ALICE M. RIVLIN

Sustaining the Good Economic News

THE REMARKABLE PERFORMANCE OF THE U.S. economy in the late 1990s—the simultaneity of strong growth, low unemployment, and quiescent inflation—has everyone asking "How long can the good news last?" Are we enjoying some brief moment of serendipity when the economic stars happen to be aligned? Or is there something we can do to keep the strong performance going?

The past couple of years have been a convincing demonstration of the benefits of supertight labor markets. When workers are scarce, those with less skill and experience get a chance to show what they can do. They acquire skills and work histories that they would never have had if unemployment were higher and employers could be more choosy. Workers at all levels get opportunities to move to better jobs, obtain more training, and switch to new careers or other parts of the country with less risk of winding up jobless. With the unemployment rate below 5 percent for more than two years, welfare rolls have plummeted and those with the least skill and education have finally begun to see their incomes rising.

Alice M. Rivlin, a senior fellow in the Brookings Economic Studies program, recently resigned as vice chairman of the Federal Reserve Board.

More remarkably, recent experience has called into question the usual assumption of economists that tight labor markets are bad for productivity growth because they force employers to scrape the bottom of the proverbial barrel and make do with employees with less skill, experience, or attachment to the labor force. Under current conditions of fierce global and domestic price competition and rapid technological change, the scarcity of workers may actually be forcing employers to use workers more intelligently, to reorganize their workplaces, substitute machines (especially computers) for people, enhance worker skills and responsibility, and end up with more productive operations.

Recent experience has also reminded us that low inflation enhances the ability of businesses, individuals, and governments to plan ahead. Low inflation means lower interest rates and favors long-term investment. Moreover, because inflationary expectations tend to be self-fulfilling, low inflation makes it easier to have more low inflation.

The pleasant surprise of recent years is that the U.S. economy has proved far less inflation prone than most economist thought it would be at such low unemployment rates.

Some of the reasons reflect the current state of the world and are likely to be temporary. The high value of the dollar has made imports cheap and put strong downward pressure on the prices of domestic products that compete with imports. The deep recession that followed the fiscal crises in Asia, Latin America, and Russia has kept commodity prices low. As the world recovers, Americans are likely to find imports, including commodities, more expensive and their own price level rising more rapidly as a result.

Other anti-inflation forces are likely to prove more lasting. Technology continues to shrink the significance of distance and the cost of information. Price competition in product markets will only get more and more fierce as customers learn to use the internet to get the best deal in ever-widening markets. Deregulation and freer movement of products, capital, and even labor are almost sure to keep putting downward pressure on prices, here and abroad.

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But at least part of the answer to the question how long can we keep labor markets tight without rekindling inflation is up to us. Smart policies can improve the chances that we can continue to benefit from both low unemployment and low inflation. What can we do?

For openers, we can keep running a substantial surplus in the federal budget and retire a significant portion of the national debt. Reducing the national debt will put downward pressure on interest rates and foster the long-term investment that we so urgently need to have a more productive economy as our population ages. This is certainly an inopportune time for a major tax cut—whatever one's beliefs about the desirable size of government. A big tax cut would only make an already hot economy run hotter and make it more likely that the Federal Reserve would raise interest rates to ward off future inflation. The Fed has so far been quite restrained about raising rates in the face of record low unemployment rates. But why make their job harder and risk combining tighter monetary and looser fiscal policy to the detriment of future growth?

State and local governments also have a chance to act prudently as strong revenues roll into their treasuries from the vibrant economy. They can build up their rainy day funds, retire debt, and invest in needed infrastructure.

But it is a mistake to think that only governments make economic policy. The combined actions of many different kinds of economic actors will be needed to maximize the chances of keeping the good news flowing. Workers and potential workers can acquire more skills and education at all levels. They can take the risk of moving to better jobs or starting new businesses. Companies can focus on cutting costs and increasing productivity: they can foster research and innovation; they can offer training and employee incentives to acquire more skill and education. Colleges and universities, community colleges, and technical institutes can offer courses at times and in places convenient for workers and "nontraditional" students. Communities large and small can diversify their economic bases, upgrade and modernize their school systems, and welcome new kinds of workers and companies.

There is no guarantee that the good news will keep flowing—it's unlikely that the business cycle has disappeared forever. But there are plenty of actions that, taken together, will increase the probability that the economic outlook stays positive most of the time. ■

Correction

In "The Birth of the Euro" (Summer 1999, page 27), Robert Solomon wrote, "Neither the ECB nor the Federal Reserve Board undertakes market transactions directly." Although that has been correct so far, the European Central Bank, in contrast to the Federal Reserve Board, has the power and the facilities to buy and sell financial instruments in markets and with financial institutions.

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