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IS THIS THE HEALTHIEST ECONOMY IN THREE DECADES?

HEARING

before the

JOINT ECONOMIC COMMITTEE CONGRESS OF THE UNITED STATES

ONE HUNDRED FOURTH CONGRESS

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IS THIS THE HEALTHIEST ECONOMY IN THREE DECADES?

Friday, March 22, 1996

CONGRESS OF THE UNITED STATES,
JOINT ECONOMIC COMMITTEE,
WASHINGTON, D.C.

The Committee met at 10:05 a.m. in Room 106 of the Dirksen Senate Office Building, the Honorable Connie Mack, Chairman of the Committee, presiding.

Present: Senators Mack, Bennett, Bingaman, Sarbanes, Robb; Representatives Maloney, Hinchey, Ewing, Thornberry, Sanford, Quinn and Manzullo.

Staff Present: Missy Cortese, Donald Evans, Chad Stone, Lisa Baumgartner, Jeff Given, Robert Cresanti, Bob Hardos, Brian Wesbury, Roni M. Singleton, William Spriggs, Jim Datri, Stacey Gavin, Ross Lindholm, Creighton Lynes, Paul Merski, Lee Price, Bill Buechner, Robert Mottice, Myndii Saalfield, Greg Williams, and Shelley Hymes.

OPENING STATEMENT OF SENATOR CONNIE MACK, CHAIRMAN

Senator Mack. Welcome to the hearing of the Joint Economic Committee. We will have brief opening comments from the Chair and other Members. Then I think you have about a 10 minute opening statement which we'll be glad to hear.

So, again, welcome.

Four years ago, candidate Bill Clinton was running for Office, telling Americans he felt our pain. He also told us we were mired in the worst economy in 50 years, and that the only issue that really mattered was "the economy stupid", and I guess that's a phrase we've all heard over and over again.

Here we are in 1996, and the economy is still a problem. Yet, in his State of the Union Address, this past January, President Clinton claimed that today's economy is, quote, "the healthiest in three decades", end quote.

Frankly, I don't know how he came to that conclusion, and that's part of what we're going to be discussing this morning.

And certainly some recent statistics suggest that the economy may be improving a bit. But the people I'm hearing from and reading about are telling a very different story.

A CNN/*USA Today* Gallup Poll taken last weekend showed that 66 percent of Americans think the state of the economy is only fair or poor.

Only half that many people believe the economy's either in excellent or good condition.

On top of that, only 36 percent of those surveyed are satisfied with how things are going in the country, compared with 61 percent who believe the country is heading in the wrong direction.

All this is right in line with a January *U.S. News and World Report* Poll in which nearly 70 percent of Americans said the economy's either stagnant, in a recession, or even in a depression, while only 22 percent said the economy is doing well.

And I grant you those are not economic statistics, but they are a reflection of what people in the country are expressing with respect to their beliefs and their attitudes and their perceptions of what is happening in the economy.

Hardworking Americans are deeply skeptical and they are right to be. They feel like no matter what they do, they simply can't keep up.

And people in Florida tell me America's economy has to do better, and people in Kansas and California are echoing the same sentiment.

Even the Clinton Administration Secretary of Labor admits this growing problem, repeatedly referring to an anxious class who feel they are being left behind. Still, the President says we are in the middle of the healthiest economy in three decades, and something clearly is wrong.

A major cause of that anxiety is that middle class incomes have stagnated during President Clinton's term.

Look at 1995's economic growth of 1.4 percent and the 1.9 percent projected for this year. That kind of growth is just too weak to boost incomes in any meaningful way.

So Americans have been forced to work longer and harder with little, if anything, to show for it.

And after having already increased taxes, spending and regulation, President Clinton wants to increase Government interference in the economy even more.

An economy just plugging along, too slow to create high paying and stable jobs is simply unacceptable. We can and must do better. We in Congress have passed a balanced budget, tried to restrain the growth of

Government spending, scaled back onerous regulation, and cut taxes for working Americans.

But President Clinton has vetoed our efforts at every turn, without providing the economy with a clear vision of his own.

One day the President blames the Federal Reserve for slow growth, and the next he's telling everyone that he's created the best economy in 30 years.

In 1992, with the economy growing at 3.7 percent, President Clinton said we were in the worst economy in 50 years.

Now with real growth at only 1.4 percent, he says the economy is healthy.

It's difficult to reconcile those messages.

We owe the American people some straight answers.

And Dr. Stiglitz, I'm glad that you're here to help us clear up those discrepancies.

[The prepared statement of Senator Mack and accompanying charts appear in the Submissions for the Record.]

OPENING STATEMENT OF SENATOR JEFF BINGAMAN

Senator Bingaman. Thanks for holding this hearing.

Let me first just welcome the two House Members who are here, Carolyn Maloney from New York, and Maurice Hinchey from New York.

Thank you very much for participating.

Of course, Senator Robb is a regular stalwart which we appreciate.

Let me also welcome our guest, our witness, Dr. Stiglitz. He's a very distinguished economist and head of the Council of Economic Advisers.

I do think we have a very interesting issue and one that we need to understand better.

I know this hearing was billed as a question about whether the economy is giving its best performance in 30 years.

I think there are really two issues.

One is the overall economic situation, and secondly how working families in the country are doing in that situation.

I do believe that the overall economy is strong, and I think there are a great many indicators to point to, and I'm sure Dr. Stiglitz can go through that for us and will.

At the same time, I do think there are millions of American working families that are scrambling to pay the bills each month, that are not sharing adequately in the growth that is occurring in our economy, and that is a concern.

I know it's a concern for this Administration, it's a concern that we've had with us for about two decades, as I understand it, or a little more than two decades, and one that we need to find some ways to deal with.

I personally of course, am in disagreement I believe with you, Mr. Chairman, in that I don't think the total solution is to just rail against Government.

I think that there are other solutions that we need to pursue and seriously consider. And I hope that Dr. Stiglitz can discuss some of those possible solutions because I don't think that this should be just a political issue, where I think that it's a circumstance that has existed in our economy for over two decades now. It's a result of a great many changes, and it causes us, I think, to rethink not only our governmental policies but our relations with financial markets, our relations with the business, the corporate community as well.

I hope we can get into some of that, and again I appreciate you having the hearing. I think it's an extremely important subject for a lot of the people we represent.

[The prepared statement of Senator Bingaman appears in the Submissions for the Record.]

Senator Mack. Thank you.

Representative Ewing?

OPENING STATEMENT OF REPRESENTATIVE THOMAS EWING

Representative Ewing. Thank you, Mr. Chairman. And excuse my tardiness. We had a conference on the other side of the Capitol and I was in that meeting.

I would just say very shortly, I'm pleased to be here. I think the business of this commission to look into how healthy our economy is and the types of jobs that we're creating is there's nothing more basic with the people we represent than to do what we can, either by getting government out of their lives, or through government actions, to see that our economy stays healthy, that we have good jobs for American working men and women. That will make our country the strongest that it can be.

And I just am glad to be here and look forward to the testimony.

Senator Mack. Thank you.

Senator Robb?

OPENING STATEMENT OF SENATOR CHARLES ROBB

Senator Robb. Thank you, Mr. Chairman.

I too commend you for having these hearings. I think the topic is certainly timely and important. There's room for honest difference of opinion.

With respect to some of the answers to those questions, I suspect Dr. Stiglitz will be able to help enlighten the Committee.

And in your opening remarks, you made reference to some public opinion polls and if the true economic indicators, as viewed objectively, paint a little different picture, it might suggest that we haven't been as effective in communicating exactly what the implications of what is happening to the public as we might be.

So we might take a look back in terms of what we say, in terms of how the public perceives whether or not we're making some progress in this area, and some of the challenges that face us.

But in any event, it should be opportunity for a lively exchange, and hopefully a little learning on the part of everyone concerned, and I thank Dr. Stiglitz and the others who are going to appear this morning.

And I thank you for calling the hearing.

Senator Mack. Representative Maloney, welcome. We are delighted to have you at the Committee this morning.

OPENING STATEMENT OF REPRESENTATIVE CAROLYN MALONEY

Representative Maloney. Thank you very much, Mr. Chairman.

It is a special honor to attend my inaugural hearing as a member of the Joint Economic Committee, and to sit on a Committee where Members are not just from different and both political parties but also from both Houses of Congress.

I'm also very pleased to be joined on the Committee with my colleague, Maurice Hinchey, who is also my very good friend.

Mr. Chairman, we may disagree on what makes good economic policy, but we can all agree it's important to take stock of where we are and what we can do to improve the lives of working Americans.

Our nation's economy is a strong one. Since President Clinton took office, the deficit has been cut nearly in half to $160 billion. And that responsible deficit reduction has helped keep interest rates stable and low.

We have the lowest combined rates of inflation and unemployment in 27 years. Unemployment stands at 5.5 percent. Over seven million new jobs have been created, and business investments are up over 18 percent annually.

And with this strong economy, inflation is just 2.6 percent, the lowest since President Kennedy was in office.

These are not just numbers, they are a strong string of accomplishments that improve the lives of American families.

Millions have been able to purchase their first home because of the low mortgage rates, and many others have saved money through refinancing. Low interest rates have helped spur a needed boom in new business incorporations, the largest boom since World War II.

But there is much more that needs to be done. Even though many more Americans have jobs than when the President took office, many of these workers still face continued job insecurity, especially with the downsizing that's taking place.

And in many American families, two workers are in the job market trying to maintain the same standard of living their parents supported on one wage.

This is unfortunately a long-term trend that began long before President Clinton took office, but there are ways we can provide new opportunity and security for American workers.

Health care coverage should be portable and pre-existing condition exclusions should be eliminated. Americans should know that they won't lose their health insurance if they change their job.

That's why I've co-sponsored a bill offered by a very distinguished Member of this panel, Senator Kennedy.

For those just trying to get in on the ground floor, we need to make work pay. We need to raise the minimum wage because $4.25 is no longer a liveable wage. If people are willing to work, they should have an income they can live on.

That's why I've co-sponsored legislation to raise the minimum wage by 90 cents. For the same reasons, we need to preserve the earned-income tax credit because it encourages work and encourages families to move from welfare to work.

Most of all, we really need to save the course with responsible deficit reduction that maintains critical investments in research, our infrastructure, our children, and our schools.

The American public are responding to President Clinton because there is a lot to be pleased about.

But there is truly a great deal more that we can do and that we must do. The very worst thing we could do is lose the ground we've gained. That could happen if we go back to the policy that brought us to the stagnant economy of 1992.

Thank you very much, Mr. Chairman. And again, it's an honor to be a member of this Committee.

Senator Mack. Thank you very much.

Representative Hinchey?

OPENING STATEMENT OF REPRESENTATIVE MAURICE HINCHEY

Representative Hinchey. Well thank you very much, Mr. Chairman.

I want to say that I very much appreciate the opportunity to serve on this Committee with you as Chairman, and I look forward to the work that the Committee is going to be engaged in over the months ahead.

And I very much appreciate your calling this hearing which I think is a very important subject which needs to be dealt with, and I think that this Committee can provide some of the intellectual input to the Congress that it needs to deal with some of the important questions that you're raising in the context of this hearing.

I also want to welcome Dr. Stiglitz, and I look forward to the insight and expertise that you bring to this hearing, as the President's chief adviser on the state of the economy.

The subject of the hearing is whether this is the healthiest economy in three decades, a subject the President spoke about quite eloquently in his State of the Union Address.

In many ways, this is the healthiest economy that we have seen in some time, and the Administration should receive, I believe, high marks for its role in moving us toward four years of respectable growth, low inflation, and lower unemployment.

National unemployment is currently at a rate of 5.5 percent. The inflation rate remains below 3 percent. The stock market reached a new market high this week, and we are experiencing growth in the economy at a time when many predicted a national recession.

Under the President's economic plan that Congress enacted three years ago, the budget deficit has been cut almost in half from $290 billion in 1992 to $162 billion today.

And it is now smaller as a share of the economy than any major industrial country in the world.

Although the economy has slowed in recent months, I believe this can be attributed more to the restrictive policies of the Federal Reserve Board, which has largely ignored its full employment mandate by doubling short-term interest rates since February of 1994.

Although the broad economy is faring quite well, the rising tide obviously is not lifting all boats equally.

There are a great many people in this economy who are being left behind, and who look at the increase in the stock market only with some form of wonder and amazement as to how this could occur while they are not doing well in their own personal lives and their own economic circumstances.

Whether it is the erosion of wages, the rising cost of health care, or a flurry of corporate downsizing, the people are feeling anxious about this economy.

In my District, large corporate employers have laid off thousands, thousands of highly skilled workers in recent years, and unemployment has risen quite significantly due to the lack of job opportunities available to middle-income people.

A recent study by an economist at Princeton University exposed one of the issues that is at the heart of the American people's current anxiety, and that is the bleakness caused by widespread corporate layoffs.

According to the study, the rate of job displacement during the past recession, which was generally viewed as mild, exceeded even that of the deepest recession in recent memory, which occurred in 1981.

Additionally, for the first time in our nation's history, the layoffs were directed at middle-income people, white-collar workers and middle managers, a segment of our labor force that has been traditionally viewed as secure in their jobs.

The study also found that one in four displaced workers could not find a new job after being laid off. Of those who do find work, they earn significantly less and only one in four actually wound up working only part-time.

It is the issue of economic anxiety that is gripping the middle class and which I believe this Congress must take steps to address.

Senators Bingaman and Kennedy, much to their credit, have also put forth comprehensive economic proposals that would encourage businesses to pay high wages, provide good benefits, and take steps to avoid layoffs of their workforce.

So I look forward to working closely with the other Members of this Committee on these issues in the weeks and months ahead, and I welcome you, Mr. Stiglitz, and I look forward to hearing your remarks.

Senator Mack. Representative Thornberry?

OPENING STATEMENT OF REPRESENTATIVE MAC THORNBERRY

Representative Thornberry. Thank you, Mr. Chairman.

I too commend you for holding this hearing. I think there are some very important questions that need to be addressed.

Whatever the numbers show, the folks in my neck of the woods are not feeling more prosperous. In fact, they feel as though they are working harder and harder, and having a tough time keeping up.

So I think there are some important questions that need to be asked about what's going on, but it also will help give us the clues to -- I think maybe on -- what additional action we need to take.

So I look forward to the questions and the answers.

Thank you, sir.

Senator Mack. Dr. Stiglitz.

PANEL I

STATEMENT OF JOSEPH E. STIGLITZ, CHAIRMAN, COUNCIL OF ECONOMIC ADVISERS

Dr. Stiglitz. Thank you, Mr. Chairman.

I think the introductions have framed the issues that I hope to address.

It is a pleasure to appear before the Joint Economic Committee today.

My testimony this morning will focus on the performance of the U.S. economy over the past three years, and put it in the context of the economy's performance over the past three decades.

From a variety of perspectives, our economic performance over the past three years has exceeded expectations.

In the 1970s and 1980s, our economy faced high inflation, high unemployment, and soaring budget deficits.

Today, inflation and unemployment are low. Job growth has been strong. The American economy has added 8.4 million jobs over the past three years, 93 percent of which are in the private sector.

We have also sharply reduced the deficit from $290 billion in fiscal year 1992 to $164 billion in fiscal year 1995.

Senator Mack. Let me ask you again, bend that microphone down a little closer to you. There you go.

Dr. Stiglitz. Okay.

And if you saw the newspaper this morning, the numbers for 1996 look even better. The Federal Budget deficit is down to about $145 billion.

The Budget submitted by the President on this past Tuesday would eliminate the deficit by 2002 using CBO's economic assumptions.

To be sure, we still face many challenges, some of which I will discuss later. But in many ways, our economy is healthier and the fundamentals are stronger than they have been since the 1960s.

First let me talk about inflation and unemployment.

The first chart shows that inflation, the inflation rate, as measured by the Consumer Price Index (CPI), has been lower over the past three years than at any three-year period since 1967.

The second figure shows the monthly unemployment rate which is hovering around its lowest level in almost six years.

Perhaps the most striking current feature of the economy is the combination of these two events. Even at our low unemployment rate, inflation remains subdued.

And this is illustrated in the third chart where the rate -- the so-call "Misery Index" -- of unemployment is combined with the inflation rate. This combined rate is at the lowest level since 1968. And that number provides perhaps the single best statistic summarizing why it is that we say that the economic performance today is the best it's been in terms of these macroeconomic indicators in three decades.

Senator Mack. So again, that's the primary point upon which the President's made --

Dr. Stiglitz. That's the macroeconomic indicator which is the single characteristic of the economy, and which provides the underpinnings for some of the things I'm going to be talking about a little later.

I want to stress the importance of achieving low unemployment with low inflation.

Excessive unemployment is a waste of our most valuable resource, the human capital embodied in American workers. It is also devastating for the individuals involved and their families.

For the young, unemployment prevents the accumulation of work experience and impedes an attachment to the work force with deleterious effects, even years later.

For more settled families, unemployment can mean losing a home or asking one's children to forego a college education.

