

KENILWORTH UNION CHURCH PUBLIC AFFAIRS PROGRAM

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Thank you. Happy to be here. I've seen a list of your past speakers, and I'm honored to be a part of such an impressive group.

Also appreciate that each of you came here this evening. Sometimes people are scared off by the prospect of hearing an economist. You may have heard the jokes about economists. If all the nation's economists were laid end to end, they still wouldn't reach a conclusion. And the follow-up—that laying all the economists end-to-end would be a good idea. Or...what is the difference between going to an anesthesiologist and hearing an economist. The anesthesiologist is *supposed* to put you to sleep.

I hope I'll put any fears to rest by saying up front that I'm not planning a heavy-duty talk on economic theory. You won't see any overheads with equations from me. I'd like to take a fairly informal approach instead and share my hopes for the economy in the long run...sort of a wish list for the 21st century.

But first I'd like to take a few minutes to give some background about the Federal Reserve and its regional structure. I think that will help put my remarks in context—as many have said—how you see the world depends on where you sit.

My observations about the Fed are in keeping with the general theme of my remarks—taking the long view. The Fed has a decentralized, regional design. That makes it a very unusual central bank. That design is important because it facilitates effective, *long-term* monetary policy. The Fed's mission is to foster a safe and sound financial system and a healthy, growing economy. Specifically, we formulate monetary policy...we supervise and regulate banks...and we provide financial services to depository institutions and the U.S. government.

Congress created the Fed in 1913 with a structure that balances the public and the private...the central and the decentralized. This system of checks and balances still exists.

The 12 regional Reserve Banks have a mix of public and private features. The governing board in Washington, D.C., is made up of seven public officials appointed by the President and approved by the Senate.

Congress insulated the Fed from day-to-day political pressures. Why? There's always the temptation for elected representatives to "gun" the economy periodically. That's appropriate at times. But you need to do it in response to the business cycle—not the election cycle. The central issue is balancing short-term gains against long-term considerations.

To help the Fed focus on the long term, Congress provided fourteen-year terms for the Board of Governors. Congress also freed the Fed from depending on appropriations to meet its expenses. Congress does review our budget, however. And we turn over more than 90 percent of our earnings to the Treasury every year. So we're insulated from political pressures, but we're ultimately accountable to Congress and the American people.

The Reserve Banks have a number private sector characteristics. For example, each Reserve Bank has a board of directors. Each board consists of leading private citizens in the region. The directors are responsible for appointing Reserve Bank presidents, with the approval of the Federal Reserve Board in Washington. And, as I mentioned, the Reserve Banks compete in the marketplace, selling financial services such as check processing.

The Federal Open Market Committee, or FOMC, is the best example of the Fed's checks and balances. It performs the Fed's most important function, formulating monetary policy. The FOMC is made up of the seven members of the Board of Governors and the 12 Reserve Bank presidents, five of whom vote on a rotating basis. I rotate annually with the president of the Cleveland Fed, and I'm serving as a voting member this year.

The Reserve Bank presidents get a constant flow of input from beyond the Washington "beltway" because of our regional structure. So our regional structure has two major advantages. It insulates us from narrow influences. And it helps us gather information and ideas from all over the country.

The Fed's structure is vital for developing effective policy. I think our economy is in solid shape due in part to the Fed's ability to take a longer-term view. Our structure helps us maintain a delicate balance. It helps us focus on policy, not politics.

Now that you understand, as my kids say, "where I'm coming from," I'd like to turn to that wish list for the century. I could mention a lot of different ideas, but here's six items that would make my top ten list. I'll cover each one very briefly, and I'll be glad to discuss them in more detail during the question-and-answer session.

My first wish is very much associated with my job. I want to see the Federal Reserve increase its focus on customers. That may sound a bit strange. What's the first thing that pops in your head when you think of the Federal Reserve? Money...Alan Greenspan...maybe even Paul Volcker and his cigars. (option—bonded scotch story) But customer focus? Probably not. But I think it's absolutely necessary for the Fed to focus on customers.

It's certainly necessary for the private sector. It's a matter of survival. The customer is the judge, the jury, and, sometimes, the executioner. It's somewhat different for the Fed. Our bottom line is serving the public good. Some of the Fed's customers might want us to stop worrying about inflation. But that wouldn't be in keeping with our obligation to our most important customer—the public at large.

Customer focus can even help us supervise banks. We consider the banks we supervise to be customers of sorts. Obviously, that doesn't mean we do whatever they want. It means that we work with them and listen to their

ideas and concerns. The Fed and bankers have a common goal at the end of the day. We both want a safe and sound banking system. Listening to each other helps us reach our common goal.

That's why we need to focus on customers. It helps us do our jobs better. It helps us respond to a rapidly changing environment. We all know how quickly things are changing. That's certainly true in the banking industry. It's widely recognized that the Fed needs to respond to those changes. I think it's less widely recognized that we are responding to them.

