

## **Vital Economic Issues Confronting the New Congress Discussed at Women's Economic Round Table, September 30, 2010**

*Notes by Tita Beal and James Shields*

Mary Hayes, a Senior Portfolio Manager with Bank of America (host for this Round Table Program), welcomed attendees not just from the Women's Economic Round Table (now part of Columbia School of Journalism's Knight-Bagehot Fellowship in Economics and Journalism) but also from the Financial Women's Association, the Women's Exchange and NYC LEAD for Women. She also added a warm welcome to the men in the audience, and acknowledged the vision and efforts in creating this important program by Dr. Amelia Augustus, WERT's cofounder with Maria Rolfe.

The discussion, video taped by Susan Thompson of Media Logistics, can be seen at [www.wert.org](http://www.wert.org) later this month, but some of the highlights follow below from this Round Table with Abby Joseph Cohen, Goldman Sachs' President, Global Markets Institute and Senior Investment Strategist and Sandra Pianalto, President and CEO of the Federal Reserve Bank of Cleveland. Questioners were Greg Farrell, US Business Correspondent, *Financial Times* and Mark Whitehouse, Senior Economics Correspondent, *The Wall Street Journal*.

### **Key Points from Presentations**

#### ***Abby Joseph Cohen, Goldman Sachs' President, Global Markets Institute and Senior Investment Strategist***

*(For information on GMI, go to [www2.goldmansachs.com](http://www2.goldmansachs.com) and follow links to Global Markets Institute)*

**1. Consistent signs of slow but increasing growth** with some labor improvement at the end of 2010 or early 2011

Negatively Cohen stated that:

- Currently we are in the weakest portion of growth

However, on a more positive note, she pointed out that:

- Although the recession produced a deceleration in economic activity (GDP down from 3.7% to 1.7% GDP), corporate balance sheets are now flush with cash
- Investment in capital goods is increasing as well as 10% increase in exports and 10% increase in industrial production
- A recent survey shows that 70% of large U.S. companies are spending more, particularly on technology and business equipment
- The preconditions for improved labor situation are less gloomy. A recent report documents increases in number of hours worked and in overtime hours in some

key industries. After a certain point, employees cannot work more hours and companies need to hire

- These are signs of confidence, but not enough to encourage hiring.
- Double dip recession not expected because:
  - although unemployment at 9.6% is high, governments around the world are not tightening policy, and
  - there has been consistent growth, although slow, for several months

## **2. Current Proposals and Strategies in Response to the unusual patterns of this recession have not been tested so must be monitored carefully**

Cohen noted that:

- Usually as a recession ends, there is more vigorous economic activity at the start of recovery because of investments, fiscal/monetary stimulus, and increased consumption, then later deceleration
- But today, the unusually low starting point (1.7% GDP) is not fast enough to address 9.6% unemployment
- Also, consumption is not keeping pace
- The effects of the stimulus are now fading
- State and local governments are under severe financial duress
- Although policy makers are developing short term strategies for returning to growth, they must also seriously analyze structural causes and needed restructuring:

## ***Sandra Pianalto, President and CEO of the Federal Reserve Bank of Cleveland***

### **1. The Federal Reserve's objectives are to achieve maximum employment and manage price stability, with a goal for inflation around 2%**

- Recovery is slow because the recession resulted from a financial crisis; it takes time for consumers and businesses to rebuild lost wealth and recalibrate balance sheet
- Today consumers are saving more and reducing debt, but many are hurting. Many businesses are also still suffering
- Although in some industries, profit numbers are returning to normal and we have a positive GDP and the economy is growing now, it is not enough to lower unemployment. During 2010, companies will be slow to add jobs. Inflation will remain at low levels
- Fed Funds rates are essentially zero right now. Inflation rates are too low. The Fed has bought one trillion in long term securities. Mortgage rates and U.S. Treasury securities are too low.

**2. Given the low levels, the Fed's options for promoting price stability are uncharted.**

- Because unconventional policy tools are being used, the Fed is continuously monitoring their effectiveness in order to respond to evolving developments
- In this deepest recession since the Great Depression, the economic recovery is slow, growth is weak, unemployment high, inflation too low and economy is far from full potential
- For two years, there was an unusual degree of cooperation between other Central Banks with leadership from the U.S. Federal Reserve, and among Finance Ministers around the world who followed a coordinated, harmonized strategies, even if not exactly the same and despite political risks
- Partly because of Bernanke's study of the worst decisions during Great Depression at Princeton, the Fed was able to avoid the poor economic policies and destructive competitive economic policies between nations during the late 1920s/30s