In sum, unemployment imposes tremendous costs on the affected workers and their families. Our standard of living is undoubtedly higher if we can sustain a low level of unemployment without inducing inflationary pressures.

Let me now talk about deficit reduction.

The next major macroeconomic indicator I want to examine is the budget deficit. Regardless of how it is measured, in dollar terms, in real terms, or as a percentage of GDP, the deficit soared in the 1980s.

And the next three charts show those numbers in terms of dollars, in real dollars adjusted for inflation, and as a percentage of GDP.

Since the Administration took office, however, the deficit has fallen dramatically, from 4.9 percent of GDP in fiscal year 1992 to 2.3 percent in fiscal year 1995.

And as the next chart shows, the debt/GDP ratio which measures the accumulation of past deficits relative to current output fell from 82 percent in 1950 to 27 percent in 1980. This is a pattern that's very common after a war.

During wars, like World War II, money is borrowed to finance that war and the debt/GDP ratio goes way up, and after the war, the debt is worked down.

That pattern was reversed in 1980. The debt/GDP rate climbed dramatically throughout the 1980s and reached 50 percent in 1992. But as the chart also shows, the debt/GDP ratio has at last stabilized since passage of the Omnibus Budget Reconciliation Act (OBRA) ‘93.

Another way of viewing our remarkable progress on the deficit is to examine what's called the primary budget deficit. The budget balance that would have been had we not inherited any government debt. So it's equivalent to talking about the operating surplus.

The primary budget is now in surplus. In other words, if net interest payments are excluded, the Federal Government is running a surplus.

Let me now turn to some other indicators of the U.S. economy's underlying strength.

Exports are up 31 percent over the past three years, providing about one-third of the cumulative growth in real GDP. This rapid export growth is testimony to both the competitiveness of American firms and the success of Administration efforts in opening markets abroad.

We have signed numerous trade agreements, including 20 with Japan. Our exports have succeeded in becoming more competitive. The results are impressive.

The United States is now the world's leader in automobile production for the first time since the 1970s. And we are the world's largest exporter, with 13 percent of the world export market compared to 8 percent for Japan and 9 percent for Germany.

Exports are not the only sector experiencing a boom. Investment in physical capital is also. We experienced double-digit equipment investment in 1993, 1994, and 1995.

This rapid investment growth was at least partly the result of our deficit reduction efforts, which should help to promote increased productivity in the future.

To be sure, not every category of investment is at an all time record. In the early 1980s, commercial real estate enjoyed an artificial boom, spurred by distortional tax provisions. For example, depreciation allowances far larger than true economic depreciation. This artificial expansion could not and did not last.

And it contributed, in no small measure, to the savings and loan debacle which in turn was a driving force in the economic recession of

1991, and which cost the American taxpayers over $150 billion to resolve.

Let me put that number in perspective. It is approximately equal to the proposed seven-year savings in both Medicaid and welfare under the Republican proposal to balance the budget.

Let me talk for a minute about our performance relative to the other major countries, Japan and Germany.

The healthy state of the U.S. economy is highlighted by comparisons with Japan and Germany. Over the past three years, the United States. has grown twice as fast as Germany and five times as fast as Japan.

Employment in the United States has risen by over 2 percent per year, whereas it has stagnated in Japan and actually declined in Germany.

Japan faces serious problems in the banking sector and Germany has a significant unemployment problem.

Furthermore, as Figure 8 shows, our budget deficit is a smaller share of GDP than either Japan or Germany or in fact any of the other G-7s. Relative to other industrialized economies, the U.S. economy appears remarkably dynamic.

There are other indicators of progress that I want to mention very briefly. Before moving on to discuss some of the challenges we face, I want to take a broader look at living standards relative to 1960.

In that year, the civilian unemployment rate averaged 5.5 percent, precisely its current level. However, along a variety of dimensions, our quality of life has improved dramatically since then.

For example, infant mortality has fallen from 26 per thousand live births to eight per thousand live births.

The elderly poverty rate, in those days before Medicare and the expansion of social security, hovered around 30 percent. It is now below 12 percent.

The overall poverty rate has fallen from 22 percent in 1960 to 14.5 percent in 1994. The percentage of the population age 25 and over with a college degree was 8.4 percent in 1960, and it is now almost three times that amount, 22 percent.

Life expectancy at birth was 69.7 years in 1960. It has now risen to over 75 years.

Despite the encouraging economic and social indicators that I have described, America still faces several important challenges. The two most important are raising productivity growth and ensuring that all Americans have the opportunity to participate fully in the success of our economy.

In manufacturing, annual productivity growth has averaged a robust 3.5 percent since the first quarter of 1993. But for the economy as a whole, productivity growth continues at the same place as in the '70s and '80s, which is slower than in the '50s and '60s.

Most economists date the beginning of the productivity slowdown to the early 1970s, and there appears to be no simple, agreed-upon explanation.

The next figure, Figure 9, shows the historical record over a relatively long period of time in which the period immediately surrounding World War II appears as an historical aberration.

Could it be that the unique events of the 1930s and '40s inducted this aberration.

The heavy investment by the government in research during the War, from innovations in airplanes to developments in the nuclear industry, paid dividends to the economy in the years after the War.

Another factor explaining the slowdown in measured productivity growth may be shifts in the sectoral composition of output.

Most economists believe that there are serious problems in the measurement of productivity in services. And the service sector is clearly becoming an increasingly important part of the economy.

Any downward bias in measured productivity growth from services therefore implies an increasingly large downward bias in aggregate productivity growth over time.

But both of these explanations -- that productivity growth is abnormally high in the immediate post-War period, and that measured productivity is increasingly biased downward -- still leave us wondering why productivity decelerated so abruptly in the early 1970s. Why then?

Measurement problems arise not only with respect to productivity, they also complicate analysis of real wage trends. Typically, real wages are calculated by dividing nominal wages by consumption prices.

But the choice of deflator is crucial. For example, as the next figure shows, the real product wage, nominal wages deflated by the nonfarm business GDP deflator, has increased much more rapidly than the conventionally -- real consumption wage which is defined as the nominal wage as deflated by the consumption deflator.

The point of this chart is not to gloss over the wage issue. Indeed, real wages tend to track productivity over long periods of time and therefore the slower pace of productivity growth since the early 1970s would be expected to manifest itself in a slower pace of real wage growth.

While the chart reminds us that we must be very careful in deciding how to measure the real wage, it also reminds us that productivity growth remains relatively slow. This is a crucial challenge for American workers and policymakers.

Raising productivity growth requires productivity enhancing policies: investments in education, research and technology; deficit reduction done the right way, that is, deficit reduction that preserves investments; and finally, a strategy for raising productivity in the public sector by reforming, streamlining, and where necessary, eliminating government programs and regulations.

The Administration's strategy for raising productivity growth include all of these elements. But we are realistic about the immediate impact of such policies.

The problems that have been allowed to fester for two decades cannot be rectified overnight.

A second major challenge is enhancing opportunity for all Americans. The disparity in incomes between high school graduates who do not go on to college, and those who complete college has widened sharply over the past 15 years.

The next figure shows that in 1979, mean earnings for a male college graduate were 49 percent higher than mean earnings for a male high school graduate.

By 1993, this ratio had widened to 89 percent. In other words, our high technology economy has been putting an increasing premium on skills.

Those at the bottom of the income distribution have actually seen their real incomes fall, with a turning point again in the 1970s. Between 1950 and 1979, mean family income for the bottom quintile of the population rose 141 percent in real terms.

Between 1979 and 1993, that same portion of the population experienced a 15 percent real income decline.

Again, we can't expect these long-term trends to be reversed overnight, and it is too soon to tell for sure but there may be some initial encouraging signs.

For example, in 1994, the most recent year for which we have data, the poverty rate fell and real median family income rose by 2.3 percent for the first time in five years.

Before moving on, let me stress that we should not become complacent, even with such initial signs of progress.

Now is not the time to be cutting back on policies that share the benefits of growth more widely.

It is not the time to reduce the EITC, to cut back on education and training, or to decimate crucial social safety net programs.

I want to stress the importance of education and training.

Senator Mack. Dr. Stiglitz?

Dr. Stiglitz. Yes?

Senator Mack. If I could just interrupt for a second. You've been going now for some 12 minutes or so. I know you've got a time restraint, apparently.

It's been indicated to me that you have to leave here at 11 a.m.?

Dr. Stiglitz. I can stay until 11:15.

Senator Mack. All right. Well then if I could get you to wrap up so we could get into some dialogue with you.

Dr. Stiglitz. Okay, fine.

Let me move on to talk about two labor market issues because they are, I think, the source of a lot of the concern.

The two issues are the quality of jobs being created and the reduced sense of economic security felt by many American workers.

The data suggest that a disproportionate number of the new jobs being created are in the service sector, which conjures up images of hamburger flippers. But the service sector embraces far more than that. It includes the dynamic financial sector, many high technology sectors, such as computer programming, and a host of other high-paying industries.

If we break down industries more finely, the data show that more than half of all the jobs created in 1995 were in high paying industries, those whose wages were above the employment weighted media in 1993.

And the other way of classifying jobs by occupational categories also indicates that it's the higher paid categories that have grown most rapidly.

Another aspect of job quality is whether the position is full-time or part-time. There is no evidence of disproportionate increase in part-time work from the payroll survey data.

A simple calculation using data from that survey suggests that the economy created about seven million full-time equivalent jobs between January 1993 and December 1995, the vast majority of the increase in the number of jobs during that time period.

To be sure, some people prefer to work part-time. The question is therefore whether those who would prefer to work full-time are denied the opportunity to do so.

We find no empirical evidence for such hypothesis.

According to data from the Bureau of Labor Statistics' Household Survey, part-time employment for economic reasons has actually fallen slightly since January 1994.

Now let me turn to the issue of job security.

Many Americans are feeling less secure. Unfortunately, we do not have the data to make meaningful comparisons between the economy of the 1950s and '60s, and that of today. But we can analyze what has happened over the past 15 years.

There is no strong trend in the overall displacement rate since the early 1980s. But the characteristics of displaced workers have changed somewhat.

Displacement rates for older, better educated and white-collar workers have risen, although they still remain low relative to those for younger, less educated and blue-collar workers.

Job displacement rates in manufacturing have actually fallen, although they remain higher than in services.

I want to stress that when we say the economy has created more than eight million new jobs, that is a net figure. The gross job creation is far greater. We have created jobs for new labor market entrants, and we have created jobs to replace those lost in declining industries.

In addition, we have created enough new jobs to bring the unemployment rate down from over 7 percent in 1992 to 5.5 percent today.

As I have said, the overall performance of the economy has been impressive, but we recognize that this is not particularly comforting to an individual who is dislocated. Dislocated workers do face significant economic losses.

Although experiences vary widely, workers displaced from a full-time job who are re-employed in another full-time job, suffer, on average, a 10 percent decline in real earnings. And although these costs are little different today than they were 10 years ago, The Administration wants to make job transitions less painful.

Easing the adjustment costs associated with the dynamic economy has therefore been another focus of this Administration's policies. Studies show, for instance, that more educated workers experience fewer difficulties in transitions between jobs, providing an additional motivation for boosting investments in education.

And since we have an employment base system of health insurance, one of the real anxieties that Americans face when they lose a job is the loss of health insurance. Portable health insurance, as embodied in the bipartisan Kennedy-Kassebaum bill, would be a significant improvement over the current situation.

We also need to provide health insurance as a component of unemployment insurance as we proposed, once again, in the budget released on Tuesday.

Other elements of the budget are intended to improve the efficiency of the labor market, for example, by making other benefits, especially pensions, more secure and more portable.

Mr. Chairman, let me conclude by noting that this is the 50th anniversary of your Committee and of the Council of Economic Advisers, both of which were established by the Employment Act of 1946.

We should recall the circumstances and anxieties that motivated the passage of that Act.

In 1929, the economy went into the worst depression that it ever experienced with one of every four workers unemployed. It was not until World War II that the economy fully recovered.

As the War ended, there was great concern that economic performance would revert to the dismal experience of the pre-War years.

The Employment Act committed us to pursuing policies to promote maximum employment production and purchasing power.

I would like to think that the guidance provided by your Committee and our Council to the Legislative and Executive Branches has contributed in some small measure to the economic successes of the intervening 50 years.

From our perspective, the combination of low unemployment and low inflation, which has alluded us now for almost three decades, is at last within our grasp.

Thank you, and I would welcome any questions.

[The prepared statement of Dr. Stiglitz and accompanying charts appear in the Submissions for the Record.]

Senator Mack. Thank you for your testimony this morning, and I take those last comments as a plug for keeping both our organizations going.

Is that a fair assessment?

Dr. Stiglitz. Well, it was an accurate description, I think.

Senator Mack. I want to go back to I guess what is really the heart of the discussion here this morning, and that is the issue about the fundamentals.

You stated in your testimony, and I think you have in other places, that the fundamentals are better now than they were in the last three decades.

I think at other times you've said in comparison to the 1980s.

What I find a little interesting, though, is the use of the "misery index" as being kind of the fundamental, the basis upon which to make that decision or that statement.

I would have thought that the Administration would have chosen incomes as the basis of the determination about the strength of the economy or the fundamentals in the economy. If incomes are not rising, it's very hard, and I suggest it's probably the reason for the statistical data that I gave earlier about people's attitudes about the economy. I suggest that's probably where it's coming from.

I'm wondering what you are forecasting with respect to income growth as far as individuals are concerned, median family income, for example. I think you used that figure for 1994 indicating it was the first year where there was positive growth out of the last five years.

Again, I'm a little bit surprised, given Secretary Reich's focus, at least for a period of time, on this anxiety that he has identified out there, and given some of the focus that there has been on downsizing, layoffs and so forth, I'm a little bit surprised that the Administration hasn't put more emphasis on the cause for this anxiety, number one.

And the second point that I would make, and then I'll give you a chance to respond to the income question, I'm reminded, in this discussion here this morning, frankly, of discussions that took place in '91 and '92 during the Bush Administration when the Secretary of the Treasury was before various Committees of the Congress explaining the strength of the economy then, when people in the country were saying, you know, I hear what you all are saying up there and the statistical data that you are using to comfort each other. But back home, where the folks are at work, the message is, you know, not very strong, not very good, a weak economy.

So on one hand, I'm -- I mean, I understand the situation, because in 1991 and '92, the Republicans were trying to make the case that we had a very strong economy. The economy frankly was in trouble.

And I have a feeling that this Administration finds itself in the same position wanting to talk about the strength of the economy, but at the same time knowing that people back home say that job security is no longer there, a husband, a wife, a family member has lost a job, or a wage earner has not received a pay increase in the last two or three years.

So there's a lot of angst out there. And so again, I'm a little bit surprised that you all haven't placed more emphasis on income.

Dr. Stiglitz. Okay. Well I did mention this, and this is a chart that does show that median family income had been falling very dramatically from about 1989 down to 1994. But since '94, you see that it's upturned slightly.

It's still not up to where it used to be, and we would obviously like to see real median family income rise more.

The Administration is concerned about how you go about increasing real median family income.

And the main way of doing that is to increase economic growth.

Now how do you go about doing that?

Well, the first point I emphasized in my testimony was that --

Senator Mack. Can I break in for just a quick comment?

Dr. Stiglitz. Yes.

Senator Mack. It would imply then from both those comments that you made, that in 1994 there was an increase in real family income, real median family income. In '95 I think there was --

Dr. Stiglitz. The data's not here yet.

Senator Mack. That's right. The point would be that if we had a 1.4 percent growth in 1995, I suspect then we're going to see probably at least a stagnation and probably a decline then in real median income.

Dr. Stiglitz. There was real growth in 1995.

Senator Mack. No, I understand that.

Dr. Stiglitz. And there was real growth per capita.

Senator Mack. I thought you just told me that the figures weren't in yet on real?

Dr. Stiglitz. No, we don't have the median family income.

Senator Mack. That's my point, which is different.

Dr. Stiglitz. Yes.

But if you're trying to make a guess on the basis of where real GDP is going, it's a little too early to say and I don't want to forecast what the numbers are going to come out to be, but --

Senator Mack. Let me try for the sake of -- I don't want to overdo this, but 1995 real GDP was 1.4 percent?

Dr. Stiglitz. In 1995 real GDP went up 1.4 percent, yes.

Senator Mack. And all I'm saying is that if we're connecting --

Dr. Stiglitz. That's fourth quarter to fourth quarter.

Senator Mack. -- if we're connecting growth to growth in incomes, all I was suggesting is hat that may be an indicator that real median family income for 1995 at best may be stagnant and may be falling.

That's all I was suggesting.

Dr. Stiglitz. Yes, and what I'm saying is that the increases in productivity growth have continued going at basically the pace of 1.1 percent, which, as I said before real product wages tend to track real productivity and so that overall trend and unemployment rate has continued to remain at a very low level, so I think it would be premature to try to say what's happening exactly to real median family income.

