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Remarks by

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at the

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Over the past several days, you have been engaged in sharing a good deal of practical information on developments in the financial services industry and on the evolving set of laws and regulations that influence the availability of credit in the communities that you serve. No doubt, many of you are here this morning because of your long-standing interest in the Federal Reserve's implementation of the Community Reinvestment Act (CRA). However, because we are now in the final stages of drafting regulations on the Sunshine Provisions of the Gramm-Leach-Bliley Act, I am prohibited from commenting at this time. Instead, I would like to discuss with you, in broader terms, some of the challenges facing businesses, workers, and consumers--including those in your communities--as the U.S. economy embarks on a new century.

As you know, we have recently established a record for the longest economic expansion in this nation's history. In recent years, it has become increasingly clear that this business cycle differs in a very profound way from the cycles that have characterized post-World War II America. Not only has the expansion achieved record length, but it has done so with far stronger growth than expected. A key factor behind this impressive performance has been the remarkable acceleration in labor productivity, with output per hour in the nonfinancial corporate sector increasing since 1995 at nearly double the average pace of the preceding quarter-century. And because technological change has spawned so many opportunities for businesses to expand the range and value of their goods and services, the introduction of new efficiencies has not led to higher unemployment. Rather, the recent period of technological innovation has created a vibrant economy in which opportunities for jobs and new businesses have expanded, enhancing the living standards of a large majority of Americans.

Our challenge, then, is to ensure that we--both policymakers and community leaders--extend the favorable macroeconomic performance and strive to bolster the capabilities of all Americans to share in the prosperity that is being generated.

When historians look back at the latter half of the 1990s a decade or two hence, I suspect that they will conclude that we are now living through a pivotal period in American economic history. New technologies that evolved from the cumulative innovations of the past half-century have now begun to bring about dramatic changes in the way goods and services are produced and in the way they are distributed to final users.

How did we arrive at such a fascinating and, to some, unsettling point in history? While the process of innovation, of course, is never-ending, the development of the transistor after World War II appears in retrospect to have initiated a special wave of innovative synergies. It brought us the microprocessor, the computer, satellites, and the joining of laser and fiber-optic technologies. By the 1990s, these and a number of lesser but critical innovations had, in turn, fostered an enormous new capacity to capture, analyze, and disseminate information. It is the growing use of information technology throughout the economy that makes the current period unique.

For the consumer, advances in technology and in the flow of information have greatly facilitated the development of a wide range of new financial products that are better suited to meeting the preferences of diverse populations. Similarly, in the case of consumer and business credit, computer and telecommunications technologies--the same forces that are shaping the broader economy--have lowered the cost and broadened the scope of financial services. As a consequence of these developments, borrowers and lenders are increasingly able to transact

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directly with each other, and we have seen a proliferation of specialized lenders and new financial products that are tailored to meet very specific market needs. At the same time, the development of credit-scoring models and the securitization of pools of loans hold the potential for opening the door to national credit markets for a broad spectrum of businesses operating in local and regional markets. Indeed, the CRA data on small business lending show that institutions located outside the local community are an important source of credit for many businesses.

Much attention is focused on the role of corporate giants in fostering innovation, but we would be foolish to understate the extent to which America's innovative energy draws, and will continue to draw, from the interaction of both large and small businesses. Nowhere in the world are the synergies of small and large businesses operating side by side in a dynamic and competitive market economy more apparent than in this country. Of course, the surging growth of young high-tech firms and the flashy presence of new Internet businesses capture the most public attention. But judging from our contacts through our regional Federal Reserve Banks and information collected in surveys of small businesses, times have been good for expanding traditional lines of business as well. The most common complaints include the difficulty of finding qualified workers in the midst of strong competing demands for labor. In the current expansion, the vast majority of small businesses have not listed access to credit as their top concern, although, as you know, many business owners are quite apprehensive about the future as the familiar ways of financing business undergo sometimes dramatic changes.

Several recent developments hold the promise of improving links between financial institutions and the small businesses in your communities. First, major banks and finance

companies are trying mass-market approaches to small business finance, similar to the approaches used in the consumer credit arena for many years, and this effort has greatly expanded the competition for loans. In addition, new innovative intermediaries--such as community development corporations and multibank and investor loan pools--are seeking to develop expertise in specific segments of the marketplace for small and minority businesses.

