REMARKS BY

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I am honored to be here to address the mid-Winter meeting of the New York State Bankers Association. Last February in my first appearance before this gathering as President of the Federal Reserve Bank of New York, I shared with you my thoughts on some long-term policy issues facing the banking industry and the financial sector of the U.S. economy. Over the past year, the condition of U.S. banks and banks in New York has remained strong, while, at the same time, the banking industry, on the whole, made further progress in the management of risks. The current strength and resilience of the banking system bode well for the industry's future, a future in which banks and their regulators will continue to face challenges in adapting to new market practices, managing risks and dealing with financial innovations.

The long-term future health and competitiveness of U.S. banks will be enhanced by the implementation of the recently enacted Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994. The interstate banking and branching provisions of this law, long overdue in my opinion, represent the first "chipping away" at some of the boundaries, geographic and otherwise, that have restricted banks' activities, while, at the same time, preserving the dual banking system that has served the nation so well for so long. I think the opportunities for banks are numerous, although we all recognize the risks that accompany them. We in New York, in particular, should welcome this development. Our history

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has demonstrated that locally-based institutions have a competitive advantage in terms of understanding the needs of local businesses and residents that is not easily overcome by outsiders. Some of you perhaps remember firsthand what happened in New York State when branching throughout the state was permitted in 1975. Many feared that the smaller institutions outside New York City would be swallowed up. But, a generation later, I am happy to say that New York State continues to have a healthy and highly competitive banking industry, with institutions of all sizes, from smaller community banks to regional banks to money center banks, offering a wide variety of services to a very diverse customer base.

Today, I want to step back from many of the important banking and financial issues that have occupied so much of our time and energy in recent years, and talk with you about another important set of issues--the role of banks in the regional economy and community development, and, more generally, the challenge that we all face in promoting growth and job opportunities in our communities.

Let me begin by noting some facts about the New York State economy. Since 1989, economic performance of the state has lagged the average national performance. The recession in New York began a little earlier, cut a little deeper and lasted a little longer than was the case for the nation as a

whole. And, by nearly all measures, the cyclical recovery in New York has been weaker than the national expansion. Over the last two years, job growth in New York averaged below 1 percent, less than half the 2 percent pace for the nation as a whole. The softness in job growth is not just a matter of weakness in New York City and is, in fact, widely spread across various regions of the state. Taken as a whole, job growth outside New York City has been only somewhat better than in the City, although some areas such as Buffalo, Rochester and Utica recently have done considerably better than other places in the state.

On the surface, personal income growth--another broad measure of economic performance--suggests that New York's overall economic performance may have been stronger than indicated by job growth figures. Over the last two years, personal income growth in New York was only modestly weaker than the average national pace. But the strength in income growth is somewhat misleading. Part of the strong personal income growth reflected unusually high compensation in the form of bonus payments for a relatively small number of people in the securities industry. The bulk of the state's population has not benefited from those extraordinary compensation gains in the securities industry.

The reasons for New York's poor performance relative to the nation as a whole are not immediately apparent. There may

not be a single dominant cause of the state's subpar economic performance in the last five or six years. New York State has experienced disproportionately greater problems than the nation, either directly or indirectly, in several areas, including (1) massive restructuring in some of the key industries--banking and finance, and high-tech manufacturing, in particular--(2) commercial real estate overbuilding, and (3) the slower growth of exports.

On top of these essentially cyclical problems, several structural difficulties have contributed to the lingering weakness in the New York economy. Perhaps most important among the structural impediments to economic growth are much higher tax burdens, especially in New York City, relative to the rest of the nation, generally high costs of doing business and living in the state, and low labor force growth and participation rates--among the lowest of any state. The low labor force participation rate is a double-edged problem since it causes the tax burden to be spread over a proportionately smaller work force, on the one hand, and increases the fraction of the state's population on public assistance, on the other. The increased demand for social services associated with low participation rates aggravates the structural pressures on the state's budget deficit.

I can assure you from personal experience that the wave of restructurings will not last forever, and that New York

will move into the positive side of the restructuring cycle--greater productivity, new investments and job creation. As you may know, I was born in the Midwest, and spent much of my life there. During the early and mid-1980s, the manufacturing sector in the Midwest, especially heavy industry, went through a huge restructuring cycle, much greater than the current cycle in New York State. Today, Midwest heavy industry is, once again, a strong competitor in the world economy. The vast majority of displaced workers have been reemployed--many of them earning more than if their old jobs were still in place--and the region as a whole has been among the nation's success stories. Whether the end of restructuring in New York will follow the Midwest experience and bring about as strong a resurgence in economic growth is, of course, unclear at this time.