I should make one other comment on this before we get too negative a view of what's going on. And this is a point I think that, and the written testimony I saw from Chairman Boskin that you'll be getting later, is there are some problems with the price deflator that probably make these numbers a little bit lower than they otherwise would be.

Senator Mack. Very good.

Senator Bingaman?

Senator Bingaman. Thank you, Mr. Chairman.

Let me just start by putting up a chart -- that is one I took from a book Jeffrey Madrick came out with just recently called the "End of Affluence", I think is the name of his book.

And he has tried to summarize in this chart what I think is reasonably accurate, and I'd ask you if it is, but the point being that if you take a long perspective, the historical perspective for the last 120 years at least, from 1870 until 1973, he indicates that there was a 3.4 percent growth rate in the economy over that 100-year period.

When you look at the last 20 years, from '73 to '93, and that's the only period he carries it through, the growth rate is 2.3 percent.

And he then argues from -- I'll paraphrase what I understand him to be arguing -- that that lessened growth rate in the last 20 years is a substantial part of the reason we have the deficit that we've got, a substantial part of a lot of the economic difficulty that some individual families face.

I guess I would ask a couple of questions from that. First of all, do you agree with his basic statement about what did happen historically, what has happened historically.

And secondly, are there some policies that you believe will change this, or are we into a period of our history where it's not changeable for a variety of reasons?

I think, you know, there's a tendency always to say what's happened in the last year or two, and let's put a political spin on that and try to make some points.

I think it's more important to try and look at this problem that has existed, as I understand it, for a couple of decades.

Dr. Stiglitz. Let me begin by answering the second question, because I think that's the more fundamental question: the question of what we can do about the current rate of increase of productivity. And the answer, I think, is a set of policies that are mainly focused on investments: investments in people and education, investments in technology, and investments in physical capital.

And the way you increase investment in physical capital is to increase national savings, and the most direct way we have of doing that is reducing the deficit.

So if you'll look at the kinds of policies that we've been working on enacting in the last three years, it's been exactly addressing those issues: education, technology, deficit reduction.

Senator Bingaman. Let me put up one other chart, just since I know my time's going to run out here.

This is a chart that we got this information from the Economic Policy Institute here in Washington. And it tries to show the number of workers, or the percentage of the work force that have changed employers at least four times during the decade. And it takes the 1970s and shows that a little over 10 percent of all workers changed employers four times, and then it says the 1980s that went up to over 20 percent, indicating a fairly substantial increase in the turbulence in the labor market.

Do you agree that that's occurred? And if so, what can be done to deal with it?

Dr. Stiglitz. Again, I think the focus ought to be how do you address the issue of greater mobility in the economy, and I think one important ingredient of that is increasing portability of benefits, like increasing portability of health insurance, the Kennedy-Kassebaum bill.

Increasing portability of --

Senator Bingaman. But that's a way to react to the problem. I'm asking is there a way to reduce the extent of the problem rather than react to it?

Dr. Stiglitz. Let me say that my own feeling is that for a dynamic economy, you are always going to have change. We are creating export industries. As I said earlier, exports have grown by 31 percent.

And, export industries are our strongest sectors. They pay above-average wages, wages that are 13 to 15 percent larger. We want these sectors to grow. So we want growth.

Senator Bingaman. So you don't think we should be trying to reduce the extent of the job change that takes place; instead we should be equipping people to deal with that?

Dr. Stiglitz. Exactly. I think we should be ensuring access to education and making sure that workers have the tools they need to cope with transactions.

Senator Bingaman. Thank you, Mr. Chairman.

Senator Mack. Representative Ewing?

Representative Ewing. Thank you, Mr. Chairman.

I think in your testimony, Doctor, you refer to the 1970s, trends starting in the 1970s several times.

Is there a particular reason that the 1970s was the beginning of some of these negative trends?

What reasons do you attribute to that?

Dr. Stiglitz. Well, this is an issue on which there's a lot of disagreement among economists. The data speaks fairly clearly that this was the time of the break.

Some people give the oil price shock in 1973 as the explanation. Some people, explain the high rates of productivity growth in the '50s and '60s, by pointing to the innovations that had not been put in place in the '30s and '40s and innovations that occurred as part of World War II. In the '50s and '60s that backlog was worked off, and all of a sudden there was no more backlog to work off, and that would be translated into slower productivity growth.

And it may have been the oil price shock of '73 crystallized something that would have happened eventually anyway.

Representative Ewing. The second question. I thought in your testimony, as I was listening or following along, you talked about the job growth and that a lot of it was in the service industry?

Dr. Stiglitz. Yes.

Representative Ewing. Which isn't necessarily all at McDonald's but in many other facets.

On Chart 12, is that showing me something different?

Dr. Stiglitz. Yes. Chart 12 shows another classification.

There are two ways that jobs are classified. One is by industry, the other is by occupation within that industry, such as managerial and professional, or blue-collar jobs.

The upper categories, like managerial and professional, are higher paid. And what that chart shows is that a disproportionate share of the job growth has been in the higher paid categories.

So it reinforces the view that the jobs being created are, on average, above-average jobs.

Representative Ewing. When did the figures for that chart -- what period of time are we looking at?

Dr. Stiglitz. January '94 to February '96.

Representative Ewing. Is that a marked difference from the period before, as far as the creation of jobs and the classification, or did we just reclassify them?

Dr. Stiglitz. Well, the data that I've seen that are a comparable basis, show that job quality did increase significantly in '95, the new jobs relative to what it had been in '94, and that was better than '93, and that was better than '92.

So there has been a successive increase in job quality over time on the basis of these preliminary data that we've been looking at.

Representative Ewing. And for what reason?

Dr. Stiglitz. Well, part of it is what I said before. Export sectors are growing. Those are strong sectors of growth. One-third of our increase in GDP is related to exports.

That increase in exports is primarily in higher wage sectors because those are our economy's competitive strength sectors. And so you would expect to see, if that's the growing part of our economy where we're creating new jobs, you'd expect to see higher quality jobs being created.

Representative Ewing. And are those trends that create those results? Often times they don't happen abruptly.

Dr. Stiglitz. No, as I say, it's been gradual. Every year has been a little bit better than the previous year.

Representative Ewing. Thank you.

Senator Mack. Representative Maloney?

Representative Maloney. No questions.

Senator Mack. Representative Hinchey?

Representative Hinchey. Yes. Mr. Stiglitz, I'm fascinated by the fact that in 1973, something very substantial occurred which apparently remains a mystery to policymakers and economists alike, but which nevertheless was a very dramatic watershed in the history of the American economy, and which caused it to change in a direction contrary to which it had been flowing for the previous several decades.

Since the end of the Second World War to about 1973, this economy had been growing steadily and healthily and strongly, as was indicated in the chart that Senator Bingaman put up just a few moments ago.

Then in 1973, something substantial happened.

You suggested a few moments ago that some people attribute that to the spike in energy prices which occurred as a result of OPEC and their activities in '73 and then again in 1979.

That seems to me to explain economic conditions that occurred at those moments and during that period of time. But I do not believe that they adequately explain the continuing deceleration in growth rate as opposed to that which we had experienced prior to 1973.

So I don't think we can hang all of this blame on increase in energy prices. I think we've adjusted pretty much to those increases in energy prices, and we're moving along fairly well in this new condition of increased energy prices.

Something different occurred.

It seems to me that it might be this, that during that period of time, we had conditions of relatively low interest rates, and significant investment on the part of the public sector in the economy.

Now initially, that public sector investment was circumscribed around the Second World War. But after then it was the Eisenhower initiative on the interstate highway system, it was the creation of the G.I. Bill of Rights, it was the investment of the Eisenhower Administration in education as a result of Sputnik.

And there continued to be significant investments on the part of the public sector in the economy. That continued and even accelerated during the 1960s with the Great Society Program of Lyndon Johnson.

Then in 1973, in the Nixon Administration, that all began to change. And it seems to me that a large part of our problem is associated with the fact that we are no longer investing in ourselves in the way that we did prior to the early 1970s. We're not investing in our infrastructure, basic infrastructure, current infrastructure needs. We're not investing in anticipated infrastructure needs, such things as highspeed rail, for example, and things of that nature. We're not investing in education. We're not investing significantly in research and development.

The whole computer industry developed out of a need that was expressed by the United States military in the context of the Second World War to IBM and from that need, that expressed need by the military, flowed an enormous industry which stimulated growth throughout the post-World War period and continues to stimulate growth to some extent.

I would just ask you to reflect upon that analysis for a moment, if you would.

Dr. Stiglitz. Yes. Well I very strongly agree with you that a critical part of any program to try to increase economic growth has to be to increase and sustain at least the levels of investment in the public sector in infrastructure, in technology, and in education.

The importance of this is illustrated by one small investment: the Internet, which has now become a central part of many people's lives. It was started by a relatively small investment by the Federal Government.

But to put these investments in context it is important to note that these are not new ideas. The whole telecommunications sector, in some sense, can be dated back to Samuel Morse. And the first investment in that area was from Baltimore to Washington, the telegraph line, and that was supported by the Federal Government.

Federal Government invesments in technology have historically played a very important role.

I also think your analysis of the question -- I was very tentative about talking about oil prices -- is I agree with you because in 1986 oil prices went down, and if that were the core explanation, that would have had the reverse effect. So that's only part of the, clearly at most, part of the story.

Representative Hinchey. But in your answer earlier you cited a need for investment, you cited three things. Need for investment, education, and research and development, I think.

Dr. Stiglitz. Research and technology.

Representative Hinchey. And getting the deficit down.

Dr. Stiglitz. Yes. I would have mentioned infrastructure too, if I had more time. But, getting the deficit down is important because it lowers interest rates, and lowering interest rates is what leads to more private investment.

And so that deficit reduction is a key part of the strategy.

Representative Hinchey. Mr. Chairman, if I may just make one last final point?

Senator Mack. Sure.

Representative Hinchey. And that is, if I remember the figures correctly, the deficit now or the national debt now is about 55 or so percent of GDP.

Dr. Stiglitz. A little lower than that, yes.

Representative Hinchey. Fifty-six, 60 percent.

Dr. Stiglitz. It's down now to about 51 percent.

Representative Hinchey. Fifty-one percent of the GDP.

At the end of the Second World War, it was 120 percent of GDP.

Don't you think we're too heavily fixated on this budget deficit problem at the moment? If we're really interested in growing this economy, ought we not be paying attention to things other than the budget deficit in this kind of fixated way in which we have at the moment?

Dr. Stiglitz. Well, let me say it was very important to get the deficit down because if we hadn't done that, the debt GDP ratio would have continued to soar.

If you saw that graph that I gave earlier, you saw it increasing year after year, and that would have placed heavier and heavier burdens on the Treasury.

As taxpayers, we'd have to be paying more and more interest, so it was just crucial to stop that ever-mounting ratio of debt to GDP.

Senator Mack. Representative Thornberry?

Representative Thornberry. Thank you, Mr. Chairman.

Doctor, I want to ask you about something that I did not hear in your oral testimony or see a chart on, but I think may be a factor in explaining why the macroeconomic statistics may not exactly be consistent with what people are feeling out there, and that is level of taxation.

My understanding is the typical family of four is now paying about 38.2 percent of its income in taxes, something like 26 percent to the Federal Government, 11 percent in state and local taxes.

And while I'm sure you saw a recent poll that showed across all races, across all income levels, most Americans think it ought to be closer to 25 percent.

My first question is, what is your opinion on what is the optimum level of total taxation that a typical family ought to bear.

And my second question is, do you agree that at some point, it becomes rational for workers to stop working and either get on the government system or as is happening increasingly, I understand, bypass the tax system altogether?

Because I've had a number of folks from the IRS discuss with me the compliance problem which they are experiencing.

Is that not part of the problem?

And I would like to know what you think the proper level is, and at some point, don't we really run into problems?

Dr. Stiglitz. First, to look at some of the statistics, the median, the average combined tax rate for the median family income, median income, family with median income is now 24.46, which is lower than it was in 1991 and 1992.

Secondly, in assessing the impact of these tax numbers, one has to be very careful.

We have now put social security, or are in the process of putting social security, on an actuarial basis where what individuals get back is related to what they pay.

The kinds of disincentive effects that one used to worry about, do not occur if an individual is putting money away as if it were into a savings account and getting it back.

So you can't look at payroll taxes in quite the same way that you look at other forms of taxes.

I think the issue, to a large extent is, what are people getting for the taxes that they pay. And that's why it's critical to make sure that the government and the public sector is as efficient as it can be, and that it delivers on the services that it promises.

But I think if you ask people would they want to give up on their protection of health, safety, environment in return for a very small reduction of taxes, and the answer is no. Those tax dollars are well-spent.

Representative Thornberry. Is it your testimony then that the total taxation for a median family, including state and local taxes, is 24 percent, rather than 38 percent?

Dr. Stiglitz. I think the numbers I was giving were for the Federal level. And the state and local varies greatly from one state and one locality to another.

And in those cases, quite often it depends on what services again are being provided.

Representative Thornberry. Well, we're going to be pretty close then. If you're at about 24 and my numbers show about 26, and you add state and local, on average that adds 11 or 12 percent to it, is my understanding.

But I just want to clarify it, so basically your position is it's not too much of a concern how much money government takes out of people's pockets if government just does enough good stuff for them?

Dr. Stiglitz. Well, obviously we would like to have low taxes, but there's also a lot of services that are very, very valuable.

We talked a few minutes ago about some investments in education, how important they are. You have to pay for those. So you have to balance the costs and the benefits.

Representative Thornberry. Thank you, Mr. Chairman.

I think the difference comes down to who can best make those investments, whether it's the family in education or whether it's the Federal Government.

I thank you for the time.

Senator Mack. Senator Sarbanes?

OPENING STATEMENT OF SENATOR PAUL SARBANES

Senator Sarbanes. Well, first of all, I want to say a word about the 50th Anniversary of the Council of Economic Advisers and of the Joint Economic Committee, as we mark the enactment of the Employment Act of 1946.

I happen to think that the Council, over those 50 years, has done a very distinguished job, and as you look down the list of Council members, and indeed, I dare say, if I were to go and look down the list of staff, but you have a list of the Council members in your annual report, it's really a "Who's Who of American Economists?"

There's some notables that are not on it. Neither Paul Samuelson nor Milton Friedman ever went on the Council, but leaving that to one side, we've had some very distinguished people, a great number of distinguished people.

Now I say that because there's a chart I want to just talk about for a moment. This is the movement in real GDP, beginning in 1890 and running up well, to 1990, but if we ran it out, it would show the same thing.

And the thing that's absolutely striking about this chart is how in the post-World War II period, since the Employment Act of 1946, we've markedly reduced the fluctuations in GDP and essentially have kept them positive with just a couple of times when we dipped into negative growth.

Now I don't think that's just by happenstance. And so I think that the Council and this Committee and the policymakers deserve some credit for the use of fiscal and monetary policy over this period that has given us this economic performance compared with that one.

And I wonder if you have any comment about that?

Dr. Stiglitz. Well, I agree very strongly. I think we have made a difference. Economic policy has made a difference.

And you know, we talk now, we worry about slowdown in the economy. Those negatives that show in your chart are real disasters for the economy, and we've basically stopped those.

Senator Sarbanes. That's right.

I mean, this is the Depression and we went to, you know, minus 15 percent in terms of negative GDP growth.

Now let me ask this question. When was the inflation rate, it's now at 2.6 percent?

Dr. Stiglitz. Yes.

Senator Sarbanes. When was it last that low for a year?

I know the figure I'm using is a monthly figure now, but when were we last that low?

Dr. Stiglitz. Well, about six years ago, we had a small period of time in which it was that low. But if you look before that small period, then you have to go back a long time before that to get another period of sustained low inflation.

Senator Sarbanes. Well now, do you have your report there with you?

Dr. Stiglitz. Yes.

Senator Sarbanes. We all carry it around with us, right?

(Laughter.)

Dr. Stiglitz. And you'll notice the cover is gold for our 50th Anniversary.

Senator Sarbanes. I noticed.

Page 348, the CPI all items...1995 is 2.5, working back, 2.7, 2.7, 2.9, '92, 3.1, '90 was 6.1. Then if you run it on back, except for that fluke year in '86 at 1.1, which I think was essentially tied to energy, as I recall, except for that fluke year, you have to go all the way back to 1965 to find an inflation figure below 3.0.

Isn't that correct?

Dr. Stiglitz. That's right.

And you were right. The 1986 number was very much a fluke.

Senator Sarbanes. Now let me very quickly -- because my time is running, on the employment figure, unemployment rate, if you go to page 316, we're now at 5.5 percent, correct?

Dr. Stiglitz. That's right.

Senator Sarbanes. Now if I run that back, we were below that in 1989 at 5.3, but if I keep running on back, I have to go all the way back to 1973 at 4.9 to get below it.

Is that right?

Dr. Stiglitz. That's right.

Senator Sarbanes. So with one exception, we've got the lowest unemployment rate now since 1973, correct?

Dr. Stiglitz. That's right.

