find a period in which inflation was so moderate for so long. The U.S. unemployment rate averaged 5.6 percent during 1995, again lower than the average for the last five years, and considerably lower than the average for the five-year period preceding that. Again, one has to go back to the '60s to see such sustained low unemployment rates.

Beyond these broad measures, many of the key indicators of the underlying structure of the economy are also favorable. In particular, productivity growth has been stronger in the 1990s than in the 1980s and especially strong in 1995. Productivity growth lies at the heart of our economy's ability to grow at a solid pace without generating inflationary pressures. Many people, and I am one, suspect that the official productivity

numbers may understate the extent of cost reductions and quality improvements taking place in our economy. Rapid growth in U.S. exports provides some confirmation that the competitiveness of U.S. industry has improved, although as long as our nation remains heavily dependent upon foreign savings, we will continue to experience large balance of payments deficits. Even here, however, there is reason for optimism. While the size of the federal deficit and the dissaving it represents remain a serious concern, the deficit has fallen in relation to overall economic activity from where it was in the 1980s and early 1990s. Assuming we can make further inroads, and that is obviously no small task, this progress augurs well for the availability of funding for private investment and for future productivity growth. Finally, one can hardly ignore the buoyant financial markets, which have added to household wealth while facilitating corporations' ability to raise funds.

These favorable measures extend to Massachusetts as well. Jobs have grown in the Commonwealth over the last three years at better than a 2 percent pace, local inflation has been low, and the unemployment rate is below the national level. Consumers both in the state and regionally are more confident than at any time over the past 5 years, and while that confidence level as well as retail sales and housing data have flattened locally, it's tough to argue that 1995 wasn't a good year here.

Most forecasters expect this situation to persist in 1996--though I know I am at risk here of seeming a bit of a Pollyanna. Real GDP is expected to grow about 2 percent in 1996, with the unemployment rate remaining below 6 percent and inflation at or below 3 percent. If these forecasters are right, we will have achieved the soft landing that is so much talked about but seldom--or never--seen. We will have successfully made the transition from a period of vigorous recovery as the economy absorbed the slack created during the recession of the early 1990s, to a more moderate rate of growth consistent with the growth in the economy's productive capacity and sufficient to keep labor markets reasonably tight without generating inflationary pressures.

Given this favorable state of affairs, this "best of times," why aren't people happier? Why is there an almost palpable sense of uncertainty and uneasiness? Why is it so difficult for many to perceive that economic conditions, at least in the aggregate, are pretty good?

One major reason is, I suspect, that our transition to a more moderate and sustainable growth path has not been smooth, and the challenges to keeping it that way seem considerable. Growth in 1994 was very strong; and 1995 began with concerns that the economy might be on the verge of overheating. It soon became

apparent, however, that some of the strength of 1994 had come at the expense of 1995. Inventories began to accumulate, prompting production cutbacks. The result was that growth slowed abruptly, from 4 percent in 1994 to less than half that in the first part of 1995.

The economy then grew very rapidly in the third quarter, propelled by business investment in equipment, purchases of consumer durables and a recovery in residential construction. Growth seems to have slowed again in the fourth quarter, but even with a fairly pronounced slowdown, growth in 1995 will average about 2.5 percent, roughly equal to its average over the past twenty years.

These fits and starts, however, have made some people anxious about the sustainability of the expansion. A slowing in growth tends to produce a string of unfavorable economic news, and even with reasonable levels of growth, not all sectors are growing and within growing sectors, some firms have experienced flat or declining demand. Moreover, inherent in achieving such favorable, though bumpy, patterns of overall economic growth is the problem of how to keep them that way. And here the challenges to both monetary and fiscal policy are considerable. Let me reflect on some underlying issues for monetary policy first.

One key to continued economic prosperity is continued economic growth. This can be spurred over the short run by increasingly accommodative monetary policy but, using traditional measures, the economy has little slack at the present time. Faster growth could risk an acceleration of inflation. Historically, whenever unemployment rates have been below 5.5 percent, we have seen inflationary pressures build. Labor costs start to rise, as turnover increases and wage demands pick up. Tight labor markets also tend to coincide with tight markets for other products. Bottlenecks appear and overall prices rise.

Now some analysts claim that times have changed. They argue that global competition, the restructuring of industry, and the impact of technological change have made firms much more cautious about raising prices, and workers more wary about switching jobs or demanding higher wages. Thus, the unemployment rate that is compatible with stable inflation may be lower than in the past. Some have also suggested that productivity growth is greater than the measured figures show, which means that the economy could grow faster without generating inflationary pressures.

