

# A National Voice, a Regional View

by Sandra Pianalto

One of the great strengths of the Federal Reserve System is its structure, a practical mix of centralized and decentralized elements. Locating the power to make monetary policy within a central body, the Federal Open Market Committee, allows for swift decision making and consistent action. Giving other powers to 12 Federal Reserve Banks, including voting rights on the FOMC, enables the different regions of the country to be represented in the policymaking process. As president of a Federal Reserve Bank, I work to understand the unique characteristics of my district, and the presidents of the other 11 banks do so in theirs. Together, we bring a regional perspective to the national dialogue.

I won't go into great detail about how each FOMC meeting unfolds, but I will tell you that during every meeting, we have what is known as a "go-round" where each president reviews developments in his or her region. These insights are a critical part of the policy- and decision making processes.

Yes, we receive and are constantly reviewing the latest national and international economic statistics. We employ several hundred economists throughout the System. These experts pore over the data, conduct research, and create models to project economic activity. A significant part of my preparation for the meetings essentially involves sifting through the different explanations that *might* lie behind the national statistics.

Very often, the official data that are available are just not current enough for a forward-looking enterprise like monetary policy. So to prepare for

FOMC meetings, I must rely not only on my team of economists—as talented as they are—but also on people in the community. Input from business-people and consumers provides me with reliable information on the economy far ahead of when the official statistics are released. But there is a more subtle value to this firsthand information.

You might think of the statistical data that we gather on the economy as being a bit like the readout on your car's dashboard: All of the information is meant to tell you *what* is happening to your car, but typically does not tell you *why* it is happening. When the oil light on your car's dashboard comes on, you know that the oil level is probably low, but you don't know why. Maybe there's a leak, or maybe your mechanic left the cap off. To find out, you have to look under the hood.

Meeting with people is my way of looking under our economy's hood. The conversations enable me to understand the *why* behind the *what*. They help me judge which of the various explanations being offered for the condition of the national economy is most reasonable.

For me, this process of learning about my District's economy has been energizing and educational. I have traveled a mile beneath the earth's surface to observe state-of-the-art coal mining technology. I have witnessed the most powerful fireworks I have ever seen as 200 tons of scrap steel were melted with electrodes and then transformed into some of the world's strongest steel bars. I have seen cookies frosted by robots and hogs tenderly cared for by computers. I have watched a surgical team, headed by a world-renowned

**Sandra Pianalto, president and chief executive officer of the Federal Reserve Bank of Cleveland, discusses the way the Federal Reserve System ensures that different regions of the country are represented in making monetary policy, describes the way our economy is changing, and suggests some ways the nation can meet economic challenges ahead. This *Commentary* is adapted from her remarks to the City Club of Cleveland on March 5, 2004.**

surgeon, stop, repair, then restart, a human heart. I experienced all of these extraordinary events within the confines of my District.

I take these stories and the lessons I learn from them to Washington. They allow me to attach reality—not to mention human faces and voices—to what would otherwise be seemingly sterile statistics. This information plays a key role in shaping our national policy decisions.

## ■ What the Economic Statistics Tell Us

So what kind of shape is our economy in? The national economy is expanding. It grew at an 8.2 percent annual rate in the third quarter of last year, the steepest quarterly increase in nearly 20 years. Current estimates indicate that this was followed by solid growth of 4 percent in the last quarter of 2003. And many forecasters are predicting that growth this year will fall into the 4 percent to 5 percent range.

Although economic growth has been strong, labor markets have not kept pace. History tells us that employment typically returns to pre-recession levels within about two years. However, it has been three years since the last recession started, and the latest data show our employment levels still remain about 2.4 million jobs below their March 2001 peak.

Why are so many companies—even this far into the economic expansion—holding at relatively low levels of employment? An important part of the answer is that these businesses are adjusting to changes in global trade patterns, and they are taking advantage of new technologies.