Senator Sarbanes. That's 23 years ago.

And we have the lowest inflation rate, again with one exception, since 1965.

Dr. Stiglitz. That's right.

Senator Sarbanes. Mr. Chairman, I think that's a pretty good performance. The lowest inflation rate in 30 years with one exception, and the lowest unemployment rate in 22 years with one exception.

Now I'd be happy to engage in the debate over the income's policy at any point, but I don't think it comes with a lot of strength for those who want to limit the earned-income tax credit, don't want to consider the minimum wage, in some instances want to drop full employment as a goal, to come forward here as the bearers of the banner with respect to income's policy.

Senator Mack. Senator Bennett?

OPENING STATEMENT OF SENATOR ROBERT BENNETT

Senator Bennett. Five minutes being as short as it is, I will run through a number of issues as quickly as I can, and if you want to respond in writing, Dr. Stiglitz, I'd appreciate your response. But I don't think we have time for an extended dialogue here on all of these issues.

First, what happened in the 1970s? What was the key event that caused all this to change? The clear answer is, nobody knows.

Let me put on the table, however, just for consideration, the fact that that was the time when America took its currency off its tie to gold. Richard Nixon closed the gold window in the early 1970s. Economists said, at that point, the price of gold would drop from $35 an ounce to zero, because there was no logical reason for anybody to buy gold, and the price of gold is now $400 an ounce. The economists were wrong, and something may have had something to do with the fact that we no longer had a stable currency, at least tied to a particular commodity.

I'd just raise that as one issue. You can debate it with Dr. Greenspan.

The second question, investing in education. I hear that all the time. It was education that got me back into public life when I was made chairman of the Strategic Planning Commission on Education for the Utah State Board of Education.

I didn't realize this was going to be the cry that we have heard here. If I had, I'd have brought the chart from Ben Wattenberg's book, "Values Matter Most", in which he shows a line starting from this end of the chart going down to the other end of the chart on reading scores and educational accomplishment, and a line starting at the bottom of the chart, and going straight up the other direction on expenditures in education.

We must understand that spending money on education willy nilly without changing the educational system is not going to do us a lick of good.

And one of our colleagues facetiously, and he's known for his facetious but trenchant comments, Pat Moynihan, said if you take this and attribute a direct cause and effect relationship, it is clear the more you spend on education, the lower you drive the test scores. He was making a significant point. That we miss the point when we say throwing money at a problem automatically solves it.

Senator Sarbanes. Is the reverse of that true? The less you spend, the higher the test scores go?

Senator Bennett. If it means that there's less government in it, the answer is yes.

(Laughter.)

Senator Bennett. I'll be happy to debate that with you at some other time.

Now I'm fascinated by your comment about taxation because of my first experience as a Member of this Committee. We had Dr. Laura D'Andrea Tyson here, the newly-appointed chair of the Council of Economic Advisers, and she made the statement at my first appearance of this Committee, that one of the problems we were facing in this economy was that compared to other industrial societies, we were significantly under-taxed.

And I asked her that time, when you say that, do you include in your figures state and local taxes?

She gave me kind of a blank look and she said, "Well, no, Senator, we're only dealing with Federal taxes."

And I said, "Coming as recently as I have from the private sector, I can tell you that people have to pay state and local taxes whether they're included in your calculations or not. Would you please make those calculations and tell me whether or not you still think we are seriously under-taxed with respect to other countries when you include the tax burden of state and local taxes."

She said she would. She has not.

And in view of the exchange that just took place here where you took, as your figure, 25 percent roughly, the Congressman had as his figure, 38 percent, I would renew the request that you would take a look at the total tax burden that citizens have to pay because in terms of the economic impact in their pocketbook and their ability to make choices, there is really no difference between state and local taxes.

And when we talk about infrastructure investments, the most massive infrastructure investments that are being made in the State of Utah are being paid by the taxpayers of the State of Utah through Utah State taxes.

And if we're going to talk about this whole thing, we've got to talk about it intelligently instead of breaking things up into categories that make the political points.

My light has gone on. I did my best to fill my whole five minutes with as provocative a stuff as I possibly could.

Thank you, Mr. Chairman.

Senator Mack. I will give Dr. Stiglitz the opportunity to respond in writing, if you want, as it was suggested. Again, I'm sensitive to your time constraints. It is now a little bit after 11:00.

Representative Maloney wants to ask a question, and then we can conclude it, but you're certainly --

Dr. Stiglitz. Let me give it one minute.

Senator Mack. Sure.

Dr. Stiglitz. It won't be a complete response, given the limited time, but talk about at least two of the issues that were raised.

First, I wouldn't want to use the word "under taxed" but I would use the phrase "comparison of the taxes." If you look at, the OECD does collect tax data about comparing the overall tax or share of government expenditure.

And the United States is one of the lowest in the world among the major industrialized countries.

Senator Bennett. Do you consider that bad?

Dr. Stiglitz. No. That's why I was very careful of the words I used. I just made a descriptive statement.

Senator Sarbanes. Now that comparison includes all taxes, does it not? Not just taxes leveled at the national level?

Dr. Stiglitz. That's right. That's what I was saying. The OECD data compares and says that relative to other industrialized countries, our overall tax burden is less.

Senator Sarbanes. That's right. But that in effect answers this assertion that state and local taxes are not being considered. That comparison includes our state and local taxes and whatever the comparable equivalent is in the other industrial countries.

Dr. Stiglitz. That's right. It has to because in different countries, there are different divisions, so the only way they can make the comparisons meaningful is to do it at the national level, to aggregate all of them together. So that's the way it's done in the standard statistics.

The second issue is on the relationship between expenditures and education and performance.

Now obviously money can be wasted in education just like it can be wasted anywhere else. The issue is if you spend money well, does it produce results.

The most striking evidence on this is an experiment that was done in Tennessee where they looked at the effect of class size, which is one of the major determinants of expenditures. If you reduce the class size, it costs more money.

The evidence was fairly clear that reducing class size does increase performance.

And, there have been other studies that have looked not at the intermediate variable which is test scores, because after all, we're not really interested in producing test scores. We want to produce people who are productive and get high wages.

If you look across, if you look at states that spend more on education, and ask are their incomes of their students later on at a higher level, the answer is yes, that it does produce results.

So I think the evidence is that spending more money does produce results.

Senator Bennett. Well, this is not the place to get into it, Mr. Chairman, but I can't resist. The State of Utah is 51st in expenditures per pupil, 51st out of the 50 states plus the District of Columbia. The District of Columbia is first.

I would suggest that the District of Columbia has something to learn from the State of Utah about how to educate its children.

The reason we are 51st, I might have to say, we happen to have the largest family size of any state, so even though our expenditures per family are maybe number three or number four among the 51 jurisdictions, by the time that gets translated down per child, it becomes the lowest per child expenditure.

The difference between Utah and the state that's number two in family size is greater than the difference between the state that's number two and number 51. We just have really big families in Utah and we spend less per child than anybody and when you look at what happens in the school system in the District of Columbia where they spend the most per child of anybody, you can't say automatically that that's a good measure. And I couldn't let that one pass.

Senator Mack. And I'm going to end that discussion and turn to Representative Maloney.

Representative Maloney. Thank you very much, Mr. Chairman.

Senator Sarbanes clarified some very important economic facts and I'd like you to clarify the facts around exports.

The Administration has repeatedly stated how pleased they are that exports are growing, yet a packet of material issued by this Committee's majority, called the *Clinton Economic Record*, makes the following claim, and I quote:

"The President took office when the world was emerging from a global recession. Our growing exports are a sign that the world economy is growing faster than the United States' economy."

But in your testimony, Dr. Stiglitz, you argued that the U.S. has grown faster than Germany and Japan.

Which is true?

Dr. Stiglitz. What I said was true.

(Laughter.)

In fact, one of the things, if I had more time to point it out, was one of the really impressive aspects of the performance of our exports in 1995 is the fact that we did so well, given that our major trading partners were doing so poorly.

Japan was having a hard time. Mexico was having a hard time. Canada was having a hard time. And our growth way out surpassed Germany. So, when you look at what was going on in the rest of the world, what we did was really impressive.

Representative Maloney. Dr. Stiglitz, I picked up this report, when I came in, from the majority staff of the review of the facts on economic policies.

And it states in 1982 to ‘89, the Reagan growth era, sharp reductions in tax rates and regulatory moderation.

Looking back at the early 1980s, did most economists think that the Reagan policies would result in huge deficits?

What was the projection?

Dr. Stiglitz. Almost all the economists predicted that when the changes went into place in 1981, that there would be marked deficits that resulted. In fact, some of President Reagan's own advisers were very strong about the importance of deficit reduction, and that he ought to address the problem.

So people expected that there would be this problem. They knew that the reduction in the tax rates would not elicit the kind of growth that had been predicted, that savings was not that interest responsive and labor supply was not that responsive, and that there would not be this burst of growth that would be so great that tax revenues would actually increase.

What happened, it's one of those cases where I don't give high marks to the economists because this was an easy one, they predicted that deficits would grow and they really did grow.

Representative Maloney. Well, we certainly did get large deficits under Ronald Reagan, but supply-siders defend his policies. They also argue that we got the largest peace time expansion in our nation's history between ‘83 and ‘89. Are the supply-siders right, that cutting taxes and reducing government regulation accounted for faster-than-average growth for ‘83 to ‘89?

Or do you have an alternative?

Dr. Stiglitz. This is one of those things that happens in partisan debates. The people try to do the dating to make their numbers look good.

If you begin your dating from the trough of the worst recession since the Great Depression, when one out of 10, more than one out of 10 people were unemployed, you can have a lot of growth potential because you're digging yourself out of a big, big hole.

If you look over a longer period of the whole Administration, you know, from the beginning to the end, and not from the bottom and then up, you see that the performance is not as impressive as it's been in the last three years.

Representative Maloney. During this Congress, which has probably been the most partisan in history, certainly on the House side, there has been a big emphasis on deregulation, both from the Administration and from the Majority in the House.

Can you draw a contrast, a distinction between the Administration's view of the role of regulation and deregulation and economic policy and that of the Republicans in Congress?

I just have to mention some of the deregulation measures that the House Republicans are proposing and some of which have passed, such as halting new standards for meat inspection, cutting EPA's enforcement budget by 50 percent, eliminating all clean drinking water state loan funds, and it goes on and on.

I'd just like to hear your comments on it.

Dr. Stiglitz. Well, I believe very strongly that regulations ought to be market-oriented. They ought to be cost effective. They ought to be evaluated to make sure that the benefits justify the costs.

One has to ask why are there regulations in the first place. And the reason is that in the absence of the regulations, we have polluted air.

I grew up in Gary, Indiana, which was a steel-making town, and before they had these regulations about air pollution, every night we had sort of an aurora borealis. The sky was all red. It was very beautiful but I'm sure it shortened my life span.

And by our house, we had a river that every once in a while caught on fire because it was so polluted. I think Americans really do care about the quality of the environment they live in, and you need regulations to do that.

Now one of the important things, is to make regulations as market-oriented as possible, like having tradeable permits so that it is done in the most efficient way.

The Telecommunications Bill is another example where we pushed very hard to change the regulatory structure of the telecommunications industry to respond to the changes that have occurred in that industry.

But at the same time, we wanted to impose safeguards so that abuses did not occur.

A couple of other initiatives that we've put on the table are pension simplification where we want to encourage small businesses to provide pensions.

This goes back to the feeling workers have that they are less secure. We need to make sure that people are able to move to another job and be able to keep their pensions. But at the same time, we don't want the pensions to be raided, and we want to make sure that the pensions are there when the people come to retire.

So you have to have regulations to make sure that when the pensions that workers have counted on are there when they come to retire.

So that there are a whole host of issues where you need to ask: what are the reasons for the insecurity and how can we help reduce this in the most effective way.

But we recognize there's some real important public purposes being served.

Senator Mack. Dr. Stiglitz, I want to thank you for your testimony this morning, and we've kept you now some 35 minutes longer than you had anticipated.

My closing comments, which I will take as the prerogative of the Chair from time to time, is that while we have been debating now for the last hour-and-a-half or so, the strength of the economy, the real decisionmakers, that is, the workers of America, are going to make their decision later this year.

And when I look at some of the other things that I think are fundamental, incomes have stagnated and I realize the comment that was made by my colleague from Maryland with respect to the concern that some of us have about wages, I would point to the period of time of 1982 to 1989, a period of time in which real incomes went up.

In fact, you referred to the last time they went up was 1989.

I think the policies of less taxing, less spending, less government, more freedom frankly do produce higher wages, and when the people of America make their decision later this year, I think that they're going to look at what has happened in the last several years.

Incomes have stagnated. Wage and benefit increases are at a 14-year low. Real final sales are slower. Real GDP has grown more slowly, and job growth has not matched the pace of previous recoveries.

So the final decision about economic policy will be made probably outside this Committee, but I appreciate your being here this morning, and I apologize to the other, to the second panel, that we have taken so long to get to you.

Thank you very much.

If the second panel would come forward.

Again, I welcome the second panel.

The first witness will be Dr. William A. Niskanen, who served on President Reagan's Council of Economic Advisers for four years before he took over his current post as Chairman of the CATO Institute here in Washington.

Dr. Alan Blinder was a member of President Clinton's original Council of Economic Advisers, before leaving to become Vice Chairman of the Board of Governors of the Federal Reserve. Dr. Blinder recently left the Fed to return to Princeton University where he's currently a professor of economics.

Dr. Murray Weidenbaum was President Reagan's first president of the Council of Economic Advisers. He's now a professor of economics at Washington University in St. Louis, Missouri, where he also serves as chairman of the University's Center for the Study of American Business.

And I now see the picture of Dr. Boskin on the television. He will be joining us via video. He was Chairman of the Council of Economic Advisers under President Bush. Dr. Boskin is currently a professor of economics and senior fellow at the Hoover Institute at Stanford University.

Thank you very much.

And I think we will begin with Dr. Niskanen.

PANEL II

STATEMENT OF WILLIAM A. NISKANEN, FORMER MEMBER, COUNCIL OF ECONOMIC ADVISERS

Dr. Niskanen. As is often the case, I have good news and bad news. The good news is obvious. The American labor market is a marvelous jobs machine. The employment rate is near an historical peak. The percent of those employed part-time for economic reasons is unusually low. The unemployment rate is about as low as in any year in the past two decades, and although job turnover has increased slightly, the median duration of unemployment is only eight weeks.

The economic insecurity theme of this year's election stories to me seems largely a creation of the press.

Certainly the inflation rate is about as low as in any year in the past three decades.

Although the stock market has been quite volatile, the major stock price indices have registered a new historical high almost every month. April will be the start of the sixth year of economic recovery and the pattern of leading indicators provides ample reason to expect the recovery to continue.

President Clinton, as with any incumbent, will take credit for the good news.

But he is more like an agile surfer on a long, smooth wave. Clinton's timing and balance are superb but he did not create the wave. But good news should not divert your attention from the several important problems of the American economy.

The one most important problem is that the average productivity growth rate has declined somewhat unevenly for about 30 years.

On a five-year moving average basis, the highest peak productivity growth rate was not '73 but was '64. So we've had a period of over 30 years now of declining average productivity growth.

Since 1979, productivity has increased at only a 1.2 percent annual rate, about half the annual rate of the prior 15 years.

My profession is not of one mind about the relative contributions to this decline in productivity growth. But the following conditions I suggest are at least partly responsible.

We've had a slow growth of human capital per worker despite an increase in real spending per student by about 30 percent a decade. The composite SAT score peaked in 1963, declined almost continuously until 1980, and then has been roughly stable since then.

Taxes have increased about five percentage points of GDP beginning with the expansion of the welfare state and the Vietnam war in the late 1960s.

The costs of regulation and litigation have increased sharply beginning in the early 1970s. And the net national saving rate declined sharply in the 1980s reflecting a combination of both a sharp decline in the private savings rate and a sharp increase in the Federal deficit.

The private sector has been able to maintain a somewhat higher investment rate only by a substantial increase in borrowing abroad.

The first major problem, the slow growth in productivity, has led to a correspondingly slow growth in average real compensation. The rapid increase in non-wage compensation, mostly for social security taxes and health insurance moreover has led to some decline in average real wages.

Most male workers have experienced some decline in real wages since 1973, with the largest decline among those with the least skills. Most female workers have experienced some increase in real wages in this period, with the largest increase among those with the most skills.

Again, my profession has not sorted out the reasons for this increased variance of real wages. Some part of this development must be attributable to the rough doubling of the trade share of GDP in this period.

Skilled labor is more scarce in the world economy than in the United States, so increased trade increases the demand for our skilled labor. Unskilled labor is more plentiful in the world economy than in the United States so our unskilled labor is increasingly in competition with unskilled labor in other countries.

In general, increased trade will create problems for low-skilled workers in high wage countries.

In the United States, this has contributed to a reduction of real wages for our low-skilled workers. In Europe this has contributed to a sharp increase in unemployment.