I am a little more sympathetic to these arguments than I used to be. At roughly 5.5 percent the unemployment rate is now at the low end of the range that most economists thought compatible with stable inflation. Yet even with such a low

unemployment rate, inflation has been well-behaved, and expectations of inflation seem to have drifted lower. But we must be cautious.

While the growth in labor compensation has been very moderate, some of this reflects smaller increases in health benefit costs. It is open to question whether this moderating influence will persist or whether it is just a temporary development due to a one-time restructuring in the health care industry. We should also recognize that we have had several consecutive years in which energy prices have been very well-behaved and have pulled down the rate of inflation. Obviously, this could change.

Finally, and to me most significantly, we saw the consequences of rapid growth in an economy operating with little slack as recently as the late 1980s. We had achieved, it seemed, a soft landing, with unemployment around 5.5 percent and inflation stable around 4 percent. The Federal Reserve was cautiously raising short-term interest rates, to keep the economy on a course of noninflationary growth, when the stock market crash of 1987 raised concerns about a possible recession. We held back a bit, the economy rebounded, the unemployment rate fell still lower and inflation took off, setting the stage for the 1990-91 recession.

And it is inflation itself that will be most destructive to economic growth over the longer term. Since at least the early 1960s, whenever unemployment rates and inflation have both been low at the same time, what brought this situation to an end was not the economy running out of steam and sliding into recession. Rather, the problem has been that growth accelerated, straining labor and other resources, and creating inflationary pressures that ultimately led to recession.

Inflation has a great deal of persistence, and it creates uncertainties and distortions that impede decision-making and divert investment into less productive uses. Through the miracle of compounding, even small differences can mount up creating inequities that are intolerable. Thus, while it is easy to argue that monetary policy should be more supportive of growth, if we're not very careful, actions in this direction can have exactly the opposite consequences. A challenge for us at the central bank, to say the least.

The challenges to fiscal policy are just as great. Much about what forecasters see in terms of growth over the next year reflects the expectation of progress on the budget front. While the direction of the deficit has been reasonably good, at least when compared with overall GDP, without careful attention deficits could clearly get out of hand. As a nation, we need a

carefully thought-out approach to deficit control and elimination that will ensure that public dissaving does not crowd out private investment and keep interest rates higher than necessary.

Another reason for the skepticism with which the public seems to regard pronouncements that the economy is doing well may be that the fruits of economic progress are not being shared by all. Inequality has increased, with the big losers being men with only high school educations. Technological change, the shift from manufacturing to services, and increased competition from low-wage parts of the world have all contributed to a decline in real wages for unskilled and semi-skilled men, even as the wages of women and those better educated have stabilized or risen.

In my view, extreme and ever widening differences between the "haves" and "have nots" of society are inimical to the very idea of democracy and potentially a threat to its existence. We can and should guard against them.

But even among those who do not lie at the extremes, anxiety levels have risen. As companies in all industries have sought to become more efficient, people in professions and positions where life tenure was once considered the norm have found themselves vulnerable to layoff. Although most displaced workers do find new employment, they can experience sizable salary decreases, with older and less educated workers suffering the greatest difficulties. Over time, as people come to accept that the labor market has become more uncertain and plan their lives accordingly, the prospect of layoffs may become less traumatic; but in the meantime, I believe there are many who feel that the system has let them down and that implicit contracts have been broken.

Monetary policy's role in addressing these issues is critically important but limited in scope. Keeping the economy growing at a sustainable pace helps to ensure that new jobs are created. Keeping inflation down helps people to plan for their future and prevents distortions that divert investment into unproductive activities. In other words, the ultimate goal of monetary policy is to provide an environment favorable to long-term job growth and productivity gains.

It is only through productivity gains can we avoid a zero-sum game and have everyone better off. Productivity gains come about primarily through the efforts of companies such as yours to become more competitive. Thus, the greatest contribution you can make to addressing these problems is to continue doing what you are doing. In effect, doing good by doing well.

In addition, successful business leaders can play a role in helping ensure that these productivity gains are broadly shared. Much of the increase in inequality has arisen because people lack the skills to perform the jobs that pay satisfactory wages today. No longer does sheer strength and a tolerance for unpleasant working conditions count for much. The wage premium that higher education commands has soared. In addition, many jobs, even quite low-level ones, require the ability to communicate and deal with people, skills that many manual workers lack. Geographic and cultural isolation also keep many from sharing in the fruits of prosperity. The poor are becoming increasingly concentrated in our nation's inner cities, where they have limited opportunity to develop the social networks, goals and behavior patterns that are critical to success.