Structural problems of the New York State economy have been around for many years and may have become less tractable over time. Yet, the recent election results in New York, as in the rest of the country, suggest a clear trend toward a voter preference for smaller government and a heightened desire for lower taxes. The new public sector initiatives to accomplish these objectives will probably help, at the margin, in reducing impediments to growth, but if history is a useful guide to the future, I think the impact of such initiatives will fall well short of expectations.

While we are all against "wasteful" government and "high" taxes, practical difficulties of defining and implementing policies for lower taxes and lower spending at the same time are enormous. Elected public officials as policy makers must confront tradeoffs and inconsistencies in policy choices that may have eluded them as candidates for public office. In the end, reducing taxes and the role of government to any significant extent, I believe, will inevitably require some reductions in total public spending and social services, at least in the short run. This will be the case even if we assume an optimistic scenario in which long-run benefits of new policy initiatives more than fully offset their adverse effects.

Whatever the contribution of any new public sector initiatives, increased private sector efforts, in my view, will be critical for strengthening New York State's economic performance. While the state has lost many corporate headquarters and manufacturing companies over the years, its economic base remains rich and diverse, and offers great opportunities for enhancing economic growth. The state's economy has several sources of underlying strength:

- A major source of the strong potential is the presence of several key industries that now lead the world economy, including banking and finance, high-tech manufacturing, high-value added business

services such as advertising, and tourism.

- Another important source of strength is an outward looking, internationally oriented business community. New York State's international ties extend well beyond New York City's role as, arguably, the most important international financial center in the world. For example, New York ranks third behind California and Texas in exports of goods, and would almost certainly be our largest exporting state if data on service exports were available on a state-by-state basis. New York's international orientation is well reflected in its exports which come from establishments of all sizes, from giant corporations to Buffalo stores which specialize in selling to Canadian shoppers.
- While a considerable fraction of New York's population lacks essential skills and education to participate in the labor force, the large size of the highly educated and skilled work force is an important source of underlying strength for the state. The state has a larger share of more highly educated residents than the nation, and, for years, it has produced a dramatically disproportionate number of the most scientifically talented high school seniors in the United States. For example,

in the last several years, about 1/3 of the winners of the Westinghouse Talent Search competition have come from the State of New York.

By taking greater advantage of these and other strengths of the state, I believe it is possible not only to expand job opportunities for all, but also to improve materially the lot of weaker segments of our society, especially those in the inner cities. The banking industry is in a unique position to play an important role in this process. Its financial condition is sound, its capacity to meet the growing credit needs is strong, and its future looks bright.

In working to enhance growth and job opportunities around the state, and the region more generally, the challenge we as bankers and regulators face collectively is the challenge of sustaining our communities that, in turn, sustain us and our families. The Community Reinvestment Act and the current efforts to "reform" the implementing regulation are certainly sources of controversy. In my view, it would be a serious mistake if the efforts to make CRA assessments more objective ended up with government credit allocation. Such an outcome would increase regulatory burden on banks, and could prove to be both costly and ineffective. Federal Reserve and other regulators have worked to ensure that informed judgment continues to play an important role in the credit-granting process. We have also tried to reduce the compliance burden,

particularly on the smaller banks. I hope when the final rules come out you will agree that we have been able to strike a fair and reasonable balance.

But the importance of stable and vital communities to all who live and do business in them transcends any debate about legislation or regulation. Even without regard to any legislative imperative, each of us--and all of us--must find the most effective role to play in meeting the problems posed by the growing credit needs, particularly in the inner cities and other poor communities.

For our part, we at the Federal Reserve Bank of New York are taking a more active approach in reaching out to all of the different elements of our community. Last year, we created an Office of Regional Strategies that began work on identifying opportunities for better coordination with community development organizations and act as a catalyst for broadening our regional research and economic education programs. This year, we plan to further sharpen our focus on regional matters and Second District community development and urban issues.

I want to assure you that my commitment to these efforts is real and enduring. Beyond the initiatives that we have undertaken at the New York Federal Reserve Bank, I am--and have been since my days in Chicago--personally involved in community development issues. For example, I have taken an

active role in the Neighborhood Housing Service, an organization that arranges traditional and non-traditional sources of funding for low- and moderate-income housing in the inner cities. In each of the three roles that I have played over the past several years--as a banker, a private citizen, and a bank supervisor--I have had the opportunity to witness first hand the direct effects of community lending and the efforts of organizations like the Neighborhood Housing Service. I encourage you to visit these neighborhoods, as I have done, and get a sense of the dedication and commitment that keeps them vital. By just listening to the achievements of those involved with and helped by the NHS and its community lending programs, it is impossible not to be convinced about the breadth of what can be achieved if we work together to develop solutions for the problems confronting us today.