This is an awkward conclusion for economists because reducing trade barriers clearly increases productivity and average real earnings.

The best response to this condition, however, is to focus on increasing skills, not increasing trade barriers.

Many economists have attributed this increased variance of wages to changes in technology, but I am most skeptical of this explanation.

The evidence for this effect of technology is largely anecdotal and technology is most likely to be commercially successful if it substitutes for high-priced resources, not for low-priced resources.

Another plausible explanation, I suggest, merits more attention than it's been given. My judgment is that the level of job skills at the bottom of the skill distribution has probably declined. One does not need to go far for an explanation of this; a rapidly increasing share of our young workers have grown up without a father and were very poorly served by our public school system.

The third major problem of the U.S. economy is the fiscal threat to our children. The Federal Government continues to make huge promises to the current generation that will either be broken or require a huge increase in future taxes.

The current Federal deficit is only a small part of this problem, and it is the part that is most likely to be reduced soonest.

Larger, less transparent threats to our fiscal future are the promises for future social security benefits, Medicare benefits and Federal employee retirement benefits.

Our implicit debt for these programs is many times the formal recognized Federal debt held by the public.

The sooner these other problems are addressed, the better.

You must not allow those who refuse to address these massive intergenerational transfers to claim the mantle of compassion. In fact, they are being generous with other people's money, in these cases, that of their children and that of our children.

In summary, the quality of political rhetoric would be much improved if we were all more careful about attributing credit and blame.

President Clinton did not create the major problems of the U.S. economy but he would be properly judged by what, if anything, he has done to reduce them.

Thank you.

[The prepared statement of Dr. Niskanen appears in the Submissions for the Record.]

Senator Mack. Dr. Blinder?

STATEMENT OF ALAN S. BLINDER, FORMER VICE CHAIRMAN, FEDERAL RESERVE AND FORMER MEMBER, COUNCIL OF ECONOMIC ADVISERS

Dr. Blinder. Mr. Chairman, Members of the Committee, thank you for the opportunity to testify here this morning on the health of the U.S. economy. I propose to spend just a few minutes reviewing the current cyclical situation, which is very good indeed, and then move on to the two long-run problems that have bedeviled our country for about two decades now, and they've been mentioned already: slow productivity growth and widening income inequality. There the record is not very good.

Both the CEA and the JEC, as was mentioned awhile ago, were founded 50 years ago to assist the government in its pursuit of macroeconomic stability.

Viewed from this perspective, the last few years must be viewed as a stunning success. The unemployment rate has now remained below 6 percent for 18 consecutive months. It has also been extraordinarily steady during that time. It has never risen above 5.8 nor fallen below 5.4.

Inflation has also been low and steady. The core CPI inflation rate has averaged a bit below 3 percent over the past three years, during which time the 12-month moving average never rose higher than 3.5 nor fell lower than 2.6.

When I joined the government in January 1993, I believe you could have gotten a thousand to one odds on a bet that, three years later, the unemployment rate would be below 5.5 percent and the inflation rate below 3 percent.

Yet, that is precisely where we find ourselves today. America should congratulate itself on this achievement which is the envy of the industrialized world.

How did it happen?

Well, most of the action was, as always, in the private sector. Credit American business and labor.

But government policy also played a constructive role. Traditionally, the government has been viewed as having two tools with which to pursue price stability and full employment: monetary policy and fiscal policy.

But for the last dozen years or so, the fiscal arm of stabilization policy has been paralyzed by the need to reduce the budget deficit. So monetary policy has had to carry the ball alone. And it has, very well.

However, since the 1993 Budget agreement, responsible fiscal policy has played an important supporting role. By reducing the structural budget deficit, fiscal policy has helped create more favorable conditions for monetary policy to do its work.

As you know, we now have the smallest budget deficit relative to GDP in the G-7. So if fiscal responsibility is graded on a curve, the U.S. Government has already earned an A.

But there is more to do, and almost all economists applaud the resolve in Congress and in the White House to reduce the deficit still further.

While the United States is cyclically healthy today, little has been done in recent years to address what I believe are its two lingering long-run maladies: slow productivity growth and inequalities that are too large and may or may not be still rising.

I cannot over-emphasize how important these two problems are. Productivity growth is the main source, and indeed ultimately the only source, of increases in standards of living. And democratic institutions get stretched to the limit when economic growth becomes, for the majority of the nation's citizens, a spectator sport rather than the participant sport it was meant to be.

Yet current political trends offer approximately nothing that would cure or even alleviate these problems. In fact, some recent policy proposals would even exacerbate them.

I view this as a potential tragedy in the making.

Let me start with slow productivity growth and especially the implications for real wages.

Since the recent *Economic Report of the President* (ERP) is being highlighted in this hearing, the charts in my testimony to illustrate this point come from that document.

Chart 1 -- do Members have the prepared testimony?

Yes? Thank you.

Chart 1 shows vividly what we've been speaking about for the last few moments: that the trend in productivity growth took a sharp downturn around 1973-74, and has shown no sign of improvement in recent years.

There is evidence of a snap back in the level of productivity from the recessionary lows in '91 and '92, but that's what always happens after a recession.

A salient fact is that this chart shows not one shred of evidence that the trend in productivity growth has accelerated in recent years.

The implications for real wages are depicted in Chart 2. As I walked in the room, it was exactly what Dr. Stiglitz was speaking about, so I will be able to be much briefer.

This chart shows two measures of real wages, the real product wage and the real consumption wage, which I believe he probably defined for the Committee as I was walking in.

Is that right?

So I won't bother repeating that.

Unsurprisingly, the real product wage tracks productivity almost perfectly. However, the chart shows that the story is worse when you look at the real consumption wage which has sagged relative to the real product wage.

The CEA, in doing this chart, defines the real consumption wage as labor compensation deflated by a price index of the things people buy. That, of course, is what measures increases in standards of living, not the real product wage.

Tragically, the real consumption wage has increased only about 7 percent in the last 14 years.

Now a discrepancy between these two measures of real compensation means, as a matter of arithmetic, that the buying prices of American workers have grown faster than the selling prices of American businesses.

You might ask, how could that be so?

The first thought is that it has to do with exports and imports. But when you actually look at the data, that is not the case.

Rather, the two bundles of goods and services are different. One major difference is that services bulk much larger in the consumption bundle than in the production bundle.

The second major difference is that consumers purchase few of the investment goods produced by American industry and those prices have risen very slowly or have even fallen.

So, as economists put it, the terms of trade have turned against American families.

The second long-run problem is that while average incomes and wages have grown slowly in real terms, the distributions of incomes and wages have become more and more unequal. There are many ways to show that indisputable fact.

One of these is Chart 3 in my testimony, which again comes out of the *ERP*. It shows for two historical periods the percentage gains in real family income for different income groups -- ranging from the lowest 20 percent, over on the left, to the highest 5 percent, over on the right.

Over the period from 1966 to 1979, shown by the solid black bars, the percentage gains are comparable across income groups.

But things changed dramatically in the period from 1979 to 1993, shown by the striped bars. The top 5 percent does roughly as well as it did in the first period, but all the other groups do less well, and the lower 60 percent loses absolutely.

Furthermore, there is a perfect, and a distressing, correlation between the real income gains and the position in the pecking order.

In brief, the rich got richer, but the poor got poorer. That's what I meant when I said earlier that economic growth has become a spectator sport for most Americans.

On average, the lower 80 percent of the income distribution has not participated in real income growth for something like 15 to 20 years. That, I would say, is hardly a sign of economic health.

The causes of the productivity slowdown and of the rising inequality are not entirely clear; and neither are the appropriate remedies.

In the case of productivity growth, it's useful to break the total into two parts: one part contributed by equipping workers with more capital, and then everything else -- what economists call total factor productivity.

We understand the first part pretty well and, up to a point, know what to do about it. Indeed, the prime rationale for deficit reduction both in 1993 and today is to lower real interest rates and thereby to spur private capital formation. That argument is correct.

But the productivity enhancements you can reasonably expect from deficit reduction are modest. Perhaps the simplest evidence of that is what's happened in recent years. The deficit has fallen as a share of GDP, the share of GDP devoted to business fixed investment has soared, and there has been absolutely no detectable pickup in productivity.

So what about total factor productivity?

The truth is that no economist can provide you with a reliable recipe for raising total factor productivity. I continue to emphasize, as I have for years, a wide variety of human capital investments ranging from early childhood education to industrial training.

These boringly familiar ideas hardly constitute a magic bullet, but they do have two important advantages. One is that there is real evidence that investments in education pay off.

Second, properly targeted educational investments should lower, not raise, wage differentials by education and skill.

That brings me to inequality, where I will finish.

Over the last 15 years or so, labor markets around the industrialized world -- that's not just in America -- seem to have changed in ways that disadvantage low-skilled labor relative to high-skilled labor.

The prime suspect is technological change but it's only a suspect. Put simply, it appears that the skill requirements of American jobs have grown faster than the skills of the American workforce, leading to larger wage premiums for highly educated workers.

If that is what happened, then two policy responses are suggested. The first, as Bill Niskanen said a few moments ago, is to spend more on education and training to raise the quality of the workforce.

The second is that it seems to me singularly inappropriate to weaken and to lower the social safety net just when the market is turning so ferociously against the poor.

To my way of thinking, circumstances like that increase the urgency of government policies that mitigate income inequalities. But it's precisely such programs that are under attack in Washington these days.

Thank you for listening.

[The prepared statement of Dr. Blinder appears in the Submissions for the Record.]

Senator Mack. Thank you, Dr. Blinder.

Dr. Weidenbaum.

STATEMENT OF MURRAY L. WEIDENBAUM, FORMER CHAIRMAN, COUNCIL OF ECONOMIC ADVISERS

Dr. Weidenbaum. Thank you, Mr. Chairman, Members of the Committee.

I'd like to update Charles Dickens. This may not be the worst of times but it surely is not the best of times.

It's ironic that the same folks who wouldn't admit a real economic recovery was underway in 1992 are reluctant to acknowledge that in 1996 that same recovery is now old and tired.

In fact, there was no mention of the recent or current U.S. growth rate in Dr. Stiglitz's formal testimony or in his 13 charts.

I'd like to help him by filling that gap. Let's begin with the GDP, the most comprehensive measure of the economy.

It grew a modest 2 percent last year. The prevailing forecast for 1996 by experienced forecasters is even more anemic, 1.9 percent. Even the expected inflation rate is higher at 2.3 percent.

We shouldn't forget that, in the past, the U.S. economy has experienced periods of far more rapid growth while inflation was held in check.

In 1984, GDP grew 6.8 percent, and the deflator, measuring inflation, rose 3.8.

In 1966, economic growth was 6.4, the deflator rose a modest 2.8.

Even in 1992, the year of supposedly nonexistent recovery, GDP increased by 2.1 percent and inflation 3 percent.

If 1992 was not a year to write home about, it's hard to see how '96 is sensationally better.

When we dig below the surface, we find a number of concerns, and those words are not limited to Republicans and Independents.

Robert Reich, the Secretary of Labor, as we know, has identified all sorts of deficiencies, some even real, in the economy.

And if you look again at the measures, the growth of productivity which is the key to rising living standards and international competitiveness it has dipped from 3 percent in 1992 to an average of 2 percent since then. Not all sectors of the economy are participating in the recovery that is continuing.

Real farm income, for example, is down from $40 billion in 1992 to an average of $33 billion more recently, but some things are up.

Consumer bankruptcies are setting new highs.

But, as I said at the outset, this is not the worst of times. Unemployment has been declining, so has the budget deficit. The American economy is neither going down the tubes nor is it a candidate for the "Guinness Book of World Records".

But the key point is that the economy can do better.

Let me mention something also excluded from Dr. Stiglitz's charts. The economies of Southeast Asia are booming. They're growing several times the rate of the American economy. There are parts of the world that are doing better.

By the way, looking at our own country, the sharp rebound in Southern California has offset the painful decline in defense employment there. That's a heartening indicator of our future potentials.

The rapid increases in civilian jobs in that state are not a response to public sector initiatives but to the resourcefulness of the private sector. As we look back, we should be glad that the pressures for expensive Federal defense conversion initiatives were mainly ignored.

I'd like to conclude with just a few policy prescriptions. I've submitted a detailed statement which I hope you'll put into the record, but let me be very brief.

Number one. Policymakers should take an economic equivalent of the Hippocratic oath. First, do no harm. The economy will only suffer from brave new government spending programs or tax increases or regulatory expansion. In fact, a significant amount of today's unemployment results from the phenomenon of the discouraged employer, discouraged from hiring more people by a thicket of Byzantine workplace regulations and costly mandates.

Point two. My standard advice is still pertinent. Don't just stand there, undo something. The performance of the economy will improve if Congress undoes complicated taxation and burdensome regulation, and reduces the growth of Federal spending, especially for consumption.

Such structural reforms will increase the flow of savings for new investment and encourage the creation of new and improved products and production processes.

The result will be an economy with greater productive capacity that can grow 3 percent a year or faster, and thus provide a higher level of sustained employment.

Thank you very much.

[The prepared statement of Dr. Weidenbaum appears in the Submissions for the Record.]

Senator Mack. Thank you for your testimony and I compliment you for being within the five-minute time frame. Thank you very much.

Dr. Boskin, we welcome you and look forward to your testimony.

STATEMENT OF MICHAEL J. BOSKIN, FORMER CHAIRMAN, COUNCIL OF ECONOMIC ADVISERS

Dr. Boskin. Thank you very much, Chairman Mack, Senator Sarbanes, and other distinguished members of the Committee, and thank you for accommodating my travel schedule. I was in Washington last week, and I have to be there again next week. Part of three transcontinental round trips in three weeks, which is too much, especially for my back.

So thank you for accommodating me and allowing me to appear remotely, via teleconferencing.

It's also a tribute -- I'll make a point later about changes in our data and our statistics -- to some of the quality changes that we've seen that don't get into the statistics and the Consumer Price Index (CPI). They're not able to do so.

I'd like to agree with about 80 or 90 percent of what Bill Niskanen and Murray Weidenbaum said, and about 50 or 60 percent with what Alan Blinder said, and about a quarter of what Joe Stiglitz said, perhaps not surprisingly.

Since they have focused on short-run macroeconomic conditions and the long-run productivity slowdown in growth of wages, I would just confine my remarks to brief comments on a few issues, and especially to the fact that I think some of the ways these issues are portrayed are being mis-stated because of data problems.

Clearly, the American economy is the largest and most productive in the world. It has been for many, many decades, but it does face, in my opinion, serious short- and long-run challenges.

The economy, in my opinion, is not performing up to potential.

Perhaps more importantly, we ought to be doing whatever we can to increase its potential. In my view, that potential could be improved with sounder policy.

Let me just add that even a small improvement in the economy's growth potential and performance, when compounded over a number of years, will lead to a dramatic improvement in future living standards.

Finally, we have only a modest time window, in my opinion, to begin to deal with the long-run structural budgetary problems driven by the inexorable march of demography.

If we wait, as Bill Niskanen hinted, the changes that will be required in entitlement programs will be so wrenching to the economy and/or the beneficiaries as to just dwarf the problems cited in recent debates over balancing the budget between now and 2002.

Most of my predecessors on the panel and Dr. Stiglitz separated economic performance into cyclical and long-run structural components. The current cyclical/recovery expansion from the '90- '91 recession has lasted five years, which is good.

However, compared to the average of previous post-World War II recoveries, it has only been about two-thirds as robust. It was not quite as deep as the average but it was only two-thirds as robust.

Most forecasters expect a rather anemic '96- '97 with a one-in-three to four chance of recession in those two years. Also, a majority of the National Association of Business Economists forecast worst performance if the long-run balanced budget agreement is not implemented.

So I would say, looking at our cyclical condition, we are a long way into an expansion. Unemployment is relatively low. As Bill Niskanen mentioned, the median duration of unemployment is rather modest, and inflation is low.

Relative to the chart Senator Sarbanes put up earlier, showing the improvements since the Employment Act of 1946 and the creation of a formal agency of all the panelists and of the JEC, I would say that there's one addition and one comment that I would make on it.

Starting from the end of World War II to 1980, in every post-World War II business cycle, the inflation rate went up, ratcheted up at the corresponding point in each business expansion, whether measured at the peak, the trough, or the midpoint.

Circa 1980, with double digit inflation, and I might add, a recession simultaneously, many economists and some policymakers (although, I believe, very few of the people that have appeared before you today) argued that we ought to just learn to live with double digit inflation, go ahead and index everything and live with that result.

Fortunately, that advice was not followed, and through two rounds of disinflation -- one starting in March '79 and going much further in the early '80s, and the second one in the late 1980s or early 1990s -- the Fed has engineered a remarkable disinflation. Certainly, these have been correlative costs but far fewer costs than had been anticipated by those who urged us to go ahead and live with inflation.

So I think that's unambiguously good news. I think the center of gravity of professional opinion has moved away from the notion that we can juice the economy with monetary policy, get unemployment down, and pay for it very little and only temporarily.