Business cannot solve these problems, but it can help chip away at them through hiring, training, location and procurement policies. Engaging in uneconomic practices out of a desire to do good is counterproductive, but businesses can be alert to profitable opportunities that also help those who are falling behind. Many of the companies being honored today already do much in this regard. Many have made major efforts to hire and train the disadvantaged; the banks, I know, have greatly increased their activities in inner city markets. But I am also very aware that many of the companies here are small, very lean and very focused on managing rapid growth; and big programs with dedicated staff are out of the question. But smaller scale efforts, such as using nontraditional vendors or providing opportunities for entry-level staff to improve their communications and interpersonal skills, can also contribute. Small firms, in particular, can benefit and contribute by participating in partnerships with other firms in their fields or community to organize a summer jobs program for young people, or to aggregate training needs, as the Bio-Tech Council has done so successfully.

Business executives can also help address these issues by working in collaboration with the public sector. The era of massive federal programs is past; they are simply not in the cards in this time of deficit reduction and many liberals as well as conservatives doubt their effectiveness. However, education, the program of most relevance to these problems, appropriately is the purview of state and local governments; and here, I believe, there is a lot of receptivity to business involvement.

The field of education and training offers great opportunity, not only for collaboration among firms, but especially for cooperation between the private and the public sectors. We in Boston are proud of the work the private sector has done with the Boston Public Schools to set goals and measure performance through the agreements reflected in the Boston

Compact. With 700 firms working together, we provided 3,300 jobs last summer, and, perhaps more importantly, are building a school-to-work program that is reaching 1,000 high school students already. Across the state, local school-to-work partnerships are now getting off the ground. Business people should respond to opportunities to help set curricula in new school-to-work programs, to develop partnerships with individual schools, and to introduce to school management such insights from the corporate world as the importance of establishing goals and measuring and rewarding strong performance. The expected shift of federal welfare monies to the states is also likely to foster a lot of experimentation, and business will find itself called upon for input and to help in moving people from welfare to work.

To make the most of these efforts, however, we must have business leadership, not just business participation. Recently, I participated in a program oriented around the perceived demise of corporate leadership in Boston. A recurring theme was that without a publicly identifiable leader, such as Dick Hill of the Bank of Boston in years past, there is no corporate leadership. A second concern was that the consolidation in so many industries and the acquisition of so many companies by parent companies from outside Massachusetts, have eroded business leadership.

There may be some kernels of truth here, but the actions of many of the companies in this room belie these concerns. Corporate leadership has been effective both locally and statewide in such varied arenas as coordinating the provision of the summer jobs and school-to-work opportunities I talked about earlier, providing critical input to the planning of the third harbor tunnel and central artery construction, helping shape the Commonwealth's telecommunications policy and workers compensation programs, and even regionally on issues such as energy and transportation planning.

Thus, my personal observations tell me that corporate leadership is alive and well. Why, then, is the general perception otherwise? Part of the explanation is the tendency on the part of many public figures and many in the media to view the business community as a monolith with one set of interests; thus, any disagreements are interpreted as evidence of lack of leadership. The business community is very diverse. The companies here today provide an excellent illustration. We have manufacturers, banks, retailers, and service companies. We have companies with billions in revenues and thousands of employees and companies with only 100 employees and less than 10 million in sales. To expect such a varied group to see eye-to-eye on everything is unrealistic. The more relevant question is how do they respond on cross-cutting concerns.

I also think we have tended to equate corporate leadership and even civic success with building physical structures or staging huge events. Do we have leadership only when a new convention center or stadium is constructed or the Olympics or some other sports festival is attracted here? Granted, these facilities can create jobs for area residents and these attractions are fun and can draw visitors to the Commonwealth. But in my view, whether we build a megaplex or succeed in bringing the Olympics to the state should not be the sole gauge by which the effectiveness of corporate and public leadership is judged. There are other standards. For example, do our public schools turn out students who not only score respectably on standardized tests but who can also do the jobs that Massachusetts firms need done?

In the City of Boston, I believe we are poised as never before to make a difference in our public education system. We have a Mayor who views high-quality schools as his major priority; we have an appointed school committee, fully conscious of the goals of the Mayor; we have a new superintendent with a solid track record of working with business; and we have a wide and growing base of businesses involved not just in providing summer jobs, but also in mentoring, on-the-job training, and helping develop school curricula and measures of performance. It may be a good thing to build a megaplex, but it is vital not to waste the opportunities we now have to make the Boston public school system and those of other Massachusetts communities the best they can be.

There is no better time than now to tackle these issues. The macroeconomic environment is favorable. The Commonwealth is recovering. But as the less fortunate fall further and further behind, it is up to us as business leaders and policymakers to make the investment in tomorrow's work force that will ensure our long-term economic success.