I have been troubled by charges of discriminatory lending practices which directly limit the ability of potential borrowers to build businesses and own homes, and on a broader scale, which stifle economic development and job opportunities. It is discouraging, particularly after all that has been written and discussed, to hear about cases in which loan applications by racial minorities have received rude and unfavorable treatment by bankers, apparently solely for ethnic reasons. We should all be deeply offended by such behavior.

I recognize, of course, that most of you work hard on enforcing fair lending regulations and ensuring equal credit opportunity to all potential borrowers. But unfair and discriminatory lending practices, whether resulting from habit and culture or from deliberate acts, cause great harm to our society. Such lending practices result in credit decisions that are not based on legitimate economic factors, and damage our economy and reduce profit opportunities for banks. Discriminatory lending practices are especially harmful for our poor communities and neighborhoods where economic development and job opportunities are so badly needed.

I want to emphasize that banks' involvement in community development efforts is not just good citizenship. There are numerous profit opportunities in poor communities and neighborhoods waiting those surefooted and quick witted enough to take advantage of them. I can assure you that entrepreneurial spirit is as alive in the inner cities as it is elsewhere. Indeed, the potential for small businesses to develop and grow may well be greater in our low-income communities than it is in the rest of the economy. By meeting the legitimate credit needs of all communities, including the inner cities, banks can play a vital role in stimulating small business development. As you may know, small businesses have a particularly good historical record in creating jobs; according to the Small Business Administration, small

businesses, those with fewer than 500 employees, account for more than half of private employment in the U.S. economy.

In addition to meeting the household and business credit needs of their communities, banks can also help their communities by doing other things that are also good business. For example, banks can offer business and technical advice to small businesses. Many already do this but more can do so. The large corporations will not pay you much for advice but the small businessman can make it worth your while. The advice by bankers who understand the needs of their local businesses would surely be more useful than that from a government agency where information about those businesses is likely to be limited.

It is not my objective to offer a complete agenda for banks' community involvements. My point is simply that banks as institutions and all of us as individuals must do our part, in whatever manner appropriate and effective, to help our communities. As I mentioned earlier, my own personal experience in this area has been very rewarding and even exciting.

The challenge of sustaining our communities and neighborhoods has never been greater or more important than it is today. It is a major issue not just for New York but for the whole country, and, I emphasize, not just for the banking industry but for the whole society. For a variety of reasons,

gains from advances in the economy over the last decade or so have not been shared by weaker segments of our society, and the working poor, in particular, have suffered a material blow. In fact, the real wages of low-skilled workers have fallen sharply, both in absolute dollar terms and relative to the wages of high-skilled workers.

These dramatic wage developments and growing economic disparities raise profound issues for our society--issues of equity and social cohesion that affect the very foundations of our society. If we are to go forward as a unified society with a confident outlook rather than as a society of diverse economic groups suspicious of each other and of the future, the situation of weaker segments of our society must improve. It is in this context that greater public and private sector efforts are needed to bring about stronger and more balanced economic performance, with widely shared economic benefits and job opportunities for all groups. The banking industry can, and indeed must, play an important role in this process. I have made a point in my still short time in this job to travel around the District and meet a number of you, including many who are in this room. I have always come away from those sessions impressed with the knowledge, dynamism and concern that has been expressed in regards to issues that confront you locally and regionally. I believe that all of us in the financial sector have a special and critical responsibility to

help develop solutions to the economic problems confronting us today and I know that we are up to the job.

All social programs, and all training programs, governmental or private, are doomed to fail if there are no jobs in the community. The focus of planning for any institution must include recognition of the linkage between job creation and a strong local economy. As the public and private sectors undertake new initiatives to deal with the nation's economic and social problems, we at the Federal Reserve remain firmly committed to providing a stable economic and financial environment. Our foremost policy task is to maintain price stability, which is important not simply for the usual macroeconomic reasons but also for social reasons. I believe that a surge in inflation would aggravate the problems of our poor communities disproportionately because of its regressive tax aspects and other negative consequences for the economy. Low-income workers and fixed-income individuals suffer most in an environment of high and rising inflation.

Let me conclude by returning to my theme on the regional economy. In recent years, the economic performance of the New York State economy has been weaker relative to the nation, and the economic difficulties facing the state will not be easily eliminated over the coming years. At the margin, public sector initiatives may help reduce impediments to growth in the long run, but any cutbacks in government employment and

social services will add to the economic weakness in the short run. If the state economy is to live up to its full potential, the private sector will need to take on a greater role in addressing the economic problems. I feel very strongly that banks can and must make significant contributions to enhancing economic growth and job opportunities by meeting the growing credit needs of their communities, and, more generally, through involvement in community development programs.

Thank you for this opportunity to address you today.

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