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Look to the Future: People, Technology and Trade

Thank you. I'm happy to be here.

This morning, in keeping with your conference theme, I'm going to quickly surf through a few of the major trends shaping our economy and then share my hopes for the economy in the long-run…sort of a wish list for the 21st century. The key point I'd like to emphasize is the importance of taking the long view in developing policy.

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, with 12 Reserve Banks located across the country and a governing board in Washington, D.C. Why is that design 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 banks 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 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? The reason is that there's always the temptation for elected representatives to stimulate the economy periodically. That may be 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 Chicago Fed and the other Reserve Banks have a number of 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 sell financial services such as check processing, competing in the marketplace to do so.

The Fed's regional, independent 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. 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 I'd like to turn to the major changes affecting the economy—people, technology, and trade.

First, technology. As Fed Chairman Alan Greenspan has pointed out, the U.S. economy has been transformed by a rare event. Every hundred years or so, we've seen an advance in technology that dramatically changes the structure of our economy. Our economy today has been transformed by the invention of the transistor and the integrated circuit. The modern computer and telecommunication and satellite technologies soon followed. The result has been a shift from the industrial age to the information age. Brain power has replaced horse power. Abstract ideas and concepts are more important than physical brawn.

Francis Bacon said, "Knowledge is power." He only had a quill pen at his disposal. We have the technology to produce and transmit information in less time than it takes to say "instant." Information has become a major product of our economy. It's a pervasive feature in our daily lives—from bank cards to bar codes. Technology invigorated our service economy and rejuvenated our manufacturing sector. Our industries now are more productive, efficient, and competitive.

The second major force changing our economy is globalization. We all know we're living in a shrinking globe. That's why the events of the past decade are so promising. The world is shrinking, but our opportunities are expanding. There are democracies in Eastern Europe and two stock markets in China. Western Europe is overcoming the barriers of a thousand years to achieve economic and political union.

Of course, all is not perfect. China wants our technology, not our idealogy. The people of Eastern Europe and Russia are free to renew every feud since the Crusades. Free markets have emerged in many countries; political and religious freedom haven't always followed. Some suggest the U.S. has had more luck exporting "Baywatch" than democracy.

All this change has made many people apprehensive. But globalization has been around for a long time, just more so lately. John Maynard Keynes took advantage of transcontinental phone lines back in 1914 to make world-wide investments while sipping tea in his bed. "The internationalization of economic life is nearly complete," Keynes said back then.

Some also worry about the seeming instability of a global economy. Again, this is nothing new. Take the U.S. during the 1840s. Several U.S. states refused to pay off loans to British lenders following a severe recession. British investors were outraged. Even Charles Dickens got into the act. Part of Scrooge's nightmare in A Christmas Carol was seeing his solid British assets turn into a, quote, "mere United States security."

So globalization is nothing new. But the pace of change seems to have accelerated dramatically. What does this mean for American consumers and workers? Consider this: Mexican factories are manufacturing Korean TVs for American consumers. Or this: American workers are producing Japanese cars for shipment to European consumers. Globalization means change. It means more choices at better prices for American consumers. It means opportunities for many American workers, but major challenges for others in industries that are vulnerable.

It's not just products that are exported today, as you well know. It's services, too. India, for example, has a flourishing software industry. India's software writers are highly skilled and fluent in English. Major U.S. consulting firms, accounting firms, and law firms have offices all over the world.

The free flow of services extends to the executive office. Many of you recruit internationally. And, of course, your association includes many from outside the U.S.

That brings me to the third area of economic change—namely people...our work force. This is an area where you are the real experts. I'm interested in hearing your thoughts on current developments in this area. But let me set the stage by making some general comments.

It's become a cliche to say that technology and globalization are changing the nature of work. Workers need more skills and more knowledge to perform their jobs. This isn't new. It's been going on at least as long as I've been around. But there's some evidence that it's been accelerating in the last 10 years. One study found that the skills needed for jobs have increased across the board.