A quick example: There's a committee headed by Alice Rivlin, the vice chair of the Federal Reserve Board, that's taking a close look at whether the Fed should stay involved in providing financial services. The committee's thinking about some fundamental changes. One of the most important goals of the committee is to get customer feedback. I don't know how the review will turn out, but an important consideration will be how the change would affect all our various customers, such as bankers, the U.S. government, and the public at large.

Customer focus can help in a lot of different ways. I can offer a personal testimony. I periodically visit bankers and other business leaders in the midwest. I was talking to a banker when he asked me why we didn't collate the notices we were sending to him. These are notices the Fed sends out to bankers to announce changes in regulations or new prices for financial services. These notices are sometimes very lengthy—40 or 50 pages long. They were being stuffed in envelopes page by page rather than being collated and stapled. Maybe a small matter. But we were sending out hundreds of these notices to thousands of bankers every year. Each time we did, we were adding a bit of aggravation to somebody's life.

As it turns out, our mail department was trying to be more efficient. They stopped collating the documents because our machinery couldn't do it very quickly. Well, needless to say, we now collate and staple our notices. Sometimes we have to aggravate bankers—we don't have a choice. But we should have a better reason than that.

There's a lesson to be learned there. Customer focus is all-important—even for a central bank.

That brings me to wish number two: I'd like to see consumers and businesses take advantage of electronic payments.

That's a goal that involves the Fed. People associated with the government are sometimes accused of being pencil pushers and paper shufflers. In a way, I guess the Fed would have to plead guilty. We do push a lot of paper. It's a particular kind of paper, though—checks and currency. We process checks, acting as a middleman between commercial banks. And we process currency, checking for counterfeits and destroying worn out bills. In fact, the Chicago Fed shreds enough currency every day to cover the Chicago Bears—or better yet their opponent—more than waist deep in Soldier Field. And if all the checks we process daily were laid end-to-end, they would stretch from here to St. Louis and halfway back again.

We're also heavily involved in electronic payments. For example, we provide banks with the services that make it possible to do things like direct deposit of paychecks and electronic payment of phone bills.

I think the U.S. has a major opportunity to reduce its dependence on checks. When you think about it, they're a real anachronism in an era of ATMs, smart cards, and the Internet. Clearing checks is very labor intensive. It involves physically moving a piece of paper from one place to another—sometimes across the country. Twelve people handle a check on average, from the time you write it until it gets back to you at the end of the month.

So it's not surprising that a check transaction is two to three times more expensive than an electronic transaction. Some analysts have estimated that the U.S. could save \$100 billion by eliminating checks.

That's why I'd like to see the Fed's check processing business evaporate because everyone is using electronics. And I say that even though check clearing generates most of the Fed's service revenues. Reducing the flow of paper is a major goal for the Fed. It's very much in keeping with our mission to encourage a more efficient payments system. Electronic payments are better for consumers, for businesses, and for the economy. In fact, the Fed recently took part in a nationwide campaign to encourage people to use electronic bill payment. Option: I'm curious. How many people in the audience use direct deposit? How about electronic bill payment?

We've made some progress, but checks are still very popular. There's something like 65 billion written every year in the U.S. Consumers and businesses here have been reluctant to give up on checks. I'm afraid we're well behind other developed countries in using electronic payments. I was in Europe a couple of weeks ago and I was struck by the popularity of electronic payments. You can see the difference in the statistics. The U.S. uses electronic payments for about 22 percent of non-cash transactions. France averages 47 percent...Germany averages 78 percent...and the Netherlands averages 91 percent. I hope we can catch up, but we have a long way to go.

My third wish is one you've heard a lot about in recent years—reducing the federal budget deficit. Everyone seems to agree that a balanced budget is a must, but they can't agree on how to get there.

The deficit for fiscal year 1996 was \$107 billion. That's a hard number to imagine. Let's put it this way. The ancient Egyptians used symbols for numbers. A thousand was represented by a lotus blossom...ten thousand was a pointed finger...a hundred thousand was a tadpole...and one million was a man stretching his arms to the heavens in astonishment. So if ancient Egypt had a budget deficit like ours, their economists would have to draw around one hundred thousand pictures of amazed men. Maybe that'd be appropriate.

Why is it important to reduce the budget deficit? Essentially because it will improve our capacity to produce goods and services. We need investment in the economy to improve our productivity. The money the government borrows to meet its shortfall each year doesn't get invested in the private sector.

We've been dodging bullets for years because we've had a lot of investment money flow into the U.S. from overseas. But the level of investment in an economy is ultimately determined by domestic savings. We have to increase domestic savings to increase productivity. When the government spends more than it takes in, it's offsetting private savings. So the best way to increase domestic savings is to reduce the federal budget deficit.

There's been some progress in recent years. The deficit was five percent of GDP in 1992. Last year it was just under one and one half percent, the smallest it's been since 1974.

We've made some good progress. But we shouldn't be too comfortable yet. We've entered our seventh year of economic growth. Ideally, we should be running a surplus when we're this far along in an expansion.

To make the solution even more difficult — and urgent — Social Security is facing serious problems. Baby boomers will start retiring in the next ten years. The retired boomers will begin paying less in taxes and receiving more in benefits. We won't be ready to take care of them.