That is no longer the prevailing wisdom in economics, and I think now most economists would say that stable, low inflation is an important input into sustaining long-term growth I would say that's a very big success.

I would agree with Senator Sarbanes that the amplitude of economic fluctuations has been considerably less in the last half century, and we should take some pride in that.

On the other hand, we should not be complacent.

What I'd like to talk about in the remaining couple of minutes, is the negative side of the ledger. In addition to low inflation and job growth and a flexible dynamic economy -- and the United States is by far the most flexible and dynamic industrial economy -- there are some negative things on the ledger.

The slowdown in productivity growth I see beginning to turn around in the private business data. Our own data, I think, are not quite keeping up with it.

I believe that the slowdown in the growth of standards of living is exactly that: a slowdown, not a decline. I believe they are overstated because, as the Commission I chair for the Senate on the Consumer

Price Index has indicated, and almost all professional economists agree, changes in the CPI dramatically overstate the true change in the cost of living for the typical worker.

I'd also say that among the problems confronting the American economy, the largest is getting the productivity rate up in order to get standards of living up. There, the one thing we know for sure as an important contributor to getting that productivity growth rate up would be to reverse the decline in the rates of saving and investment in the United States.

As mentioned earlier, about half the decline in saving is due to the decline in private saving and half -- over the last couple of decades -- to a rise in public budget deficits.

We need to reverse both of those with importance in controlling the growth of government spending to get the deficit under control, tax, regulatory and pension reform and work to get the private savings rate up.

Let me just add that some people have gone out and said, no problem, over the long-term. We don't really need to start dealing with these problems now. We have lots of time to deal with them. The deficit's coming down.

Bill Niskanen hinted at something that's very important. We are accruing liabilities or implicit liabilities that are not recorded the way our government budget keeps its books, which is on a cash basis.

If you look at the CBO projections of where budget deficits as a share of GDP are headed, we'll be out there in 10 or 20 years. They will be 15 to 20 percent of GDP, several times larger than the worst they were in the 1980s, and 10 times as large as they are now.

That is driven by the large, unfunded liabilities in the projected growth of social security -- hospital insurance, most importantly. We have, in my opinion, only a few years to begin to address those problems, once we address the numerically if not politically simpler problems of getting the budget balanced by 2002.

In short, none of the discussion has focused about what happens in 2003 and thereafter. Then the problem gets a lot worse. We've been on a demographic holiday. The ratio of the elderly and retired population to workers has been declining since about 1980. It's going to turn around and then start to accelerate.

We need to get our fiscal house in order in a far more serious way -- and I don't mean to be disrespectful to anybody in either party -- in a way that requires much more serious spending control than has been discussed in getting the budget balanced by 2002.

In my own view that I listed in my written testimony, which I hope will be put into the record fully, we need to slow the growth of spending to balance the budget, keep it balanced in the long-term, and that means major entitlement reforms soon -- pro-growth tax changes, less and more flexible regulation.

I agree with Dr. Stiglitz about the flexibility. We started to initiate some of that as did some of my predecessors at CEA over the years.

We also need to have the standards set at reasonable levels. Having a lot of flexibility about how to reach an unreasonable standard isn't a very good outcome.

Not much has been said, but let me take the lead in reiterating the importance, despite the current debate and political discussion, of an open rules base. Yes, with the rules being enforced, regional and world trading systems enhance productivity growth and real incomes, and the last thing we need to do is throw up protectionist barriers and throw the U.S. and world economy into a recession.

And, again, I would take umbrage with those who have said that the Federal Reserve is the prime obstacle to stronger growth. I think in the Volcker and Greenspan eras, despite some minor bickering in a couple of episodes -- those disagreements were minor -- the Federal Reserve, overall has been the star performer in economic policy, in my opinion.

Let me just add a couple of words about this inequality issue and cause and effect and so on, and some of the comparisons that people made before me.

Many said we should think we're in pretty good shape because taxes, as a share of GDP here, are a little lower than they are in Western Europe.

I, myself, would not like to see the American economy resemble, in either its structure or its outcomes, Western Europe. Western Europe has unemployment rates averaging 11 percent. In some countries, they are up to 20 percent. They have a far higher fraction of the population permanently disenfranchised from the labor market, on the dole of various types of very generous social welfare systems that compete quite effectively with after-tax wages, even though wages are in pretty good shape for those who are working. Tax rates are so high that wages after taxes for many workers are not a whole bunch better off than being on the dole.

That's before Western Europe has tried to undergo the kind of restructuring and re-engineering that corporate America has with all the complaints and agonizing that that has created in America.

So they are sitting on a ticking time bomb, starting from twice the unemployment rate we have.

When I first started studying economics in the 1960s, as an undergraduate, we had a higher unemployment rate than Western Europe. Today, theirs is consistently double ours, and I think they are the least well positioned of any part of the world for the 21st Century. So I think they provide us a window of opportunity.

Part of the way they've gotten there, and they themselves acknowledge it -- even a rather statist organization like the Organization for Economic Cooperation Development (OECD) acknowledges it -- are very high tax rates, including payroll tax rates, their ossifying regulation, mandates and so on that stifle the potential entrepreneurs from hiring people.

Let me give you one stunning statistic. Between 1970 and 1994, there were 40 million more working age people in America. The labor force increased 44 million, and the overwhelming bulk of those people found private sector jobs.

In that same period, there were about 30 million more working age people in Western Europe with far higher taxes and regulation in Western Europe. There are only 19 million more in the labor force and there are one million fewer private sector employees in Western Europe on January 1, 1994 than on January 1, 1970.

That, to be sure, is a stunning indictment of an over-regulated, over-taxed society.

I would suggest that Western Europe offers a window on our future, and the last thing we want to do is accelerate or continue or inadvertently go down the path the Western Europeans have.

That's what I worry about in our long-run budget problem.

Let me finally add that because of the overstatement of inflation, the measures that are commonly discussed here, while the trends are correct -- productivity growth has slowed, real wage growth has slowed -- these notions that these things have declined, except for those at the very bottom, real wages, that is, are in my view overstated.

But certainly the trends are correct, and I would agree that the proper dating of the slowdown is the late 1960s, not 1973.

I'd also add two other points and conclude here. One is, while the inequality of measured income has increased, the inequality of consumption has not.

I suppose Alan Blinder was saying that is a good thing because it's heavily driven by government transfer programs. I would in part agree with that, but I think the deep question and one that people have tremendous disagreements about substantively and politically is to what extent we have more low-skilled, low-income people who need support by government transfer programs and to what extent we have more of them because the government transfer programs have given them an alternative to developing their own skills and to getting out, despite the fact that some would fall through the cracks.

I take it that's at the core of the debate about what to do about the transfer programs for the low-income population.

The one thing I would say is I think that debate needs to be enjoined. I think there's some truth in both sides. The one thing I think that's important is that the problem has become so severe that the existing solutions don't work. We ought to be willing to do at least some experiments to try to have some innovative solutions to some of these problems to see if they work, with the states as laboratories, for example.

Secondly, I think we should not delude ourselves into thinking that there won't be anybody that's hurt during the transition. In my own view, we may have gotten to the point where in order to make life better for the next generation of the children of low-income people, we may have to make some wrenching changes that may harm some fraction of the existing generation of low-income people.

That's a cruel and difficult choice but it's one that we're going to have to engage in as a society.

Thank you very much, Mr. Chairman.

[The prepared statement of Dr. Boskin appears in the Submissions for the Record.]

Senator Mack. Thank you, Dr. Boskin. Again I appreciate the input from all the panel members.

I'm going to turn, at this time, to Senator Bennett, and let him raise his questions.

Senator Bennett. Thank you, Mr. Chairman.

I made this point so many times I'm bored with it, but nobody pays any attention to it, so I'll raise it again, and again and again and again.

All of the discussion about the income gap and the lowest quintile and the top quintile and the 80 percent here and the 20 percent there ignores the fact that there is fluidity between quintiles.

And if I may personalize it, if you go back to the year 1980, which by coincidence happened to be the year Ronald Reagan was elected President, I was in the lowest quintile. My net income that year was negative. I was living on borrowings because I was in an entrepreneurial circumstance.

By coincidence, if you go to the year 1992, when I ran for the Senate -- I hesitate to say this, my wife will get mad because she says it's immodest -- but my net worth was in eight figures because the entrepreneurial activity in which I was engaged was successful during that period, and we created not only me as a millionaire but a whole lot more millionaires at the same time, of people who were probably as bad off in 1980 as I was.

My only mistake in that activity was that I didn't ask for a bigger percentage of the company when I came on board as CEO so that I could have even more.

The point is people move in and out of these quintiles and to say the lowest quintile is suffering because the money is all aggregating at the highest quintile and therefore the solution is to take money from the people in the highest quintile and give it to people in the lowest quintile is a very over-simplified way of ignoring the fluidity that exists in the American economy.

And we have to keep that in mind as we're having these statistical discussions and pointing to fancy charts with pretty colors.

Now, I am particularly struck by the reference to demographics because in my opinion, the deficits that hit us through the Reagan years were not caused by tax cuts. I have the figures that show that tax revenues went up very dramatically during those years.

Tax revenues, as a percentage of the economy, remain stable as the economy was going up.

Indeed, from this Committee, Mr. Chairman, I know that in the last year of the Reagan tax structure, which was fiscal 1989, the tax system produced 8.6 percent of GDP after we had the breaking of the "read my lips" tax pledge in the Bush tax summit of 1990, and then the so-called largest tax increase in history of 1993, and I'm using the language of the political debate to describe these two.

After the Bush tax increase of 1990 and the Clinton tax increase of 1993, Federal taxes produced 8 percent of GDP, not the 8.6 percent they were producing in the last year of the Reagan tax structure.

The problem was not on the revenue side. The problem of the deficits was on the spending side, and the spending side was driven primarily by demographics. It was driven by the demographic change of the entitlement spending and the growth of entitlement spending, and if we do not address that, we're kidding ourselves long-term. That's my conclusion.

Does anybody now want to argue with that violently or agree with me?

Probably both.

Dr. Weidenbaum. I'd like to add a couple of numbers which illustrate that your experience, Senator, of moving from the bottom to the top is not unique.

For example, if you take the people who were in the bottom fifth in 1979, by 1988, nine years later, 85 percent of them had moved out of the bottom fifth. In fact, 15 percent were in the top fifth.

Senator Bennett. So I had some company.

Dr. Weidenbaum. Yes, indeed. We are a very mobile society and it's that opportunity to do better and the threat that you may do worse that makes for a productive, competitive economy.

Senator Bennett. I couldn't have done much worse than I was doing in 1980.

Dr. Weidenbaum. By the way, I generate a lot of poverty. All my graduate students are in that bottom fifth.

(Laughter.)

But I forecast that each one of them will do a lot better when you're looking at nine or even five years from now.

Dr. Niskanen. Most of our discussion today has been about the distribution of wage rates, however, and there's very much less mobility on that distribution than there is in the distribution of income. You're quite right, Murray, and others have pointed it out. There's a great deal of fluidity among the quintiles over time.

But the concern that has been the focus today is mostly the increased variance of real wages by skill group, and there is much less fluidity on that measure.

I think it's important to get the record of the Reagan years correct.

Senator Bennett is correct that the Federal revenue share of GDP in fiscal '89 was slightly higher than in fiscal '79, which was the cyclical peak prior to the Reagan years.

So the increased deficits were not the consequence of an erosion of the revenue base. Second, the noninterest spending share of GDP in '89 was slightly lower than in '79.

So it was not due to a spending explosion. The increased deficits were basically the price of getting out from under inflation in the early 80s and they were the price of the rapid military buildup in the early 80s.

The demographic time bomb basically has yet to hit. My birth year was the lowest birth cohort year I think in this century. And we have a very small rate of increase of people going into retirement at the moment.

The demographic time bomb is going to hit us in about 15 years, and it is critically important that we address these massive, intergenerational transfer programs now, rather than wait until that time bomb goes off.

We know more or less when it will happen, and it is very important to address it now, rather than later.

Senator Mack. If I could, because of time, let me turn to Senator Sarbanes, and let me try and make sure that everybody has an opportunity to participate.

Senator Sarbanes. Mr. Chairman, before Senator Bennett gets away, I want to make sure that the dramatic, I think, point that's driven home by the Blinder chart is the fact that in the '66 to '79 period, the changes in average real income were positive in every quintile.

I mean, you can give these anecdotal stories about people move out of one quintile and into another and I understand those.

And those Dr. Weidenbaum has said, you know, a graduate student isn't making much money, and five or 10 years later, he may have a pretty good income, so he's out of the bottom quintile and up into some other one. But the important thing is that each quintile was improving.

Now we have a situation in which that's not the case. The bottom three quintiles in fact are going down. So that's a dramatic difference.

Isn't that the case?

Dr. Blinder. Yes, absolutely.

May I make one more small point?

The point I'm going to make is in answer to Senator Bennett's remark about mobility and fluidity, which is of course correct. If you put together inequality, which is a snapshot concept, with mobility or fluidity, whatever you want to call it, you get a more accurate view of long-run inequality, the lasting inequality in the United States.

What we know is that the snapshot inequality has increased dramatically.

As far as we know, the mobility is about the same as it was.

Therefore, inequality in any long-run sense -- the lasting equality in any sense you want to define it -- is greater now than it was two decades ago.

Senator Sarbanes. Now, during the Clinton Administration on the primary deficit, comparing revenues to program spending, excluding paying the interest on the debt previously accumulated, we have run a surplus of $225 billion.

During the Reagan-Bush years, we ran a large primary deficit. In other words, the program spending exceeded revenues. In fact, if we didn't have to pay the interest on the debt accumulated during the period 1980 to 1993, the budget would now be in balance.

Now was it a good thing to run a surplus with respect to the primary budget over the last three years? Does anyone think it was not a good thing?

Dr. Niskanen?

Dr. Niskanen. I think it was very important to make successive reductions in the deficit, as usually measured. The fact that we have a primary surplus during this period of time is an indication of that.

I think that we should not be tolerant of deficits. We should not learn to accept them as part of our fiscal future anymore than we should learn to live with a particular inflation rate.

We need to be vigilant on both fronts on a continuous basis.

Dr. Weidenbaum. I think we need to also acknowledge that some of the deficit in the first period generated part of the surplus in the second period. I'm thinking of the swing in the savings and loan bailout. The bullet was bit in the first period, when the big Federal outlays to bail out the S&Ls occurred.

And more recently, with the completion of that bailout, those assets have been sold, generating revenues into the Treasury.

Senator Sarbanes. That's about a fifth of the deficit. That's about 20 percent of it. It is by no means a major explanation.

Dr. Blinder. I would agree with what both previous panelists said, but just point out that a large reason for the very large gap in recent years -- including before the Clinton Presidency -- between the primary deficit and the conventionally measured deficit is the huge burden of interest that has been acquired by the Federal Government due to the deficits in the earlier part of that period. That's shown up there in orange -- shall I call it? Whatever color that is.

Senator Sarbanes. Dr. Weidenbaum, I don't understand your growth argument if the unemployment rate is low. If the unemployment rate were, say, at 5 percent or 4 percent, and the economy was growing at one-and-a-half or 2 percent a year, would you still assert strongly that we ought to have a much higher growth rate?

And if we did, with an unemployment rate that low, what would happen with respect to the inflation problem?

Dr. Weidenbaum. This is precisely, Senator, why I put together in my statement a package of suggested structural changes. It isn't a matter of souping up the growth rate via an easy monetary policy. I think we have to address important structural deficiencies in the economy brought about by high tax rates, by onerous regulation, and yes, by those budget deficits.

And if we address those problems, we can generate the capacity to raise living standards through raising not just the number of jobs, but the value-added generated by each of those jobs.

Senator Sarbanes. Let me tell you, I have great difficulty with the effort on the part of some to compare growth rates for the economy in the mid-1980s when we were coming out of the deepest downturn since the Depression. At one point, the unemployment rate reached 11 percent.

And saying, well now we have a 5.5 percent unemployment rate, one-half of that other figure, that we ought to be growing at 4.4 or 5 percent.

The Fed obviously didn't think that. They thought the growth that was happening at 3 percent and above was too much and they slowed the economy down.

Now you don't assert that the growth rate ought to be the same when you're working from a 5.5 percent unemployment rate than when you're working from an 11 percent unemployment rate, do you?

Dr. Weidenbaum. No, but. And the "but" is that this economy can do better.

Senator Sarbanes. I see my time is up.

Mr. Chairman, I just want to make one comment to Dr. Boskin.

He mentioned this marvelous technology that he's using here. And I just want to say, it makes him look younger. Maybe it's not just the technology.

(Laughter.)

It's the air of Stanford and not having the burdens of being the Chairman of the Council of Economic Advisers. Anyhow, I just want to make that observation.

Michael, it's nice to see you. You're looking very well, as a matter of fact.

Dr. Boskin. Thank you, Senator Sarbanes. I am very well. Thank you, sir.