I've talked to a number of people who are concerned about the skills of workers, particularly those in high-tech industries. Just a few weeks ago, the Chicago Fed hosted a meeting of executives from high-tech companies to discuss the potential growth of high-tech in Illinois. The meeting was designed to cover a number of issues related to growth, such as the availability of capital. What was interesting was that most of the discussion focused on how hard it is to find people with the right skills and what college and universities should teach in their computer science curriculum.

The search for skilled workers isn't limited to white-collar fields. Many blue-collar positions now require more skills. A recent survey by the Michigan State University showed that 56 percent of blue-collar jobs required math skills; 26 percent required working with a PC.

So firms are looking for workers with high skill levels. They're also looking for more flexibility in hiring and keeping workers. This is a two-way street. In many cases, workers are looking for more flexibility in their jobs. Some workers don't want a full-time, 40-hour-per-week job. The result has been a large increase in the use of temp workers, a trend that's well-known to all of you. The temp industry has grown almost 12 percent a year since 1972.

Some are concerned that we're building a permanent underclass with no benefits or stability. But relatively few work as temps for long periods. The majority move to permanent jobs within a year.

Temps help to make labor markets more efficient. They may even help keep unemployment rates lower than they would be otherwise. And they help to open bottlenecks that contribute to inflationary pressures. This flexibility is a strength of our economy, unlike the more rigid barriers we see in some other countries.

Another highly publicized trend affecting the work force is "downsizing." We've heard a lot of concern about worker displacement lately. Displacement rates in the 1990s are not as high as they were during the recession of the early 1980s. But they are high when we consider how low the unemployment rate is.

Displacement is different than in the past because it's spread more evenly throughout the economy. Blue collar workers historically have been more vulnerable to displacement than other workers. Recently, though, white collar workers have been more likely to be laid-off than in the past. Certain industries have experienced substantial displacement. The financial, insurance, and real estate industries, for example, have seen displacement rates triple since 1980.

These changes seem to have created deep feelings of job insecurity. That seems to be especially true in those groups that are experiencing more displacement than in the past -high income earners and college graduates. This apparent insecurity is somewhat surprising. The unemployment rate is low, around 5¼ percent. Demand for labor has been quite strong and wages rose faster in 1996 than they did in '95.

This has made for some interesting discussions among policymakers. Typically, tight labor markets eventually lead to wage pressures. And wage hikes will fuel inflation if they increase faster than productivity. It seems that insecurity in the work force has helped to hold down wage pressures. Workers apparently have been willing to trade off higher wage increases in exchange for enhanced security. I'd be interested to hear your thoughts on this issue.

So those are the changes we're seeing. Now I'll switch to some changes I'd like to see…sort of a wish list for the 21st century. I could mention a lot of different ideas, but here are six items that would make my top ten list. I'll cover each one very briefly. 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…Interest rates. When we ask people what the Federal Reserve is, the results have been discouraging. Some people think the Fed is a game reserve or part of the U.S. Army. But I think regardless of what you associate with the Fed, it's probably not customer focus.

It's certainly necessary for the private sector. It's a matter of survival. In the private sector, 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. For example, 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 stakeholders. 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. 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 out 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 sometimes are very long, with many pages. It seems that these notices were being stuffed in envelopes page by page rather than being collated and stapled. Now maybe that's 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.

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 a large bureaucratic organization 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, looking for counterfeits and destroying worn-out bills. The Chicago Fed processes some 6 million notes each day and shreds about 2 million of those bills because they're too worn out for further use. In fact, we produce so much shredded currency each day, we could fill up a basketball court high enough to cover up Shaquille O'Neal, with three feet to spare. And if all the checks we process daily were laid end-to-end, they would stretch from here to Las Vegas.

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 and utility bills.