## **Key Points from Panelists' Cross-Questioning and Round Table Discussion**

1. Sandra Pianalto asked Abby Joseph Cohen to grade the Fed's policy actions:

- Cohen gave the Fed an A+ for doing an extraordinarily excellent job up to the credit crisis and after, based on the data that was available to policy makers
- Cohen pointed out that it is easy to forget how close to the precipice we were and how frightening it was when the economy was ready to seize up and resulting
  - Loss of trust in banks and counterparties
  - Inability of corporations to borrow and transact with each other

2. Moderator **Rachel Beck, National Business Columnist with the *Associated Press***, asked how policy makers can climb out of a situation where so many (possibly one in six) Americans are receiving some kind of government assistance:

- Abby Joseph Cohen responded that many also have no health insurance
- She emphasized how important it is for policy makers to segment strategies for dealing with the immediate problems from the credit crisis from long term structural changes to prevent a recurrence. She pointed out that before the crisis, median income had declined by 5% - and a worse decline of 8% among low income groups (relative to inflation).
- Cohen also added that research studies over the last 75 years reveal the top two unchanging factors that drive growth rate and income levels:
  - educational levels
  - rate of innovation

This started a discussion between Cohen and Pinalto about where we are today in these two areas. Key points covered:

### **Educational Levels**

1. The U.S. has one of the strongest, highest quality university systems in the world, but young people cannot or do not make use of it
2. Seventy-five years ago, Ohio was the 7th largest state in terms of growth and income. Today, it ranks as 39th among states whose adults have college educations - and much lower in income level and growth
3. Currently:
  - Percentage of young adults with a college education peaked 10-12 years ago, particularly for men. Women today make up 53-54% of university students
  - Young men who could previously skip higher education and go straight from high school to relatively high paying construction or manufacturing jobs face a contracting job market. Unemployment for men is 2% higher than for women.
  - One of every five men, 25-54 years, is currently unemployed; that has never happened in the U.S.
  - Duration of unemployment has reached a record of about 30 weeks
  - Out of 30 industrialized nations, U.S. high school scores in math rank 25th and in science the rank is 21st, an unacceptably low ranking

### **Innovation Rate** (measured by number of patents per capita)

- Currently the U.S. ranks #1 in the world in terms of innovation, a key driver of economic growth and the standard of living, but this may change in the future if other nations invest more in education and Research & Development
- 79% of PhDs in Engineering and hard Science are not U.S. citizens
- U.S. Immigration policies are less welcoming and encourage graduates of U.S. universities to leave the country upon graduation, taking their education and skills with them - despite the fact that these are the people who will develop the patents
- Other countries are investing much more money in R&D and encouraging their citizens who graduate from U.S. universities to return to their home countries

### **Other issues brought up Panel Respondents**

Respondent **Greg Farrell, US Business Correspondent, *Financial Times*** asked if the main goal now is to reduce unemployment and create a safety net for Americans, how important is the budget deficit that is frightening so many people in this election year?

**Sandra Pianalto** pointed out that:

- Short term: Fiscal stimulus is important, based on lessons from the Great Depression and financial crises in other countries. We must be aggressive, and not remove the stimulus too quickly
- Long term: Larger looming budget deficits in the future are a concern
- Congress needs to plan to address social security, medicare and medicaid longer term while including stimulus in the short term

**Abby Joseph Cohen** who commented that a wise economist said that “the right medicine at the wrong time is the wrong medicine,” stated that:

- This is not the time to be concerned about balancing deficits or achieving a surplus. Right now we need stimulus
- Challenge: the federal government can borrow into the future, but state and local governments cannot. This is producing high stress.
- In state and local attempts to balance their budgets, funding for community colleges and state university systems is being reduced or eliminated.
- Historically during recessions, community colleges provided crucial services to adults who needed education, training and retraining for new types of skills. Today, community colleges do not have the budget to expand and deliver needed support for the unemployed, laid off and underemployed who would only be able to afford tuition at community colleges
- Higher education, currently 9-10% of GDP, may decline to 7% in near future

**Greg Farrell** then asked about regional and local bank lending to the small businesses that will drive job growth - or lack of it:

**Sandra Pianalto**

- Important because in the early phases of recovery, most job growth comes from small businesses. For example, if demand increases a 15-employee business may need to hire quickly in response while a large business has more resources and may not need to expand labor right away
- In the current environment, bank lending to small businesses is down. The Fed has been meeting with small businesses and banks throughout the country. Small business owners need credit; bankers say they want to lend but say they cannot find credit-worthy borrowers
- Reasons for the bankers’ view is most small business lending is based on collateral (often the owner’s home or 401k) but that collateral has

depreciated by 30% or more. The banks cannot renew the loan on the same basis if the value of the collateral has plunged.