Changing global trade patterns are clearly reshaping much of our economy in the services and manufacturing sectors alike, although manufacturers have borne the brunt of these changes. The recent focus of attention has been on emerging Asian economies—especially China—but our manufacturers have constantly been confronted by shifts in our trade positions. Think back to our trade relationships with Germany in the 1970s, or Japan in the 1980s, or Mexico in the 1990s.

International trade has changed *what* we produce, but the total amount of goods manufactured in the United States has actually risen. During the past 50 years, America's manufacturing output has increased nearly sevenfold, even though the number of *people* employed in manufacturing has remained relatively unchanged.

The main driving force behind this dramatic increase in output is the productivity growth brought about by technology improvements. Productivity, or output per man-hour, rose significantly in the last half of 2003 and seems poised for solid growth this year. Some have linked this productivity growth with our prolonged period of weak employment growth, concluding that we have permanently re-engineered and restructured our way out of jobs.

Many people think that we must sacrifice employment to get productivity increases. People think this way when they do simple arithmetic: For a particular level of output you can only get more productive by using less labor. But the data paint a very different picture.

The Labor Department provides data on productivity growth in 175 industries. This information reveals that over time, highly productive industries get that way more through *output* growth than through workforce reduction. So, in the long run, we should not consider productivity growth as a negative that necessarily holds back employment growth. After all, it is rising productivity that keeps inflation low, raises real income, and increases business profitability. *It's no exaggeration to say that productivity growth is the engine of our long-run prosperity as a nation.*

### ■ The Fourth District Perspective

So what does this mean for our region? I am a glass half-full person, and here's why. We are still a region that molds, coats, shapes, and assembles. We still make things, and we do it well.

The manufacturing companies that have survived have prospered because they have figured out how to do things better, faster, and more efficiently than their competitors. I got a lesson in the meaning of "efficient" during a recent visit to a steel plant in my District.

The image I had of steelmaking as a gritty, manual-labor-intensive process is clearly a picture from our past. The plant I toured is a model of efficiency, where I found highly skilled workers using computers to run the plant. Harnessing technology to improve efficiency and productivity has become the lifeline for this type of business.

While we are smarter about what we produce and how we produce it, during the past 20 years, manufacturing's contribution to Ohio's output has declined from about 30 percent to 20 percent, and the number of people employed in this sector has fallen from around 25 percent to 15 percent of total employment. However, we still rank third in the nation—only behind California and Texas—in the *number* of people employed in manufacturing.

These numbers and trends are useful, but we should keep in mind that the decline in manufacturing's *share* of employment and output is broadly similar throughout the nation. And while it is true that we are more heavily concentrated in manufacturing than most of the rest of the country, the differences among the states are not as

pronounced as they once were. Like everywhere else in the nation, most of our jobs, and virtually all of our job *growth*, come from the service sector.

While we may still think of ourselves as an industrial region, most of us are employed in nonmanufacturing industries. In fact, Ohio's service jobs have grown by nearly 600,000 since the early 1990s, and these gains have been broadly based. Financial, professional, and business services, and educational and health services were responsible for the vast majority of new jobs created in Ohio during this period. Ohio also serves as home base for many transportation, power generation, retailing, and wholesale distribution companies.

Our state and this region will certainly face challenges in generating more employment opportunities in the years ahead. As developing economies begin to trade with the rest of the world, they are creating new markets for our exports and attracting new competitors who vie for our customers. These new competitors have advantages in particular industries and have moved rapidly to exploit those advantages.

It seems reasonable to expect that as economic activity in the rest of the world accelerates, demand for our exports will grow as well. Our comparative advantage in world trade will come not by providing inexpensive labor; rather, it will come by contributing value to products through the creation and application of knowledge, not just in manufacturing but in everything we produce.

### ■ The Role of Education

Economists have a tendency to focus more on outcomes than on the transitions to those outcomes. And transitions can be painful.

