Economic Growth and Investment in Human Capital
Remarks by
William J. McDonough, President
Federal Reserve Bank of New York
before the
Association for a Better New York
New York, New York
April 24, 1996

I am delighted to be here this morning to address such a distinguished group of New Yorkers. Under the leadership of Lew Rudin, the Association for a Better New York brings together individuals who embody the creativity, energy and intellect that makes New York the great city that it is. All New Yorkers are indeed fortunate to have the Association as our advocate, working so arduously for the well-being of us all. I commend the Association for its work, and its leadership and members for their innumerable important achievements.

The many strengths of the metropolitan area as a financial and business center, and as a desirable place to live and work, are of great importance to me and my institution, the Federal Reserve Bank of New York. As you know, the New York Fed plays a special role within the Federal Reserve System in the implementation of monetary and exchange rate policies largely by dint of its unique location in the financial capital of the United States, if not the world. In addition, the New York Fed has a critical, though less well known, responsibility for maintaining the nation's payment systems that relies heavily on many components of the City's infrastructure. The New York Fed employs far more workers than any other Federal Reserve Bank -- some 3,500 at our headquarters in Manhattan and our operations center in East Rutherford, New Jersey -- and thus has a large stake in the economic and social well-being of the metropolitan area. In that context, my Bank takes very seriously its responsibility to be an active, contributing corporate citizen.

Today, I would like to begin my remarks with some comments about the performance of the national and regional economies. Next, I will discuss with you a major challenge that must be addressed head on by the business community of the City and surrounding region, in partnership with state and local governments.

I'll start with a few words about the economic picture for the country as a whole.

The national economic expansion, already one of the longest of the post-World War II era, is entering its sixth year and shows few, if any, signs of coming to an imminent conclusion. In fact, I am quite encouraged in many ways by the recent performance of most of the key indicators of current and future cyclical conditions. One of the most positive features of the ongoing expansion is the continued good news about inflation. Consumer price inflation, while up slightly during the first quarter of this year, gives no indication that it will accelerate persistently over the current and future cyclical conditions. One of the most positive features of the ongoing expansion is the continued good news about inflation. Consumer price inflation, while up slightly during the first quarter of this year, gives no indication that it will accelerate persistently over the months ahead. If that turns out to be the case, one could say that "the beat goes on." As you may recall, the CPI increased by about 3 percent or less in each of the last five years, a record unequalled since the 1960s.

I think it's fair to say that at least some credit for the nation's favorable inflation performance belongs to the forward-looking policies set by the Federal Open Market Committee. The FOMC's policy of monetary restraint, which began in February 1994, brought about a much needed slowing of aggregate demand, which had started to run well ahead of the economy's productive capacity. That move was not without its critics, coming as it did well before most analysts and economists had forecast a uptick in the rate of inflation. The Fed's pre-emptive strike against the threat of inflation was necessary, however, because monetary policy works with long and uncertain lags. Although most of the effects of monetary policy on output take place within one to two years, its effects on inflation take even longer -- on the order of three years. Thus it was clear to us in 1994, and it's just as clear today, that the failure to contain inflation at its earliest, incipient stages only makes it costlier and more time-consuming to bring it under control later.

Although actions by the FOMC play a major role in containing inflation and weakening inflationary expectations, monetary policy, in and of itself, cannot serve as the wellspring of real long-term economic growth. It cannot lead directly to the opening of stores on Staten Island, the sale of more fruit at the Hunts Point Market, or the creation of new jobs on Madison Avenue. Real growth over time results from increases in the quality, productivity and supply of both labor and capital, and from innovations in the way these factors of production are used.

What monetary policy can do is raise or lower the rate of money supply and credit growth, and help to move interest rates to levels consistent with the goal of economic growth with price stability. In the process, the Fed's actions and announcements can influence the expectations and confidence of consumers and businesses and, thereby, what they do in the various economic and financial market places. Only by the Fed muting both inflation and inflationary expectations can households, businesses and governments make the decisions and take the steps that create jobs, profits and the steady rise in output from which everyone in our society benefits. Thus, monetary policy can best help to foster economic growth by ensuring the continuation of a stable price environment.