I think the U.S. has a major opportunity to reduce its dependence on paper 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 paper 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 time more expensive than an electronic transaction. Some analysts have estimated that the U.S. could save $100 billion per year by eliminating checks.

That's why I'd like to see the Fed's check processing business evaporate. I'd like to see everyone use electronics for payments even though check clearing generates a significant portion of our 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 have made some progress, but checks are still very popular. There are something like 65 billion written every year in the U.S. Consumers and businesses 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 few months ago and I was struck by the popularity of electronic payments. You can see the difference in the statistics. How does the U.S. compare to other industrial nations? It's not even close. 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. So you can see, 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 the last fiscal year 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…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 that picture of an amazed man 100,000 times. Maybe an image depicting all that frustration is appropriate for the deficit.

Why is it important to reduce the budget deficit? 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 its been since 1974. But the deficit is expected to increase this year and next year. So although we've made some good progress, we shouldn't be too comfortable yet. We've entered our seventh year of economic expansion. 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 by 2010. The retired boomers will begin paying less in taxes and receiving more in benefits. We won't be ready to take care of them unless there are changes.

To quote that eminent economist, Yogi Berra, "When you're at a fork in the road, take it." We're at a fork. 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 one 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 human resources are not contributing to their full potential. And, therefore, our economy isn't reaching its potential. The economic pie isn't growing as fast as it could.

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.

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 education and training of workers, especially disadvantaged workers.

The problems of the educational systems in our big cities are well-known. The Midwest has been somewhat of an incubator for reform efforts from school finance reform in Michigan to a voucher program in Milwaukee. The Chicago school system has initiated a massive, wide-ranging effort under which the Mayor took control of the school system from the school hoard. There are many efforts underway, but they remain small in proportion to the number of students.

In my mind, a fundamental issue is imposing market discipline on public schools by allowing consumers to choose among alternatives. This has been tried on a limited basis, but most of these experiments have involved choices among public institutions. Do we need competition from the private sector to bring about meaningful reform? And should that choice include the ability to use public money to attend private schools? I think we need to address those fundamental questions if we are to reform our schools.

Another tough question is how to train disadvantaged workers. So far, training disadvantaged workers has been a lengthy and costly process.

Fortunately, there are a lot of innovative efforts in this area. One of the participants in our Midwest study described a relatively successful program in Chicago. Work force programs usually emphasize a strong dose of training before the worker starts a job. This alternative program stresses putting welfare recipients into some type of job environment quickly, with minimal prior training. After starting to learn the discipline of a job, the worker may be offered support services such as child care, counseling, and more extensive training. It seems that the best training is to get on the job as quickly as possible, especially for people who are still learning the value of education and training.

I don't pretend to have the answers on this issue. I'd be interested to hear your thoughts. 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 last 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 by two factors: population growth and productivity improvements. Those two things ultimately determine how fast the economy can grow. What if the Fed opened up the spigot to encourage faster growth? The answer is: We wouldn't see the desired increase in the flow of new jobs over time. 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. The end result is less saving and investment than would have been the case otherwise. And that ultimately means fewer jobs and slower growth. Now 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. Vic Braden, the great tennis instructor once said, "Losers hit a wide variety of shots, but champions keep hitting the same old boring winners." That's what I want—a lot of old boring winners.

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, although we're not yet at price stability. We have a way to go on some of the other issues I mentioned. Some are within our grasp; others are quite ambitious.

Most of these issues involve some hard work in the present that will payoff in the future. That can be tough to do in a time when many people seem to focus on quick fixes. A reporter once asked Babe Ruth how he always managed to come through in the clutch. "I don't know," Ruth repled. "I just keep my eye on the ball." Pretty simple. But a lot of people tend to take their eye off the ball, especially when it comes to longer-term goals.

In many ways, the Fed was founded to focus on the long run. The Fed's ultimate mission is to help ensure a higher standard of living for all. That's a long-term goal we all share. Making progress on this wish list 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.