- The Fed is working with the banks to balance their needs and make sure examiners are not overzealous

### **Abby Joseph Cohen**

- One sign of less gloom: a Fed survey of senior lending officers at banks shows that there is less tightening month by month than there has been since 2007
- In 2007, demand from borrowers diminished. The July Fed survey showed there is more demand now

The second respondent, **Mark Whitehouse, Senior Economics Correspondent, *The Wall Street Journal***, asked what single policy would they recommend to support economic recovery and reduce unemployment, for example, breaks in the payroll or investment tax or an extension of the Bush tax cuts.

**Abby Joseph Cohen** responded - after saying she could not choose only one solution because a mix of strategies is needed:

- To reduce the budget deficit, we must stimulate the economy because growth reduces the need for counter-cyclical measures and corporate tax revenue increases
- In addition to stimulus programs, another strategy under consideration includes the use of tax credits for corporate investment. This was tried before with mixed reviews. Effectiveness depends on timing. It might have been more effective 18-20 months ago
- The target is to stimulate those sectors that lead to industry growth and structural change. For example, innovations in clean energy, climate mitigation, and enhanced education

As part of the Federal Reserve, **Sandra Pianalto** stated that she can only comment on monetary policy, not fiscal policy. Her comments on monetary policy:

- Looking long term at all programs, some options are to lower interest rate on excess reserve and make further purchases of longer term assets
- In the past, we could lower the Fed Funds rate, but it's close to zero so we need other, unconventional tools, but must constantly assess their impact, cost/benefit, and effectiveness before deciding which tools to use

**Mark Whitehouse** also asked what kind of systemic changes are needed to prevent banks from creating the same kind of crisis in the future - how to balance concerns for

safety with the cost of lost economic dynamism and to what extent might an increase in capital requirements to 15% be optimal and outweigh the costs -- and would 30% be too high?

**Sandra Pianalto:**

- Congress' financial reform bill has steps to respond to the crisis with more capital standards, ways to close the regulatory and supervisory gaps with the oversight council and eliminating "too big to fail"
- The rules should be customized, not set up the same standards across the entire banking industry. Larger firms may need tough standards while community banks may need different rules to protect their dynamism

**Abby Joseph Cohen:**

- This is the most important policy question - it involves not just rule writing, but also issues outside the U.S.
- One major cause of the September 2008 crisis was concern about the financial health of counter-parties and intermediaries
- The danger may lie in the quality of banks outside the U.S.
- If capital requirements are raised for financial institutions, companies can count on those institutions and liquidity will strengthen
- Some large banks are already implementing higher capital requirement, some as high as 30%. Many are well-capitalized now

Audience members then joined in the Round Table discussion...

**Dr. Lawrence Parks, Executive Director, Foundation for the Advancement of Monetary Education ("FAME"):** What if analysts at the Fed have made a mistake - what options and contingency plans does the Fed have? For example, if inflation increases to 12-15% (another member of the Round Table, Chris Olsen, added "What if there's a failed market, bonds go out of control - any out-of-the-box strategies?" Risks of deflation were not discussed)

**Sandra Pianalto:**

- The Fed's mandate from Congress is to achieve price stability and maximum employment
- Currently inflation is too low, unemployment too high. We need to focus on achieving price stability and increased employment

**Eleanor Haas, Managing Director, The Calyx Group** had two main questions for the panel to address:

- 1) Why use patents per capita as the only way to measure innovation and job creation?

2) If education levels drive growth and employment/income levels, shouldn't we focus on primary and secondary education where schools are failing, not on number of college graduates?

**Abby Joseph Cohen:**

- Patents are just one measure. Money spent in R&D also drives GDP. Spending on innovation is at a low 2% in the U.S. while East Asia invests 4-5%
- Important to look at R&D spending and where it is taking place around the world because that is an indicator of future job creation abroad
- The world is changing. We cannot use the same data points we used in the past... but we can only use the data we have
- The U.S., by many measures, is the world's primary innovator. But we must look closely at which nations are accelerating investments in education, providing tax credits, encouraging citizens who graduate from the U.S. to return with their skills to their countries

**Sandra Pianalto:**

- The patent statistics are only one measure. Educational levels are also important. Those math and science rankings of 25 and 21 out of 30 were high school not college
- James Heckman, an economist at the University of Chicago has shown that the greatest return on any public investment is in early childhood learning because the brain has the highest development from birth to three years old
- Business and the public need to come together to invest more in early childhood development as well as in struggling and broken school systems