Over the last five years, economic growth has come more grudgingly to our region than it has to the nation as a whole. The 1990-1991 recession, a narrowly diffused downturn concentrated in only about a half dozen states, hit the New York City metropolitan area earlier, and hung around longer, than was the case in most of the rest of the country. Although the region has gained back some of the employment lost in the previous cycle, the recovery here has not been nearly as vigorous as the national recovery and subsequent expansion. Large-scale restructuring in the financial services sector, continued downsizing in manufacturing and defense-related industries, and the bursting of the bubble in real estate values all have contributed to the region's plodding advance. More recently, sharp cuts in state and local government spending, and the resulting loss of thousands of government jobs, have been major impediments to a vigorous overall recovery in employment.

Despite the stresses in many parts of the regional economy, most economists believe that the economy of New York and its surrounding region is experiencing at least a gradual comeback. New York's large and diverse trade and services sectors have flourished, riding on the back of last year's prosperity in the financial services sector. Barring a major reversal of fortunes on Wall Street that would cut earnings sharply and hold down year-end bonuses, the financial services sector is expected to be a source of strength to the region's economy over the remainder of the year, consolidation and layoffs at some banks notwithstanding. In addition, new jobs in the large health-related and social services fields are expected to come on stream this year, and the job count at many of the region's smaller industries, such as private education, motion pictures, and consulting, also is expected to advance. Computer-related jobs continue to spring up both in large companies and in small shops, providing a major new impetus to the City's economy. The growth of the electronic media industry in Lower Manhattan, Soho and elsewhere in the City, involving both small and large firms, is particularly exciting.

The news on inflation provides still further hope that the New York area can gain competitive strengths. Over the last several years, the rate of inflation in our region has actually been lower than that of the nation as a whole. In the real estate markets, rental costs at commercial properties are now at competitive levels, vacancy rates are generally declining, and housing has become more affordable. In addition, tourism is...
way up, generating revenues for hotels, restaurants and the area's entertainment attractions.

These advances complement the region's already strong structural characteristics to make the long-term economic outlook positive. Our region has a highly educated work force in which 26 percent of the adult population holds college degrees, compared with 20 percent in the nation overall. The region also is the center of a rich array of research and development firms, communications and computer companies, and leading universities and cultural institutions. Crime in the City and the surrounding areas has fallen compared with just a few years ago and, not unimportantly, the perception of the area by some as unsafe or crime-laden also has dissipated. Some people say that "how goes Manhattan so goes the region." Well if that's the case, the region's clearly doing better.

Yet any truly comprehensive prospective view of the region's economy must recognize the seriousness of the risks faced by the City and its suburbs as the region experiences fundamental industrial restructuring. As a native Chicagoan, I observed first hand the pain and uncertainty brought about by cyclical downturns and structural dislocations, particularly in the 1970s and 1980s. Well, look at that "rust belt" now! Entire cities have changed their character and the great core of manufacturing, now much smaller and more specialized, has gained unprecedented prosperity.

Instead of buckling under to global competition, the management of firms in the former "rust belt" made tough decisions, rethought their strategies, reshaped their companies and began to take advantage of the new markets opening around the world. Cities like Pittsburgh, Cleveland, Columbus, and many others that had been written off by many observers as dinosaurs from a bygone age of manufacturing have been transformed by service industries into more diversified, less vulnerable centers of economic and financial activity -- and there's still some manufacturing being done there, too.

For the first time in the 20th century, the New York region's largely service-based economy has been experiencing sustained restructuring and downsizing in the very industries that formed the core of our industrial mix and held up so well during the period of restructuring elsewhere in the country. Spurred mainly by advances in information processing and telecommunications, the region's largest employers have been able to produce more output with a smaller workforce, as high value-added workers -- in the most productive facilities -- have displaced many thousands of their colleagues.

Such actions are not just a cyclical response by businesses and governments to a sluggish economic recovery. Instead, they represent reasoned approaches toward making the best use of available technologies, adapting to changing domestic and international competitive conditions, and responding to the tougher demands of shareholders or the public. Consolidation among banks, the closing of hospitals, shrinkage in the business services sector, and layoffs by major employers are making the City's economy a different entity than it was even a decade ago. Eventually, most other cities will face some sort of restructuring and dislocation of workers along these lines. For now, however, it is incumbent upon the leadership of this City -- in both the public and private sectors -- to recognize the situation, measure the risks, and take the steps that will enable all sectors and groups to prosper in the decades ahead. The former "rust belt" did that, and now we must, too.