I would like to emphasize, however, that credit alone is not the answer for small businesses. They must have equity capital before they are considered viable candidates for debt financing. Equity acts as a buffer against the vagaries of the marketplace, and it is, accordingly, a sign of the creditworthiness of a business enterprise and the commitment of its owner. This is especially true in lower-income communities, where the weight of expansive debt obligations on small firms can severely impede growth prospects or more readily lead to business failures.

Overall, our evolving economic and financial systems have been highly successful in promoting growth and higher standards of living for the majority of our citizens. But we need to reach further to engage those who have not been able to participate. One way is through the education and training of our workforce--that is, enhancing our stock of "human capital," which is a necessary complement to our ever-changing physical capital. A major consequence of the fast-paced technological change of recent years and the growth of the conceptual emphasis of our nation's output has been to increase the demand for skilled workers. In today's economy, skill has taken on a much broader meaning than it had only a decade or two ago. Today's workers must be prepared along many dimensions--not only with technical know-how but also with the ability to create, analyze, and transform information and with the capacity to interact effectively

with others. Moreover, they must recognize that, with new technologies coming rapidly on line, the skills that they develop today will likely not last a lifetime.

Traditionally, broader human capital skills have been associated with higher education, and accordingly the demand for college-trained workers has been increasing rapidly. The result has been that, over the past several decades, the economic returns to workers with college training have on average outstripped those to workers who stopped their formal schooling with a high-school diploma or less. In the past few years, real wage gains for college-educated workers have continued to be rapid, but owing to dynamic economic growth and tightening labor markets, increases for other workers, on average, have kept pace. Nonetheless, a wide gap between the wages of college-educated workers and those of high-school-trained workers remains.

Another consequence of rapid economic and technological change that needs to be addressed is a higher level of worker insecurity, which is the result, I suspect, of fears of potential job skill obsolescence. Despite these tightest labor markets in a generation, more workers currently report that they are fearful of losing their jobs than similar surveys found in 1991 at the bottom of the last recession. The marked move of capital from failing technologies to those at the cutting edge has quickened the pace at which job skills become obsolete. The completion of high school once equipped the average worker with sufficient skills to last a lifetime. That is no longer true, as evidenced by the trends in workers returning to school and in businesses expanding and upgrading their on-the-job training.

Certainly, higher education will continue to play an important role in preparing workers to meet the evolving demands for skilled labor. But the pressure to enlarge the pool of skilled workers requires that we recognize the significant contributions of other educational programs in

your communities. Community colleges, for example, have become an important provider of job skills training not just for students who may eventually move on to a four-year college or university but for individuals with jobs--particularly older workers seeking to retool or retrain. In some cases, community colleges are providing contract training for employers, part of a broader trend in which employers and their workers are recognizing that to maintain human capital, investment in formal training programs must complement experience on the job.

As one might expect, greater worker insecurities are also creating political pressures to reduce the fierce global competition that has emerged in the wake of our 1990s technology boom. Protectionist measures, I have no doubt, could temporarily reduce some worker anxieties by inhibiting these competitive forces. However, over the longer run such actions would slow innovation and impede the rise in living standards. They could not alter the eventual shifts in production that owe to enormous changes in relative prices across the economy. Protectionism might enable a worker in a declining industry to hold onto his job longer. But would it not be better for that worker to seek a new career in a more viable industry at age 35 than to hang on until age 50, when alternative job opportunities would be far scarcer and when the lifetime benefits of additional education and training would be necessarily smaller? To be sure, assisting those who are already close to retirement in failing industries is an imperative. But that can be readily accomplished without distorting necessary capital flows to newer technologies through protectionist measures. More generally, we must ensure that our whole population receives an education that will allow full participation in this dynamic period of American economic history. No doubt, in your communities many workers may view the changing needs of their employers as a threat to the security of their job; and perhaps students preparing to enter the workforce see

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the demand for rising skills as a hurdle too high to overcome with the limited resources available to them. You, as community leaders, can continue to explore ways of developing creative linkages between businesses and educational institutions to better prepare students for the rising demands of the workplace and to help workers, who must keep up with those changing demands and who must cope with the consequences of global competition, renew and upgrade their skills.

