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Remarks by

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Chairman

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I am pleased to join the Italian American Congressional Delegation and the National Italian American Foundation once again. I very much appreciate the fact that both Senator Domenici and Congressman LaFalce have invited me to participate in your briefings more than once—either I have made a good impression or they're getting desperate.

This year's subject, "Business, the Economy and the New Millennium," made a choice of topic quite easy. While I suspect I will not have much to add beyond what already is well known by this group of businesspeople about efforts to remediate and test computer systems in preparation for the rollover to January 1, 2000, I want to raise with you some of the issues I have considered as I think about the likely impact of Y2K.

As you well know, we face an exceptionally complex problem that has required and will continue to require the commitment of significant amounts of resources to fix. The good news is that evidence is becoming more persuasive that our electronic infrastructure will be ready for the Century Date Change. The public's understanding of the degree of our Y2K readiness also has grown, and fears of widespread disruptions around the CDC appear to be waning, though we are not as yet home free.

There is nothing exactly like the Century Date Change in our historical annals from which we can infer its potential consequences. But as a standard for monitoring developments, it is simply unrealistic to expect our advanced technology to function any better on January 1, 2000, than it has on any other day of the year. Moreover, while systems may fail as they have in the past, these failures never have resulted in broader and persistent--that is, systemic--breakdowns in our economy. In the event of breakdowns short of systemic, history teaches us that businesses are remarkably adaptive.

In our market-based economy, economic incentives ensure that resources quickly move to their most-productive activities. In a crisis situation, whether systemic or short of that, companies expeditiously redeploy their labor and capital resources to facilitate the restoration of their key operations. Corporate management is wholly aware that a slow response to a breakdown can bring revenue losses in the short run and an erosion of their customer base in the long run. Simply put, in our competitive economic environment, the ability to recover quickly from a serious technical problem can literally be a matter of survival for some firms.

Fortunately, our country has the skilled, well-educated workforce that is a precondition for such quick action. While ingenious solutions can sometimes originate from the executive suite, more often than not they grow out of the ability of engineers, technicians, and workers on the factory floor to improvise a temporary fix for a critical problem. Depth of experience and the ability of our workers to think "outside of the box" have prevented many a problem from turning into a disaster. Thus, while no one knows exactly what will happen on January 1--the CDC is a truly idiosyncratic event--we do have a good idea of how our society will respond if problems develop.

As we prepare for the rollover, it is most important to keep in perspective just how far we have come in our Y2K preparations. Three years ago, only the largest and arguably the most forward-looking of organizations had mobilized for the Century Date Change. Today, many firms and government agencies have completed their testing, and those institutions that were late off the block are working very diligently to be ready by the end of the year. While it is easy to obsess about the few institutions in our society that may not be ready, let us not lose sight of the fact that the overwhelming majority of

us are not only prepared but have contingency plans to deal with breakdowns. It is the economic effects of businesses and households endeavoring to adjust to the CDC in the next few months that I see as replacing technical concerns as our major challenge.

I am not saying that we would have been better off if the existence of the Y2K problem had never been publicized. In that event, the remedial actions that have been expended over the past two years would surely have fallen short. Although the desirability of publicizing the existence of a pending significant technical breakdown was never in question--and never should have been--it always raised the potential hazard of an outsized, if only partly informed, disruptive reaction by the public. Given the potentially broad range of uncertain outcomes at the CDC, the cost of advance preventative preparations in most cases is probably correctly perceived by businesses and households to be low, or at least acceptable.

Thus, with their own remediation efforts either complete or nearing completion, many large businesses are currently evaluating the readiness of their suppliers and the local infrastructure on which they depend. Based on such assessments, these companies are deciding whether, for example, to hold inventory levels above their tight, just-in-time programs as a precaution against Y2K-related disruptions. Because businesses are effectively buying insurance against an uncertainty, the less uncertainty, the smaller the perceived insurance need. Thus, accurate, credible, and timely information on the general state of readiness will be essential to reducing uncertainties in the months ahead. Businesses then can make more-informed decisions as to the type and magnitude of the precautions they need to take. If only a small percentage of businesses choose to add to their inventories as a hedge, the effect on production will be insignificant. However,

should a large number of companies want to hold even a few extra days of inventories, the necessary, albeit temporary, increase in production (or imports) to accommodate such stock building could be quite large

While the evidence of precautionary inventory hedging to date is mixed, in the financial sphere, borrowers and lenders are clearly taking steps to build liquid assets and reduce their reliance on credit markets around the end of the year. This is reflected in a noticeable rise in deposit and commercial paper rates for funding that would be outstanding over year's end. Many corporate treasurers have moved forward their debt offerings to avoid any chance of a dearth of credit availability in the fourth quarter or difficulties funding short-term liabilities.

The potentially most important piece in the Y2K puzzle for the rest of the year is the uncertain response of the American consumer as the year-end approaches. A small number of households, driven by fear of the unknown, tell pollsters that they are planning to build large stockpiles of food, water, fuel, and cash as the millennium approaches. Most, however, profess much more limited plans.

Nonetheless, we at the Federal Reserve must be prepared for all contingencies and have made especial plans for currency availability in the remote possibility of heavy withdrawals from banks. I trust that such withdrawals will be modest since, as I have said before, the safest thing for consumers to do with their money around year-end is to leave it where it is.

In summary, no one really knows what will happen when the century rolls over. The Century Date Change, to repeat, is a unique event, and the complexity of the problem suggests that something is likely to slip through the cracks. But as I mentioned earlier,

the probability of a cascading of computer failures in mission-critical systems is now negligible, given the testing that has been done, the backup plans that are in place, and the great adaptability and ingenuity of the American worker. Moreover, the evidence of an increasingly compliant computer infrastructure appears to have assuaged at least some of the public's earlier Y2K concerns, according to several recent surveys.

Nonetheless, we have not yet reached the period of extra heavy focus by the media on the CDC. It is too compelling a story for audiences that thrive on countdowns to the unknown. As attention heightens and rumors inevitably mushroom, it is important that what is known and what is not known be clearly articulated by those of us in both public and private leadership positions in Y2K management. In the final analysis, facts are the only antidote for rumors.

We at the Federal Reserve are optimistic that computer problems associated with the Century Date Change and the response to the CDC will not be a major event for our nation. This is a testament to the extraordinary efforts of thousands of far-sighted technicians and business planners who, confronted with an intangible and abstract problem, have been able to convince businesses and governments to marshal vast resources for remedial actions. This has been a truly impressive feat. If we avoid fear-induced, significant economic responses in the months ahead, the Century Date Change will hopefully replicate the saga of "the dog that did not bark."