One risk too frequently given only glancing attention by members of the business community is the threat to the social fabric caused by disparities in the distribution of wealth and income. Over the last twenty years or so, growth and prosperity have not been shared widely enough, and the less educated and poorer segments of society have lost ground. One cannot be sanguine about this widening gap. Over the long term, I am convinced, strong economic growth can be sustained only if the benefits of the economic pie -- more and better jobs, higher incomes, improved housing and a higher standard of living -- are shared by all parts of society, rich and poor, skilled and less skilled. This is true everywhere in the world, but no place more so than in our own region.

What could we in this room do to help narrow the disparity in income and wealth without sacrificing the well-being of the institutions we represent? Admittedly, this is an enormous and complicated challenge.

I believe that the business community and civic leaders can most directly promote economic well-being by taking active, participatory roles in the education and training of our region's youths and workers. It would be easy to stand before you and preach the gospel of education, and tell you what you already know -- that such a pursuit is important and right. Who could ever disagree? Instead, my message today is that our focused attention on education and training is urgently needed and indispensable now. The business community must take an active role in the development of this City's human capital or risk facing a serious, and permanent, mismatch between the skills we need to run our businesses and those possessed by the pool of available workers. Our school systems are doing what they can and should have our total support, but they can no longer do enough by themselves.

While the need to match the skills of workers to the list of available jobs may sound like an evergreen issue, it has new dimensions in the 1990s that, in my opinion, expand our current challenge to unprecedented proportions. The same forces that continue to reshape the region's economy -- industrial restructuring, global competition, and rapid, persistent technological change -- are the ones that have put enormous strains on much of our nation's and the educational establishments. Students nowadays require an array of skills far beyond the three R's that shaped most of us here today. Telecommunications, computers, the information superhighway, and even television have made obsolete the standard curricula that guided education for decades, and they have changed the mix of knowledge, skills, and experiences students and workers must develop in order to function well today.

In addition, the service-based economy, which, like its manufacturing counterpart has grown very capital intensive, also requires keyboard, reasoning, customer service, and communication skills more complex and advanced than those of previous generations. These challenges arose with great suddenness, at a time when school budgets have been stretched as never before. Our failure to help schools now will mean that our businesses won't be able to hire the kinds of workers they need to benefit fully from the business opportunities opening up to us. It also will mean that income and wealth disparities among groups will widen still further and the social fabric of the region and, indeed, the nation will become badly frayed.

Every one of our organizations can and must do more to bolster the readiness for work of all who are entering, and others who have been, in the region's labor force. The investment will be meaningful, and it doesn't have to be very expensive. Whether we run large enterprises with thousands of employees, or small establishments with but a few, we have to use our doors as entrances to the world of work rather than barriers. Educators tell us that individuals learn best by doing, by participating actively in tasks, and by experiencing those tasks in new environments. We can do something about that.

Many of us can do something about it by increasing the number and variety of internships we offer, and by expanding the work-study and school-to-career programs we offer so that learning comes from doing, and not just by sitting in classrooms. In fact, our own State has begun to change its venerable Regents examinations away from pen and paper marathons to ones in which the student's grade is based on the ability to perform; this realization, however, puts an enormous burden on school administrators, teachers and students alike to gain practical experiences, and we, in the business community can provide what they need.

At the New York Fed, we have committed substantial effort to the development and implementation of a wide range of participatory instructional programs geared toward easing students' transition from school to career and toward developing a better understanding of business, economics and finance. In addition, we have a strong commitment to the training of educators throughout the Second Federal Reserve District in a variety of subject areas in which we have expertise. In 1995 alone, the Bank hosted meetings and seminars for teachers of economics, finance, law, social studies, political science, consumer economics, government, and education; we also hosted conferences for administrators, department chairpersons, principals and assistant principals, while working to help shape the New York State secondary schools
social studies curriculum. For the educators, the collaboration has provided much needed additional resources, ideas, and training; for the Bank, the time and resources devoted to these efforts helps us to fulfill our community responsibility while raising the readiness for work of thousands of students in the region from whom we, and perhaps you, will draw to meet future human resource needs.