Senator Mack. Representative Manzullo?

OPENING STATEMENT OF REPRESENTATIVE DONALD MANZULLO

Representative Manzullo. Thank you very much, Mr. Chairman.

I would suggest to Senator Sarbanes, as we go home this evening, turn on the videotape of this proceeding. I'm amazed that we've lost five years in age.

I appreciate the opportunity.

I want to make a couple comments and open it up for some comments from the other side.

You know, we have a lot of charts here that we use, and in fact I'm guilty of the same thing economists do. I'm going to use a chart myself.

But all I can tell you is that the American people are suffering. Let me suggest to you one of the reasons they are suffering, if you check the generational forecasts, which is a chapter that appears in most years' budget. It wasn't in last year's, it was in the years before. I don't know if it's in this year's budget.

But it states that because the $5 trillion national debt, unless some things occur dramatically in this country by the time children born after 1992 go into the workforce, they will have a state, local and Federal tax rate of between 84 and 94 percent.

I think that's where we've got to start.

This is nothing less than a guaranteed collapse of our Republic.

When I hear people talking about well, you know, we're not taxed as much as people in different countries, and you know, we're not doing that bad, etcetera, let me suggest to you that there's something even more pernicious that's happening in America.

We have elected to legislative bodies, the United States Congress, general assemblies, state legislatures, city councils and town councils, who have a constitutional, statutory obligation to be the ones who in fact raise the taxes.

But now we're facing something in this country that was totally unheard of until a few years ago. That's the judicial tax where we have an unrestrained Federal judiciary that, in the name of equality, in the name of bringing about some of these structural injunctions, arbitrarily raised taxes on the local level. And the biggest culprit of all was the Federal judge in Kansas City, Missouri, who spent $1.5 billion taking money from the people's pocket books and simultaneously destroying the school system.

That's what's going on in America today, is the fact that just because we have a problem, people think we have to go out and spend more money.

The same thing, the same type of reasoning occurs when people say we need more revenue, let's raise taxes.

Now let me be guilty of using a chart.

This was the CBO projection of what would happen when President Reagan made the error in 1986 of raising capital gains taxes. Whoopee, let's raise capital gains taxes and more money will come into the Federal Government.

Let's raise personal income taxes and more money comes into the Federal Government.

Here's the chart, 1985, just before the news got out that capital gains taxes were going up. It shot up dramatically. Capital gains taxes were raised in 1986. The CBO projection and the actual amount of revenue that came in from capital gains taxes, there was a difference by the end of 1992 of $170 billion.

And when President Reagan made the correct decision in 1982 to decrease personal income taxes, the actual amount of revenue from personal income taxes doubled. It doubled.

The problem is that for every one dollar in new revenue that came in, Congress spent another $1.51 in additional spending. So the problem is always that this body spends too much money. It's just too much money that's going all over the place.

And my question is when President Clinton, in 1993, raised, over a period of five years, corporate income taxes by $30 billion and energy taxes by corporations through increased fuel taxes by another $10 billion, he took $40 billion out of the economy.

And many economists are now saying that because of that spike in corporate taxes, this has resulted in many corporate restructuring and layoffs, because when you have to pay more taxes, you've got to squeeze the profit somewhere.

So the question is, did the increase in corporate taxes by President Clinton in 1993, did that lend itself in anyway to the layoffs that we're seeing today in corporations?

Anybody? If there's time.

Senator Mack. Anybody who wants to respond to that certainly is welcome to.

Senator Sarbanes. Could I ask a question?

Are you asserting that the amount produced by the income tax doubled?

Representative Manzullo. Doubled over a period of five years, that's correct.

Senator Sarbanes. Which five-year period?

Representative Manzullo. Starting in 1982. Within the next five or six years, the amount doubled from about $600 million to $1.2 billion.

Senator Sarbanes. On the individual income tax?

Representative Manzullo. That's correct, the actual amount of money paid in.

Senator Sarbanes. I'm looking at a table that says that in 1982, individual income taxes were $297 billion and in 1987, it was $392 billion. Of course that doesn't allow for inflation, so I mean some of that increase was the simple consequence of inflation, but that's far from your assertion that the individual income tax doubled.

Dr. Weidenbaum. The corporate tax revenue doubled.

Representative Manzullo. That's correct.

Dr. Weidenbaum. Not the individual, the corporate. $49 billion in 1982 to $100 billion in 1992. I believe that's .what Congressman Manzullo was referring to.

Representative Manzullo. Thank you, Doctor.

Senator Sarbanes. That's very sensitive to the business cycle.

Representative Manzullo. That's right. When people pay less taxes, they can spend more money to buy things for their corporation.

Senator Sarbanes. At least let's get our facts straight. I take it that the assertion that the individual income tax doubled over five years from 1982 is no longer being made. Is that correct?

Representative Manzullo. Perhaps 80 percent, I suppose 100 percent. But what happens is when people pay less income taxes, they have more money to spend on consumer goods, they have more things for themselves. That generates more state sales tax, which is not even figured into the equation. And in addition, it generates more corporate profits.

Senator Sarbanes. We can argue the implications, but let's at least get the basic facts straight.

I don't think it's helping the debate to make an assertion that the individual income taxes doubled in five years.

Senator Mack. Dr. Boskin?

Dr. Boskin. Let me try to get some facts on the record and what I believe is a fair reading of fiscal history. People are comparing different taxes in different years and so on, and obviously there are many ways to skin a cat.

I think the following would be a fair summary, and I'll try to just make a few simple points.

In the late 1970s, the combination of high inflation and our unindexed tax system was driving people into tax brackets at a very rapid rate. In fact, the fraction of the population subject to a high marginal tax rate of say 40 percent quadrupled between 1965 and 1980.

While 1979 was a business cycle peak, 1979 and 1980 were a little blip up in the share of Federal taxes in GDP relative to their longer term trend for a decade or so prior to that.

So it's a little bit of an elevated comparison.

But a fair statement about what the Reagan tax cuts did -- Reagan plus Congress et cetera -- let's leave aside.

When President Reagan proposed them, he got some things he didn't want, he didn't get some things he did want, and so on. I was involved in that. I prepped the first debates, and I was on some of his advisory boards and so on.

The reduction in tax rates stabilized, combined with a small increase in social security taxes that occurred later, and a partial rollback of the '81 tax cut in '82. Basically that whole episode stabilized the fraction of taxes in GDP. It led to lower marginal rates, which was a good thing, but it stabilized the share of taxes in GDP.

So those who argue that the tax cuts caused the deficits have to either believe that additional revenue wouldn't have been spent and wouldn't have affected the economy, or we would have gone ahead and spent what we spent anyway, all three of which I think are dubious assumptions. So, I side with those who say that the growth of the deficits came on the spending side.

You can argue who is to blame for that, and whether it was worth it. Some of it was the defense buildup. Did we get enough out of that? I think we did. I think it was one of the reasons communism fell, and even just on what we can sustain as a long-term defense budget, the internal rate of return on that investment was very good.

Getting back to whether the tax cuts paid for themselves: there have been many studies and I think the facts would support the following. The reductions in the top tax brackets did indeed pay for themselves. That shouldn't be surprising.

If you were in the 70 percent bracket, for every dollar you can move into fringe benefits or shelter in some way, you save 70 cents in taxes, and the reduction of those high tax rates did indeed, from many studies and Treasury data, pay for themselves.

Part of that was de-sheltering. Perhaps some of it was labor supply and other responses.

Alan Blinder and I probably disagree a little bit, but it certainly wasn't all on factor supplies. Some of it was de-sheltering.

The broad, across-the-board tax reductions -- here I think the discussion misses the middle ground -- did not pay for themselves but did generate additional revenue above and beyond what a simple static calculation would generate or would show.

So there was some revenue reflow but not sufficient to fully pay for tax reductions at the lower rates.

There are many studies that have documented this with Treasury data by respected economists. I think that's a fair summary.

So I think what I conclude from this is that there's a renewed need for spending control. The tax cuts did some good things with lower marginal tax rates. We shouldn't overstate the fact that they paid for themselves. The reduction in the top rates did.

The people who claim that we should just have a simple static analysis and assume there's no revenue reflow are wrong. As a matter of fact, President Reagan, despite the popular convention and press wisdom to the contrary, never stated that the tax cuts paid for themselves.

And in his own plan in 1981, he assumed a 17 percent revenue reflow which was quite sensible, not a 100 percent revenue reflow from the lower rates.

I would make two other comments.

Capital gains tend to be an activity that's quite sensitive to tax rights. Some other activities are, others are not. But many people and institutions have the options to defer or speed up realization of capital gains. There I think the case is pretty strong that you can get to rates which are counterproductive and probably, lowering rates in a sensible way would approximately pay for itself and be good for the economy.

Lastly, Senator Sarbanes I think is correct to point out that we should be careful in comparing in a simple static sense, growth rates in a year of relatively high employment and a year coming out of a deep recession.

I think that's a very valid point and one we should all bear in mind.

I think, however, everyone on the Committee and everyone on the panel, regardless of party and regardless of economic school of thought, would agree as we look forward, given the CBO projections of a growth potential of 2.3 percent and the discussions of the Fed and other private forecasters of the growth potential of the economy being between 2 and 2.5 percent. If that's correct, that that's what's consistent with non-inflationary growth, given the current structure of the economy, then Dr. Weidenbaum is exactly right.

Without that sort of growth as something to look forward to, that's a very unexciting, difficult, social tension-ridden future. We ought to be looking everywhere we can for ways to get the growth rate up.

As I say in my written testimony, you don't have to be talking about doubling the growth rate. It would be wonderful if we could get back to the golden era of growth from '47 to '73. That may be very difficult to do.

If we could just get the growth rate up half a percentage point, we'd bequeath to the next generation not only a larger economy than the base line, but we would add to that economy -- half of today's economy on top of that -- much higher standards of living.

That is the difference between an economy that would view itself as successful and one that will view itself as having been sick over a couple of decades.

So I just wanted to sort of say that I agree in some sense with both Dr. Weidenbaum and Senator Sarbanes. You don't want to compare coming out of a recession with a year of high employment.

But I think we can all agree that the growth potential of the economy today appears to be too low, and we need to search and search hard. Many suggestions have come out here from tax and budget deficit reduction, tax reform, and regulation reform and litigation reform.

I think all of those would help. Undoubtedly there are many others, and most will occur in the private sector. But I think we all ought to renew our attention to how we get the non-inflationary growth potential in the economy up.

That is, in my opinion, the single biggest priority for our country.

Senator Mack. Thank you very much.

Representative Hinchey?

Representative Hinchey. Thank you very much.

First of all, let me apologize to the panel. Those of us who are Members of the House had to go over for a vote, and that's why we had to leave the room, so I'm sorry I wasn't here for some of the testimony.

But it seems to me that there are several conditions that exist that are frankly difficult to understand. We have now relatively low tax rates, I mean relatively low. We have record corporate profits. We have a stock market that is breaking records on a routine basis, and we have a greater disparity of wealth and income in our society than at any time, scholars tell us since 1929.

So the private sector, that sector which we generally regard as the private sector, the corporate sector, is doing very, very well. People there are accumulating massive amounts of income and wealth.

That, however, is not being distributed through the blue-collar or the traditional white-collar sectors. The middle class in our economy is not benefitting from those enormously positive economic conditions that exist or are reflected in those numbers.

The growth rate is very low. And I agree with what was just said a moment ago, that we need to get this growth rate, and if we could get it up half a percentage point, then we would be bequeathing to the next generation something much better than that which we will do otherwise.

The question is how do we do it? What are we going to do?

I think that we have tried what Dr. Weidenbaum has suggested and what Dr. Niskanen has suggested. We've cut tax rates. Tax rates are relatively low. We've created conditions that generate enormous profits for the corporate sector of the economy.

We have been so successful in doing that that they are amassing enormous amounts of wealth and their incomes are growing astronomically whereas most other people are being left behind.

Now I would ask you, Dr. Blinder, what is it in our economy that generates these inconsistencies, and what should we do to address them?

Dr. Blinder. Well that's a very difficult question to which only a partial answer is possible. A few things have come up in this hearing already.

Both I and Dr. Stiglitz at the beginning called attention to this gap between the product wage and the consumption wage, which is largely due to changes in the terms of trade that define real wages as viewed from the consumption bundle versus productivity of the worker to the firm.

Those terms of trade have turned against labor in a fairly sharp manner over the past dozen years or so. That's number one.

The second thing that has happened is that the profit share in GDP has risen while the wage share has fallen.

The reasons for that are not at all clear. But most people believe there's been a kind of a shift in bargaining power -- due perhaps to the downsizing process and many other factors -- away from labor and towards shareholders. And I don't particularly mean organized labor because organized labor's a very small share of the workforce now. That's in the neighborhood of 1 percent of GDP.

Finally, I would say that the tax and transfer system is somewhat less distributive now than it was 20 years ago.

And I mentioned technology in my testimony. Bill Niskanen calls to our attention the fact that we often give the name "technology" to things we don't understand and can't measure, and there's truth to that. But with that qualifier, the apparent fact is that technology has shifted in a way that particularly disadvantages low-skilled labor.

And so, in addition to labor as a whole losing relative to capital, when you look inside the labor basket, you see people at the bottom have done much worse. They have fallen absolutely.

All of that, I don't think, would be a full answer to your question. But they're all pieces.

Representative Hinchey. Well, it's an answer in part because it provides somewhat of an analysis.

But the question remains, what do we do about it?

Dr. Blinder. I said in the testimony two things. There is no magic bullet. If anybody gives you a 25 word or less answer, you oughtn't to trust it. And I can't do that, of course.

I would emphasize investments in human beings, especially targeted investments in people near the bottom, to upgrade their skills so that they can provide the kind of skills that are demanded and rewarded fairly well in the modern economy. That's a whole panoply of educational investments. Some involve government, some don't. Many of them involve business decisions.

Dr. Niskanen. May I correct two, I think, misperceptions?

The labor compensation share of total national income has not dropped. It has been remarkably stable for decades, so there has been no redistribution from labor to capital in general.

There has been some changes within both categories, but total labor compensation as a share of national income has not dropped.

There's been a big redistribution within the labor share but total compensation relative to national income has not dropped.

Senator Sarbanes. Could I be clear on that?

If the CEO used to make eight times what the janitor makes, but he now makes 150 times what the janitor makes, that's still labor compensation. But there's been a marked shift in the relative positions of the two.

Is that correct?

Dr. Niskanen. That's right. It is in the form of salary as distinct from dividends that he receives from his corporate share. It's measured as salary. So the redistribution has been within the labor share.

Senator Mack. Do you want to add to that?

Dr. Blinder. I just happen to have the numbers right here. I just computed them a couple of days ago.

Over the long run Bill Niskanen is right: There's no long-run secular shift away from labor. But this is very recent, and it's atypical.

From '92 to '95, the share of total labor compensation in national income fell by a percentage point -- from 73.6 to 72.6. And the profit share of national income, which of course is heavily influenced by business cycles, rose from 8.1 percent to 10 percent.

That's what the data show.

Representative Hinchey. If I may, Senator, on that point, there have been a number of studies recently. Perhaps the one that got the most attention, including front page stories in major newspapers across the country, was the one about the 20th Century Fund.

The *20th Century Fund Study* showed clearly the enormous growth in the differences in income and wealth, particularly focused on wealth in that particular study, in the country.

So I wasn't arguing in the context that you were, doctor, a moment ago. But I think the point that Senator Sarbanes made, which is that in the Eisenhower Administration, the difference in compensation between the corporate executive and the average employee in that corporation was about 45 times. Today that difference is about 190 times, almost 200 times.

So there is an obvious great disparity in the compensation that is being given to those in the upper income range vis-a-vis those in the middle-income range. That is reflected in itself in this overall growing disparity of wealth and income, which is becoming endemic in our society.

Dr. Niskanen. Second, I wanted to qualify your conclusion that tax rates are much lower.

The top Federal marginal tax rate has increased from 28 percent to 42 percent in the last few years as a consequence of the Bush and the Clinton tax rates.

The top rate in the 1986 tax bill was 28 percent. So we have increased that top marginal rate by 50 percent, or 14 percentage points in that period of time.

Representative Hinchey. Yes, Doctor, but following your admonition a few moments ago that we not focus our attention on a few years, but we look at things in the broader picture, you will have to agree that tax rates today are dramatically lower than they were 20, 30, 40 years ago.

Dr. Niskanen. That's correct, sir.

Senator Mack. Dr. Weidenbaum?

Dr. Weidenbaum. In the discussion about the CEO versus the janitor, sure we can consider action to slow down the growth of the CEO's salaries. I say that's a job for the corporate board of directors. I worry more about the janitor. And I'm very serious.

There's close to a 50 percent dropout rate in the high schools of our central cities. Those young people will never make it in the legal economy of the 21st Century that they will grow up in.

That's where I think the society needs to pay attention. And frankly the problem isn't at the Federal level, it's at the school board level.

