Speeches by Bob McTeer

Economic Expansion in the Technological Revolution

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I last spoke at a Chamber event last August 10. I looked up my remarks and was pleased to find that I made few specific forecasts to haunt me today. As a new-paradigm optimist, what I did do was exude *new-paradigm optimism*, which I think turned out pretty well. In this economy, pessimists don't have a chance competing with optimists for more than a few days at a time. Official policy at the Dallas Fed is:

"When it's a close call, the glass is half full rather than half empty."

While I didn't—and never have and wouldn't—tie the stock market to my new-paradigm views, even the stock market hasn't done too badly—*net*—despite what's been happening lately.

On August 10, 1999:

> The Dow Jones industrial average closed at 10,655, compared with 10,906 yesterday.
> The S&P 500 closed at 1281, compared with 1430 yesterday.
> And the Nasdaq closed at 2490, compared with 3482 yesterday.

So keep the long view in mind.

The real economy has done even better. Last August 10, we had real GDP data for only the first and second quarters of 1999. The first quarter growth rate was 3.7 percent and the second was 1.9 percent. The third and fourth quarters came in at annual rates of 5.7 percent and 7.3 percent, respectively. This brought the year up to 4.2 percent year over year, or 4.6 percent fourth quarter over fourth quarter. Last year was the fourth year the economy has averaged over 4 percent real growth.

On Thursday, we'll probably get another number above 4 percent for the first quarter of 2000. (That's just a guess; I don't have any inside information.)

Last year I talked a lot about the beneficial role played by productivity growth. It's nice to have more output because more people are working or because they're working more hours. But what really raises living standards and per capita incomes is output per hour worked—which is how we define productivity.

With productivity growth accelerating, increases in wages and fringe benefits can occur without comparable increases in unit labor costs. With productivity growth accelerating, faster GDP growth will exert less inflationary pressure. Accelerating productivity growth increases aggregate supply in the economy, raises the so-called speed limit and eases the burden on monetary policy.

That does not mean, however, that aggregate demand can't grow even faster than aggregate supply and cause inflation to accelerate. A *higher* speed limit does not mean *no* speed limit. Even at the Indianapolis 500, which presumably has no speed limit, they have to slow down to take the curves.

I'm sure it's occurred to you that the race between aggregate supply and aggregate demand sounds a lot like the George Jones song "The Race Is On."

Well the race is on and here comes pride in the backstretch.
Heartache is moving to the inside.
My tears are holding back, trying not to fall.
My heart's out of the running.
True love's scratched for another day.
Well the race is on and it looks like heartache,

and the winner loses all.

(That *is* what you were thinking about, *wasn't* it?)

Last year I talked about how aggregate supply was winning the race, and I boldly stated that I thought productivity growth—which had barely exceeded 1 percent per year for two decades—could probably be sustained at a 2 or 3 percent rate in this new economy. Specifically, I said that productivity growth of 2 to 3 percent seemed doable to me. I went way out on a limb.

But apparently not far enough. In the third and fourth quarters last year, productivity growth rates came in at 4.7 percent and 6.4 percent, respectively, bringing productivity growth for the year well over 3 percent.

My guess is that technology-driven productivity will continue to produce strong growth this year. We'll get our first reading on Thursday. Stay tuned.

The title of my talk last year was "The U.S. Economy at the Millennium: A New Paradigm?" I put a question mark after "paradigm" because there was still some debate about whether our improved economic performance was just good luck—economists call good luck "positive supply shocks"—or whether something more fundamental and lasting was going on.

I like good luck; good luck is good. But I think the private sector of our economy—especially the high-tech sectors, both electronic high tech and biotech—have been making their own luck.

The Dallas Fed's views on our new paradigm—as we see it—are spelled out in our 1999 annual report essay—titled, cleverly enough—"The New Paradigm." The essay was written by our chief economist, Mike Cox, and Richard Alm of the *Dallas Morning News*.

By the way, we had a hard time deciding on a title for that essay. "The New Paradigm" won out, but "The New-Paradigm Economy" was a strong contender. So was "The New Economy." The dark horses included "Revenge of the Nerds" and "How Stella Got Her Groove Back."

By the way again, the essay and a related talk by Mike Cox are the topic of Scott Burns' column in today's *Dallas Morning News.*

I spelled out my own personal views in an op-ed piece in the *Wall Street Journal* last November. I thought I was taking a pretty extreme position—especially for a dull central banker—so I titled my piece "Out on a New-Paradigm Limb." The *Journal* ran the piece, but they changed the title to "Believe Your Eyes; the New Economy is Real." They got that title from my having quoted two of my favorite economists: Yogi Berra and Richard Pryor. Yogi is alleged to have said, "You can observe a lot just by watching." And Richard once asked, "Who are you going to believe? Me or your own lying eyes?"

"Believe your eyes" is my answer to those who ask, "Can we continue to have rapid growth with low inflation? Is it sustainable?" My answer to "sustainable" is that we've been sustaining it for four and a half years now—including this year's first quarter. When does the bell ring? A bull rider has to stay on only eight seconds.