There were 42 workers paying into the system for each beneficiary in 1945. By 1960, the ratio was about five to one. At the end of last year it was 3.3 to one. By the year 2030 it'll be around two to one.

It'll take enormous revenue to support these retirees. We need to build a surplus now so we can handle these increased costs down the road. I realize it's a difficult political process, but the President and Congress have to resolve this issue. Their action—or lack of it—could have an impact for years to come.

Wish number four is to lower trade barriers. We need to truly open world markets and expand international trade and investment. Why? Because it reduces prices and increases choices for consumers.

Most countries seem to favor free trade, but no wants to be the first to do it. That's why trade negotiations sometimes have the pace and warmth of a glacier. Yet, we've made significant progress in reducing tariffs and non-tariff barriers. 130 countries took part in the Uruguay Round. A technology agreement has been completed covering 90 percent of world trade. The agreement lowered tariffs on computer software, semi-conductors, and fax machines. A telecommunication agreement has been finished. And work is still being done on a financial services agreement.

The North American Free Trade Agreement has been a major step for Canada, Mexico, and the U.S. Now we need to extend NAFTA or negotiate separate free trade agreements with other Latin American countries starting with Chile. This is an important time to move forward with these rapidly growing Latin American countries.

The United States has a major opportunity to increase trade and investment through APEC or the Asian Pacific Economic Conference Forum. APEC includes Pacific Rim countries ranging from Japan and Korea to Australia and New Zealand to China, Taiwan, and Hong Kong. Canada, Mexico, and the U.S. are also important Pacific Rim countries in APEC. APEC's goal is to have free trade in the region by the year 2010. Keep in mind that many developing countries in this Pacific Rim grouping are the fastest growing countries in the world and excellent markets for our products and services.

But, we have a lot more to do to bring the full benefits of free trade to people all over the world. It's like riding a bicycle; we need to keep peddling. We need to keep moving or we'll fall down. Some people will be adversely affected and we have an obligation to help these people adjust to ease their transition. But we can't stop progress because more people will benefit through wider choices and lower prices.

My fifth wish is equal economic opportunity for everyone...particularly opportunity for education and training. Some people haven't had the same opportunities that virtually all of us in this room have had. They haven't shared fully in these good economic times. They haven't been able to move up the economic ladder in the same way most of us have.

In cold economic terms, these resources are being wasted — our economy isn't reaching its potential. The economic pie isn't growing as fast as it could. And that means we're all left contending for smaller and smaller pieces.

We need to find a way to solve this problem. Again, in cold economic terms, it's in everyone's self-interest. In more human terms, it helps people contribute. In moral terms, it's the right thing to do.

I'm troubled that so many people just don't have the skills that are necessary in an increasingly complex work place. The Chicago Fed recently completed a major study of the Midwest economy. We found one of the major issues that will affect the future of the Midwest is the level of training and education of workers, especially disadvantaged workers.

I don't pretend to have the answers on this issue. But we need to find a way to provide all our citizens with the skills and opportunities they need to fully participate in Economic America.

My sixth wish is low inflation. Hardly a surprising wish coming from a central banker. But why do we think it's so important? Because a low inflation rate is the surest way over the long run to achieve a higher standard of living. That's the Fed's ultimate goal.

Some people see a trade-off. They'd be willing to accept higher inflation in exchange for faster economic growth. Wouldn't it be worth a bit more inflation to put thousands of people back to work? I wish it were that easy. In the long run, there's no trade-off. High inflation inevitably leads to fewer jobs.

The economy's potential is determined ultimately by three factors: population growth, technological advances, and productivity improvements. Those three things ultimately determine how fast the economy can grow. What if the Fed opened up the spigot to encourage faster growth? We wouldn't see the desired increase in the flow of new jobs, but we would see a pickup in prices. And what starts as a trickle can quickly turn into a flood.

Closing the floodgate isn't easy. We learned that from the stagflation of the 1970s and 1980s. People start to expect inflation. They focus on protecting themselves from higher prices. They make fewer long-term investments because they expect prices to go up. They spend more on consumer goods instead of saving because they want to buy before prices increase. Some people profit when inflation skyrockets. But many others are hurt, especially those on the lowest rung of the economic ladder.

An economy that grows at a solid, sustainable pace isn't necessarily exciting. But a roller coaster economy is a losing proposition. A great tennis instructor once said, "Losers hit a wide variety of shots, but champions keep hitting the same old boring winners." [Vic Braden]

That's my wish list for the future. I guess you could say I'm guardedly optimistic. I have to admit that ever since I took my oath as a central banker, I find myself using phrases like "guardedly optimistic." I suppose that's why we're called the Federal Reserve.

I think we've made a lot of progress on achieving a low rate of inflation. We have a way to go on some of the other issues I mentioned. Some are within our grasp; others are quite ambitious. As I said, the Fed's ultimate mission is to help ensure a higher standard of living for all. Achieving these six goals would go a long way toward that end. I'll close with one final wish: Some day I hope I'll have a chance to come back and discuss how these wishes became a reality.

Thank you.