I am aware of the challenges our country and this region will face as we adjust to the changing economy. Chairman Greenspan recently gave a speech which provides us with some useful insight. He noted that research into the sources of economic growth among both developed and developing nations points to a number of factors: a population's knowledge and skill; the ability to control natural resources; the quality of a country's legal system; and openness to trade with the rest of the world.

Our country is doing very well on the last three factors, but I am afraid that we are falling behind on the first—our population’s knowledge and skill.

Studies vary on where our nation ranks on the educational spectrum. Some tell us that while our fourth graders are above average in science and math, their grasp of these subjects declines by the last year of high school, ranking our children below the international average.

Other studies paint a rosier picture—that our students are simply average. If our economy of the future is to be based not only on what we make, but how we make it *better* through technology, then average is not good enough. We must have an educated workforce that not only can compete with the best, but is second to none and is predicated on lifelong learning. The author and futurist, Alvin Toffler, said, “...the illiterate of the twenty-first century will not be those who cannot read or write, but those who cannot learn, unlearn, and relearn.”

In our region, it’s clear that there are no easy solutions to the challenges that confront us, but we can take action. I want to emphasize that I am not an economic development director. In my role as a policymaker, it is my job to focus on our national economy, providing it with a stable price environment and a sound financial system. It’s not within my power to fix our local economic woes. But the signposts from my travels throughout the region point us in several directions.

### ■ Prescriptions for the Twenty-first Century

First, *manufacturing can remain a strength*. Our state’s persistent Rust Belt label still breeds some anxiety because of the deterioration in jobs we have witnessed in the industrial sector. Yet, as I mentioned, Ohio’s manufacturers have prospered because they have innovated and incorporated new technologies into their business practices. This trend must continue. And we must create a growth-friendly environment that will help not only manufacturing, but all businesses, to thrive.

Second, in an economy that runs increasingly on brainpower, *we must invest in our most important asset—our people*. Education equals earning

power. Remember that steel mill I told you about and those plant workers who were operating computers? Manufacturing firms know how much value can—and must—come from the intellectual skill of their employees. Increasingly, these companies demand that their production workers have at least a two-year technical degree. Educational achievement must be broad based in order to benefit the entire spectrum of our population. *And finally, we must accept that economic change is inevitable.*

Lew Platt, who headed Hewlett-Packard throughout most of the 1990s, once warned business leaders that “formerly successful companies did not make gigantic mistakes...the only real mistake they made was to keep doing whatever it was that made them successful for a little too long.”


The economy is always evolving. If we don’t change, we’ll get left behind. Historically, companies have shown resilience and adapted to change through a spirit of risk-taking and innovation. This spirit must not be limited to the business sector. Government, schools, and nonprofits must also do their part. We must not be afraid to ask the tough question—is there a different and better way to do what we do? If the answer is yes, let’s do it.

Each of us has a vested interest in our region’s economic growth. We all have a role to play, and that includes those of us at the Federal Reserve Bank of Cleveland. Internally, we are emphasizing improved efficiency through operational excellence. We also conduct research on issues that are important to our region and have begun collaborative partnerships with universities, foundations, and business groups engaged in economic growth and development.

The economic changes our region has weathered have been formidable. But we cannot retreat from the challenge with defensive policies that seek to protect the status quo or that fail to acknowledge change as an agent of growth. Our region—and our people—are too resourceful for that.

To a jobless worker, it is cold comfort to be reminded of the many elevator operators, Pullman car porters, and movie theater projectionists who also had to adapt to structural change. But growth, by its very nature, requires change. We must focus more on encouraging business startups and expansions and on the real success stories, and stop bemoaning the failures that make headlines. We cannot look backward and expect to move forward.

Think of the steady, upward march of our economic prosperity as climbing a ladder, where each rung is a new stage of our economic development. Until we are willing to release our grasp on the rung we’re holding and reach for the next one, we cannot hope to reach greater heights.

  
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*The views expressed here are those of the author and not necessarily those of the Federal Reserve Bank of Cleveland or the Board of Governors of the Federal Reserve System or its staff.*

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