Many people agree with me: The people who write for *Wired* magazine and other technology publications and the technology community in general. The editorial staffs of the *Wall Street Journal* and *Business Week*. Many businesspeople. Those who know what's going on inside their companies.

But not very many economists, I'm afraid. Only a few of the more intelligent mavericks. But not many mainstream, establishment economists from elite universities that don't have good football teams.Their attitude seems to be, "It may work in practice, but will it work in theory?"

In one way, the debate is over, and the good guys won. CNBC—the nerd's version of ESPN, and that includes me—is full of chatter all day long about "old economy" stocks versus "new economy" stocks. That distinction has some validity, but it overlooks the fact that most old economy firms are adopting new economy practices. They're doing

their old things in new ways. They are taking advantage of the new technologies and innovations and bringing their processes up to date. While e-commerce gets a lot of attention, and while the Internet is collapsing wholesale and retail down to "wholetail" (to the chagrin of the Willy Lomans of the world), business-to-business applications are probably more important at this stage.

Speaking of the old economy, I grew up in the ’50s at a small truck stop by the side of the road in rural North Georgia. While my mother had me in fear of choking to death on a fish bone or putting my eye out with something, my Dad kept reminding me of dire consequences if I ever put diesel fuel in a gasoline truck or gasoline in a diesel truck. Either way, the truck and my life would be ruined.

I mention this because "trucking" for me is the epitome of the "old economy." The truck drivers who stopped at Doyal's Truck Stop drank the coffee that was free to truckers and supplemented the caffeine with NoDoz and bennies to stay awake. I fear they fudged their log books and were always on the lookout for where the highway patrol had put out the scales to weigh their trucks.

Anyway, trucking in the ’50s was before satellites and the global positioning system, which tells headquarters where each truck is every minute and has turned trucks into rolling warehouses as an integral part of just-in-time inventory and supply-chain management.

I'm reminded of a couple of songs about trucking, as I'm sure you are. One is "Eighteen Wheels and a Dozen Roses."I don't know the name of the other one, but the key lines are, "Peterbilt a truck that a man could drive. It's a pretty good living, but it ain't no life." That's especially true these days of high-priced gasoline and diesel fuel. My point—in case you've forgotten by now—is that it's hard to tell what's new economy and what's old economy. The new economy is not just about the new dogs on the block. It's also about teaching the old dogs new tricks.

Long before the romance went out of trucking, it went out of farming, and productivity gains on the farm are even more astounding. Willie (Nelson, not Loman) misses the romance of the family farm, and I wish him well in his Farm Aid efforts. But most of us are much better off now that less than 3 percent of our population is producing more food today than 90 percent of our population produced years ago. (My main worry is that most of our good country music will have to be written by city boys and girls, or, at least, by boys and girls who grow up by the side of the road.)

The first farmer I knew was Billie Joe Hopper, who lived by the side of the road about three miles north of our truck stop. I picked some cotton for Billie Joe when I was about 10 years old. I got 3 cents for each pound picked. My goal was to pick 100 pounds in a day and make $3. The old folks—the real cotton pickers—picked over 300 pounds a day and could earn more than $10.

There are no cotton pickers any more. Not human ones anyway. Think of the productivity of the guy who drives the mechanical cotton picker over many acres a day.

We now take productivity in agriculture for granted, but don't recognize that the same thing is going on in manufacturing. Many complain that we're losing our manufacturing base, when what we are really doing is producing more and more goods with the same number of people—or fewer.

In addition to cotton fields in front of his house, Billy Joe Hopper had chicken houses behind his house, those big long chicken houses that look like trains at night. My first brush with new technology in the chicken business was when Billy Joe had automatic lights and window shades installed in the chicken houses to trick the chickens into thinking it was time to eat when it really was time to sleep. Confusing the chickens raised Billy Joe's productivity. No telling what's being done to those poor chickens today. We get our chickens from Whole Foods, where they sell happy, well-rested chickens.

(Before I leave the subject of chickens, did you ever notice how a chicken can gain a whole bunch of weight and never show it in the face?)

Our annual report essay on the new paradigm has lots of gee-whiz examples of new technology at work. It doesn't mention chickens, but it does mention other livestock. For example, dairy farmers now have electronic "hoof meters" on their cows. They can double click on any cow's face on a computer monitor and get the history of that cow's food

and medicine intake, weight, milk yield, temperature and sex life.

I think Willie had it right when he warned, "Mammas, don't let your babies grow up to be cowboys." Can't you just see the 21st century cowboy going to the bar after a hard day of double-clicking and ordering a glass of white wine or a whiskey sour and complaining to the bartender about his carpel tunnel syndrome?

What would John Wayne think?

Again, in case you've forgotten, what I'm trying to do here is show how hard it is to make distinctions about the old economy and the new economy. Old dogs and new tricks.

The essence of the new economy is not just that inflation (until recently) was at a 30-year low, or that unemployment was at a 30-year low, but that both those things happened together.