As I indicated earlier, one notable aspect of the remarkable performance of our economy in recent years has been the substantial, and relatively broadly based, rise in real income. During the past several years, workers, including those at low end of the wage distribution, have seen noticeable increases in the inflation-adjusted value of their wages; more comprehensive Census Bureau figures on the real money income of families also show gains in each quintile between 1996 and 1998, and presumably when the 1999 data become available further improvement will be evident. These recent increases for low-income workers, however, have not reversed the rise in wage inequality that occurred during the 1980s and early 1990s when the gap in wages between those at the top and the bottom of the distribution was widening considerably. Nonetheless, the leveling off in that disturbing trend is an encouraging sign of what can be achieved if we can maintain strong and dynamic labor markets accompanied by low inflation.

Of course, we need also to consider trends in wealth, which, more fundamentally than earnings or income, represent a measure of the ability of households to consume. The Federal Reserve's Survey of Consumer Finances indicates that the median real net worth of families increased 17-1/2 percent between 1995 and 1998. As one might expect, the rising stock market coupled with the spreading ownership of equities was an important factor. However, even in the



face of the strong aggregate trend, median net worth declined over this period for families with incomes below \$25,000, and medians for non-whites and Hispanics were little changed.

That families with low-to-moderate incomes and minorities did not appear to fully benefit from the highly favorable economic developments of the mid-1990s is, of course, troubling, and the survey results warrant a closer look. In the details, we find that families with incomes below \$25,000 did increase their direct or indirect holdings of stock, and more reported that they had a transactions account. However, they were less likely to hold nonfinancial assets--particularly homes, which constitute the bulk of the value of assets for those below the top quintile according to income. At the same time, one encouraging finding from the survey is that the homeownership rate among minorities rose from 44 percent to 47 percent between 1995 and 1998, which may be a sign of improved access to credit for minorities.

Although market specialization, competition, and innovation have vastly expanded credit to virtually all income classes, under certain circumstances this expanded access may not be entirely beneficial, either for customers in general or for lower-income communities. Of concern are abusive lending practices that target specific neighborhoods or vulnerable segments of the population and can result in unaffordable payments, equity stripping, and foreclosure. The Federal Reserve is working on several fronts to address these issues and recently convened an interagency group to identify aberrant behaviors and develop methods to address them.

I have no illusions that the task of breaking down barriers that have produced disparities in income and wealth will be simple. It remains an important goal because societies cannot thrive if significant segments perceive their functioning as unjust. Although we have achieved

much in this regard, more remains to be done. Despite the considerable progress evident in recent decades in reducing racial and other forms of discrimination, this job is far from complete.

Discrimination is against the interests of business--yet business people too often practice it. To the extent that market participants discriminate, they erect barriers to the free flow of capital and labor to their most profitable employment, and the distribution of output is distorted. In the end, costs are higher, less real output is produced, and national wealth accumulation is slowed. By removing the non-economic distortions that arise as a result of discrimination, we can generate higher returns to both human and physical capital.

We are experiencing an extraordinary period of economic innovation. At the policy level, we must work to configure monetary policies that will foster a continuation of solid growth and low inflation. Beyond this primary mandate, we at the Federal Reserve are also responding to the challenge of ensuring that all communities can fully participate in our growing prosperity. With our Community Affairs program we provide information, instruction, and technical assistance to a diverse range of constituents regarding community reinvestment, community economic development, fair lending, and related issues. Our reach is broad: During 1999 more than 15,000 participants attended our conferences and seminars, and we responded to more than 800 requests for in-depth technical assistance. We are also increasing the research focus on topics related to community and economic development and in 2001 will host a second national conference, this one focusing on the theme of changing financial markets and community development. Your participation in, and support of, these activities is important because you play such a crucial role in helping communities respond to the evolving financial, educational, and technological demands of this new century.

As I indicated in my opening remarks, future historians are likely to conclude that the past five years have been a pivotal period in American economic history. I trust they will also conclude that it was a period that set in place policies to foster the eventual emergence of full participation of that segment of the workforce that has not fully shared in our economic progress.