Let me give you an idea of some of the more successful of my Bank's programs:

(1) "The Econ Explorers Club" is aimed at elementary and middle school students, ages 9-13. Students receive assignments that require them to gather information, collect and chart data, interview workers in various occupations, and write letters. "Explorers", for example, might go to a bank, collect a bank account application, fill it out, have discussions with a platform officer, and so forth. By so doing, they find out what the savings process is all about. Hundreds of students a year participate and get Explorers Club patches and membership cards, and the program costs the New York Fed less than $1,000 a year.

(2) "In the Shoes of a Fed Policy-maker" is intended to teach high school teachers. This program brings a couple of dozen teachers to the Bank for four days in the summer in order to gain a better understanding of how policy is made and implemented. Throughout their stay, they do as I might in the days prior to an FOMC meeting -- they get the same kinds of briefings, read the same kinds of reports, meet with the same staff members as I do. We bring the participants to our trading floors and allow them to interview traders from within the New York Fed and from Wall Street firms. The session ends with a mock FOMC meeting in our board room that culminates in the formulation of a policy recommendation. By the end of the four days, the educators know intimately about the monetary policy process, and they can teach other teachers and their students much more accurately. Cost to the Bank: a few dollars and a bit of the time of some of our staff.

(3) Our most widely joined program, "The Fed Challenge," is a competition among high school students that has earned national recognition, though it's only in its second year. One team of five students from each participating school has 20 minutes to present an analysis of current economic conditions, a forecast, and a monetary policy prescription before a panel of judges consisting of senior-level New York Fed staff; the judges then have 10 minutes to pepper the teams with questions, and believe me, the judges pull no punches. Scoring is based on the thoroughness and accuracy of the presentation, presentation skills, and teamwork. This year, 40 high schools from the metropolitan area took part with four schools from the Buffalo area.

On April 16, we crowned our District's champion, from Matawan High School in New Jersey, and the runner-up, from Edward R. Murrow High School in Brooklyn. The team from Matawan delivered a rigorous multimedia analysis and demonstrated presentation skills with a quality that would make any professional group proud. They will go on to the national finals next week in Washington to compete against the champions from the Boston, Richmond and Dallas Federal Reserve Districts.

Regardless of who wins "The Fed Challenge," the activity has energized thousands of students and teachers in more than 130 schools nationally. Whole classes get involved in doing research, gathering data and reports, preparing audio-visual materials, writing scripts and directing production. Each and every one of these skills will make the participants not only better students but more productive workers in the years ahead as their careers develop.

In addition to "The Fed Challenge" and our other innovative programs, the New York Fed engages in a range of more traditional collaborations with schools, including a Join-a-School partnership, summer internships, a mentoring program and several career days. We also provide intellectual support to Classroom, Inc., a non-profit organization that has created outstanding computer-based simulations of enterprises in various industries. These simulations teach everything from basic accounting skills to ethics by placing students in situations that require them to write, calculate, solve practical problems and make sound business judgments.

All of these collaborations have the benefit of improving the preparation of teachers and the performance of students. They also involve staff of the Federal Reserve at all levels, encouraging volunteerism and civic pride, while providing concrete opportunities to participate actively in the achievement of a major objective of our institution. While the specifics of the New York Fed's programs focus on what we do, there is no doubt that everyone in this room has the potential to engage in similar projects in your areas of specialization. It's good business to do so, and it responds to a major civic imperative.

For most of the public, the reputation of the Federal Reserve will continue to be measured mainly by our success in promoting economic growth with price stability, rather than by our interactions with educators and students. Over the months and years ahead, I will continue to advocate a monetary policy that promotes price stability, without which long-term economic growth will not be possible. Such a policy stance would be favorable, not just for the nation but for our region as well. The New York City area, with its many interest rate-sensitive industries, has prospered when decision-makers in the public and private sectors could have confidence that the Federal Reserve was committed to a growth-oriented economic environment. Price stability also promotes innovation and confidence, both of which lead to jobs, and it paves the way for the entrepreneurship that gives hope for the future to the people who live here.

Our monetary policy roles notwithstanding, the New York Fed also must respond to the social needs of our community. In that context, my Bank will continue to work both independently and with community leaders to help make the Second Federal Reserve District a better place to live and work. We firmly believe that our efforts to improve educational opportunities contribute to that mission, though we remain very aware of the challenges that lie ahead to narrow the gap in income and wealth among groups.

I encourage you to join with me and many others in committing our organizations and ourselves more fully to the task of meeting this challenge head on.

Thank you very much.