Some people who were around in the ’50s and ’60s like to point out that unemployment then was even lower than the 4.1 percent we have now. My first response to that is "just wait." My guess is that unemployment will go below 4 percent in the next couple of months. (I just messed up and put a number with a date.)

But even if I'm wrong about that, unemployment in the low 4 percent range has already done wonders. That average includes lots of places with continued high unemployment. Without them, 4 percent looks more like 3 percent.

In going down to 4 percent, minority unemployment has recently been at its lowest level on record, and traditionally high teenage unemployment has also come down substantially. Unemployment along the Tex-Mex border is now below 10 percent for the first time in years.

In my opinion, monetary policymakers in the last few years have done the country a great service by not tightening when many of the traditional milestones were reached.

From the early ’70s to the early ’90s, a consensus formed among many economists that inflation would accelerate when unemployment fell below 6 percent. When that limit was breached without inflation accelerating, 5 1/2 percent became the new limit. Then 5. Then 4 1/2. And so on.

Being willing to wait and watch and not react on the basis of past formulas and rules of thumb has paid great dividends. We've been near 4 percent for quite a while now, much of that time without any acceleration of inflation.

1998 was a particularly good inflation year, helped as it was by falling oil prices. 1999 saw a reversal of oil prices and the headline inflation rate rose, even as core inflation—the CPI without food and energy continued to decline. More recently, however, even core inflation has picked up modestly, and last month more than modestly. In March, you may recall, the overall CPI rose 0.7 percent and the core CPI rose 0.4 percent.

I was in Georgia last week and feeling nostalgic for the late, great Lewis Grizzard. If Lewis were asked to comment on the March price numbers, he would probably say, "It's a hog. You can put lipstick on a hog, but it's still a hog."

Back to the unemployment rate a moment. Actually, 4 percent average unemployment is much more of an accomplishment today than it was the last time because of significant changes in the structure of the labor force—namely, many more women and teenagers, who traditionally have higher unemployment rates or at least didn't participate in the workforce to the same extent as adult males.

I've always assumed the birth control pill had something to do with the surge of women into the workforce, but I had an economist look into it the other day and he wasn't able to confirm my hunch. That's too bad, because I could have used a good Loretta Lynn quote about "Mama's got the pill," and then we could have speculated together about the ultimate impact of Viagra on the workforce and the economy.

In the spirit of openness and central bank transparency, I must admit that my wife, Suzanne, wants me to try Viagra. She's noticed that in many of the commercials, after taking Viagra the guys end up taking their wives dancing. She

wants me to take her dancing.

Let me summarize the state of the economy as I see it. The economy remains healthy and robust. Four-percent-plus growth probably carried over into 2000. That's good, as far as I'm concerned. I think 4 percent is sustainable. The 7.3 percent growth we had at the end of last year probably wouldn't be.

I'm optimistic about continuing productivity gains. Unfortunately, we've had some inflation creep lately that bears close watching. Labor markets have been tight as a drum for a long time now, and the pool of unemployed but employable workers gets smaller every month.

They say that necessity is the mother of invention. That probably means that the tight labor markets have helped drive firms to be more productive by looking for labor-saving technologies and processes.

The tight labor market is good in other ways as well. It has helped us absorb former welfare recipients into the workforce. It is giving people who under different circumstances might not have had opportunities a leg up to the first rung of the employment ladder. On-the-job training is probably the best practical training.

Two crucial issues for the economy and for monetary policy are productivity gains (will they continue?) and the available labor supply. Probably the best thing government can do on productivity is stay out of the way.

Last year I offered two modest proposals to ease the tight labor markets. One was to eliminate the earnings penalty on Social Security recipients who want to work. Congress recently did that for those over 65. It passed unanimously in both the House and the Senate.

My other suggestion was to increase or eliminate the quotas on the skilled foreign workers needed desperately by our high-tech firms. If we bring foreigners here for the key and vacant specialist jobs that we don't have enough Americans to fill, Americans can benefit from the collateral jobs that will be created. Otherwise, our firms will have to move abroad to find the skilled workers—or find them in cyberspace.

The rest of the world worries, rightly, about a brain gain to the United States. We, the lucky beneficiary of that brain drain, should encourage it, not resist it. We're like Notre Dame deciding to recruit players only from Indiana.

Actually, I believe that more job-based immigration in general would be a good idea—not just H1-B visas for high-tech workers. Immigration has served America well. We also benefit from the immigration of low-tech and even low-skilled workers. We can have it both ways if we change the inscription on the Statue of Liberty to "Give me your tired, your poor and all of your techies."

Let me close by saying that a major threat to our prosperity is the backsliding on our commitment to free trade. Since virtually all economists on the planet believe in free trade more than they believe in anything else, the difficulty of convincing others of its merits is very frustrating and could be the subject of another speech.

The other day I heard a Suzy Bogguss song that included the line: "He convinced me with three chords and the truth." We have the truth about trade on our side. What we need to find now are the right three chords.