When I earlier talked about the need to reform the structure of the American economy, we so badly need to reform the structure of our local public school systems so they do a better job of educating and training our young people. And it isn't just a question of putting dollars into the system. It's quite clear the present system isn't working.

I don't know if vouchers or choice are a panacea but I know those who tenaciously defend the status quo are dead wrong.

Senator Mack. Senator Bennett?

Senator Bennett. Thank you, Mr. Chairman.

Again, I hate to be so autobiographical but having headed a company that grew during the decade of greed, and as a result of its growth created 3,000 jobs that weren't there before, this issue of tax rates is very, very serious.

The "S" corporation, I have discovered is the most widely misunderstood structure around here. I stood up on the floor of the Senate during the debate over the President's tax increase and said, does anybody in this Body know what a K1 is?

And I did not receive any positive responses. Anybody who has been an entrepreneur knows exactly what a K1 is. That's the form on which you report your income if you run an "S" corporation.

We built our corporation as an "S" corporation and the top tax rate, since we ran it through our personal income tax, was 28 percent. If we were to try to do that today and create those same 3,000 jobs, the top tax rate would be 42.5 percent.

And the most significant problem you face in an entrepreneurial activity is accumulation of capital. If you are growing a business rapidly, the biggest problem you face is taxes because the government insists on the taxes being paid in cash.

And you're sitting there with the growth coming and the need for inventory, the need for accounts receivable financing, and you can say, on the balance sheet I have all these assets that I have earned, but I can't turn any of them into cash.

And the tax collector says, I don't care, you have to turn them into cash and pay them in taxes or you go under.

There was serious concern among my board of directors that we were growing the company too fast. Why? Because they said you'll grow yourself into bankruptcy because of the tax burdens.

Because we had, during the Reagan years, the opportunity to use the "S" corporation device and pay taxes of only 28 percent instead of the current rate of 42.5 percent, we did not run into that problem when we created those jobs, we created that wealth, we created all of that opportunity for those 3,000 people.

So when we talk about tax rates, we have to understand that they have their biggest impact not on the CEO, not on the Michael Jordans of this world who can handle a 42.5 percent tax rate without any problems, the biggest impact of these increases in tax rates, from 28 percent to 42.5 percent, hits in the entrepreneurial sector of the economy where those jobs are being created.

The point that Dr. Stiglitz made, which was an appropriate one, is that in creating the eight million jobs that we're talking about in this current circumstance, that's eight million net. Because during that time, AT&T is laying off hundreds of thousands -- everybody's laying off.

Where are the new jobs coming from? They're not coming from DuPont or General Motors or AT&T or IBM. They're coming from the entrepreneurial start at zero, and create 100 jobs or 200 jobs or whatever, and that's where the tax problem hits.

And, if I may, one last reference to the Reagan years. In a shorter period of time than twice four years, that tax structure created 20 million new jobs net during the period of time when the Fortune 500 was downsizing two million.

So the entrepreneurial sector of the economy, the one in which I was engaged, created at least 22 million new jobs in that period under those tax circumstances, and that is at a better rate, coming out of that recession, than the Clinton Administration can claim for their eight million jobs coming out of the recession, following President Bush's,.

Dr. Niskanen. Senator Bennett, you're correct to focus on the very significant effect of these top marginal tax rates.

I want to observe, with some despair, however, that when the Congressional Republicans proposed the tax cut last year, they did not reverse the major tax increases under Bush and under Clinton.

The composition of the tax package that was proposed last year did not in any way reduce these top marginal tax rates.

So that instead of unwinding the most egregious parts of the tax code, they provided a $500 credit per child to families with probably negative supply-side effects.

Senator Bennett. I'm willing to try the other, but I couldn't get that many allies.

Dr. Boskin. May I make a friendly addition to your comment?

Senator Mack. As long as it's short.

Dr. Boskin. Senator Bennett correctly pointed out the problem of subchapter "S" corporation, but actually the problem's much more severe than that.

Eighty percent of the businesses in America are not incorporated and pay taxes on the same 1040 form you and I use. And the modest percentage of those, when they are successful, now pay much higher tax rates.

Those are the businesses that, as he said, have to rely heavily on their own internal cash to generate the investment capital to fuel their growth and job creation.

Senator Mack. I'm going to attempt to wrap this up. I've got a few comments of my own.

Senator Sarbanes?

Senator Sarbanes. I just have two comments, Mr. Chairman.

One, recognizing all that Senator Bennett has said, it seemed to me another important objective of any entrepreneur is to have someone who is willing to buy the product. I mean, I think Henry Ford said, you know, if he started paying these people a living wage, they would end up buying his cars.

And I think the Congressman has made the very effective point here that you have these tremendous disparities in income and wealth and inequality, you're going to get a thin group up here at the top with lots of economic resources and the rest of the population's not going to be able to buy their products or their services because they just don't have the wherewithal with which to do it.

So I think we have to bear that in mind as we look at these things. It seems to me that argues for when you address taxes or other matters, we have to do something about enhancing the position of working people.

And I never, I don't understand to this day the assault on the earned-income tax credit, which seems to me it is helping working people to get above the poverty level.

The final point, Mr. Chairman, just for the sake of the record, I'd like to put in the table found on page 94 of the Economic and Budget Outlook prepared by the Congressional Budget Office, the CBO, of January 1995.

I gather the one for this year has not yet been put together.

It addresses again this issue that the amount coming in from individual income tax has doubled in five years, counting from 1982, and I only make the point because, as I said before, we can argue the interpretation of the facts amongst ourselves, but at least let's get the facts straight.

What this says, in 1982 individual income taxes, revenue by major source, $297 billion. Even by 1994, not five years but 12 years later it was at $542, not yet double. And of course this doesn't account for inflation during this period. It's not, you know, the inflation would take it up 3, 4 percent a year which is what it ran during this period.

So even 12 years later, that amount had not doubled, and I ask that that page be included in the record. This is from the CBO Economic and Budget Outlook.

Senator Mack. We'll make it part of the record.

Senator Sarbanes. Thank you very much.

[The table submitted by Senator Sarbanes appears in the Submissions for the Record.]

Senator Mack. I want to take just a couple of minutes, and I apologize here. It's after one o'clock, and we've probably gone longer than any of us anticipated.

But in the spirit that we ought to debate the issues among ourselves based on facts, and I realize that from time to time, both sides will use data to support their own argument. I mean that's gone on for probably as long as man has been on the surface of the earth and probably will continue to do so.

But my focus, at least what I wanted to have happen at this hearing was to raise the question about the growth rate of the economy, and yes rhetorically get into a political debate about, you know, was the President right when he said this is the best economy in 30 years.

And each person's going to draw his or her own conclusion about that.

We know from the earlier testimony that that was based on the, at least the primary basis was that the misery index was lower now than it has been at any time in I guess 30 years.

The real question is, is that really important?

I mean, it seems to me that the reason we're all involved in trying to find ways to increase the growth rate in the country is because of what it will do for our constituents, what it will do for our families, our neighbors, for our local communities. It will increase the standard of living hopefully for all Americans.

So the question really becomes then I think how do we see that all income groups in America are better off as a result of what we do?

Now we've had Dr. Blinder's chart here, which shows average real family income, and breaks it down into two periods of time, up to 19 -- I guess it's ‘66 to ‘79, right. And then from ‘79 to ‘83.

And I would, raise the point that, I'm not sure that that is a fair representation of what is really going on.

I have a chart over there, which I'm not going to specifically refer to at this point, that has different time periods that makes the point that during this period of time, from 1979 to 1993, that there really is a different picture out there.

And that is that -- and I have a small, unfortunately a smaller chart, that has to do with average annual percentage change in real family incomes by quintile.

And this chart has been put together based on trough to trough experience, trying to get out of a situation where I claim it was the Carter years, or you get to claim it was the Nixon years, or I get to claim it was the Reagan years.

I mean, this is a trough to trough kind of situation.

And in that trough to trough situation, we find the '75 to '82 period that the low-income quintiles declined and the upper-income quintiles rose slightly.

In the 1982 to 1991 period, all quintiles rose.

And then from 1991 to present, or where we have the data, we've gone back to the '75- '82 period in which, interestingly enough, the two lowest income quintiles went down, and there was a rather significant increase, by the way, in the upper quintiles.

Now the reason that I go through this is, first of all, I think it would be helpful to me, and if each of you wants to respond, in essence, in writing to me to say whether this is a fair way to look at income, looking at a trough to trough kind of situation, I'd love to have that kind of data, number one.

And number two, do you dispute that during the period of time 1982 to 1991 that we did see income increases in all income levels in America.

And the point that I'm really trying to get at here is if that did occur, interestingly enough it occurred, and now you're going to have to allow me to be a little political for a moment, is that people want to say that it was during the Reagan years when the wealthy were better off. They made more than the people at the low-income.

It's interesting that in these two, the trough before and the trough after, that the incomes of the wealthy went up while the incomes -- income growth I'm now talking about -- income growth declined. And so I would like for, again, I have raised this question from the standpoint of a honest economic discussion, and if we are right about the 1982- '91 period, then I think it behooves us to go back and say what was going on during that period of time.

Senator Sarbanes. Were the troughs comparable?

I know you're -- I mean I appreciate the analysis you are presenting is going to be a trough to trough analysis and I think that's important to do, and we try to develop it.

But I think a further important point to make is that if the troughs are not roughly at comparable levels, then you're dealing with, then that's going to throw your comparison off.

In other words, coming out of an 11 percent recession is going to give you very different results than coming out of a 7 percent unemployment rate. At least, that would be my -- I don't know, I'd like the panel to factor that in.

Dr. Niskanen. Senator Sarbanes is clearly correct in that regard. And that makes the '82- '91 comparison somewhat misleading because the '82 trough was an 11 percent recession, and '91 I think was 7.5 percent, something like that.

I think for that reason, it's much more important to look at longer periods of time, either trough to trough or peak to peak, but periods of time in which the unemployment rate was roughly the same.

Like, for example, from '73 to '95, rather than from individual cycles.

Senator Mack. And again, I'd be interested in some of your input in this.

Yes, go ahead.

Dr. Blinder. I agree with that 100 percent.

I just want to make one point vis-a-vis your chart to the best I can read it at this distance.

The left hand panel, is that '47 to '73?

Senator Mack. That's '47 to '73.

Dr. Blinder. What you see there is that all the bars are of about equal height.

The other three panels all show the same pattern of rising inequality -- whichever period you take. The lower you were in the income distribution, the worse you did, though the levels are dramatically different for cyclical reasons.

So it's quite consistent.

Senator Mack. Yes. But you wouldn't get into the argument, would you, that we would be better off -- again, there are four groups up there -- that we would be better off in the second and the fourth because there's less of a disparity?

Dr. Blinder. I certainly would not.

Senator Mack. Clearly we would love to have a situation in which everybody's income is growing. And then the next question becomes, well gee how do we get everybody's income to be growing at the same level, absolutely.

Representative Hinchey. Senator, if I may?

The chart you were just showing there, the trough to trough analysis, I think is an important one. There may be some correlation in what you show in that chart with the aggressive fiscal policy pursued by the public sector of our economy during that period of time.

You had a growth in public sector spending expressed in the military side of the budget of very substantial amounts.

I would suggest that that is a major factor in the growth that occurred during that period of time.

Senator Mack. Let me just draw that to the next level.

You're not suggesting that we ought to find ways to have even greater public spending at this point in order to get that?

Representative Hinchey. I very definitely am, sir.

(Laughter.)

Senator Mack. That's good.

Again, I would be interested in your input with respect to this because I think it is important. I would also be interested in the response, and we can send you the transcript of the way I phrased the question.

If the purpose here is to try to figure out not just that there is growth in the economy but the standards of living of all Americans are rising, that's what we ought to be focused on I think.

And again, I thank both the Members of Congress that participated, and the panel members as well for their input.

Thank you.

[Whereupon, at 1:15 p.m. the Committee was adjourned.]

PREPARED STATEMENT OF SENATOR CONNIE MACK, CHAIRMAN

Four years ago, candidate Bill Clinton was running for office, telling Americans he "felt our pain." He also told us we were mired in the worst economy in 50 years, and that the only issue that really mattered was "the economy.....stupid." Well, here we are in 1996, and the economy is still a problem.

Yet, in his State of the Union Address this past January, President Clinton claimed that today's economy is "the healthiest in three decades." I don't know how he came to that conclusion. Sure, some statistics suggest the economy may be improving a little bit. But the people I'm hearing from and reading about are telling a very different story.

A CNN/ USA Today/Gallop poll taken last weekend, showed that 66% of Americans think the state of the economy is only fair or poor -- only half that many say the economy is either in excellent or good condition. On top of that, only 36% of those surveyed are satisfied with how things are going in the country, compared with 61% who disagree. All this is right in line with a January *U.S. News and World Report* poll, in which nearly 70% of Americans said the economy is either stagnant, in a recession, or even a depression. While only 22% said the economy is doing well.

Hard-working Americans are deeply skeptical, and they're right to be. They feel like no matter what they do, they simply can't keep up. People in Florida tell me America's economy has to do better. People in Kansas and California are echoing the same sentiment. Even the Clinton Administration's Secretary of Labor admits this growing problem, repeatedly referring to an "anxious class" who feel they're being left behind. Still, the President says we're in the middle of the healthiest economy in three decades. Something is clearly wrong.

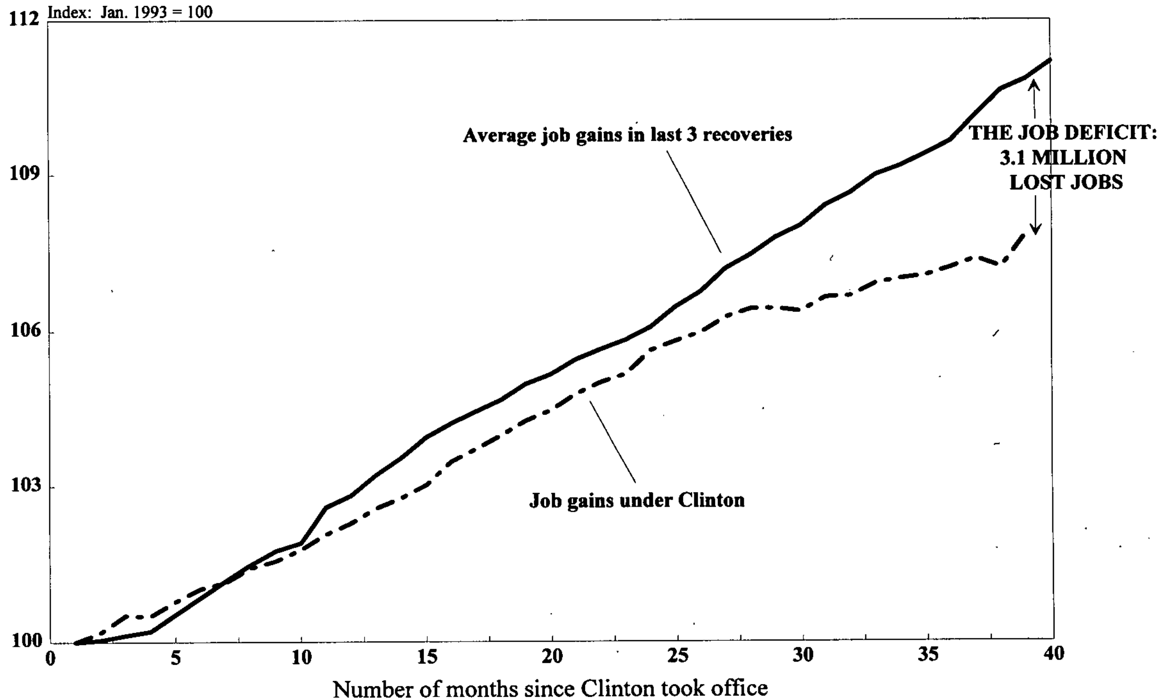
A major cause of that anxiety is that middle class incomes have stagnated during President Clinton's term. Look at 1995's economic growth rate of 1.4%, and the 1.9% projected for this year. That kind of growth is just too weak to boost incomes in any meaningful way. So, Americans have been forced to work longer and harder with little, if anything, to show for it. And, after having already increased taxes, spending and regulations, President Clinton wants to increase government interference in the economy even more.

An economy just plugging along, too slow to crate high-paying and stable jobs is simply unacceptable. We can and must do better. We in Congress have passed a balanced budget, tried to restrain the growth of government spending, scale back onerous regulations, and cut taxes for working Americans. But President Clinton has vetoed our efforts at every turn, without providing the country with a clear vision of his own.

One day the President blames the Fed for slow growth, and the next he's telling everyone that he's created the best economy in 30 years. What's going on here? In 1992, with the economy growing at 3.7%, he said we were in the worst economy in 50 years. Now, with real growth at only 1.4%, he says the economy is healthy. How should we reconcile those mixed messages?

We owe the American people some straight answers. Dr. Stiglitz, I'm glad you're here to clear up some of this confusion.

The Job Deficit

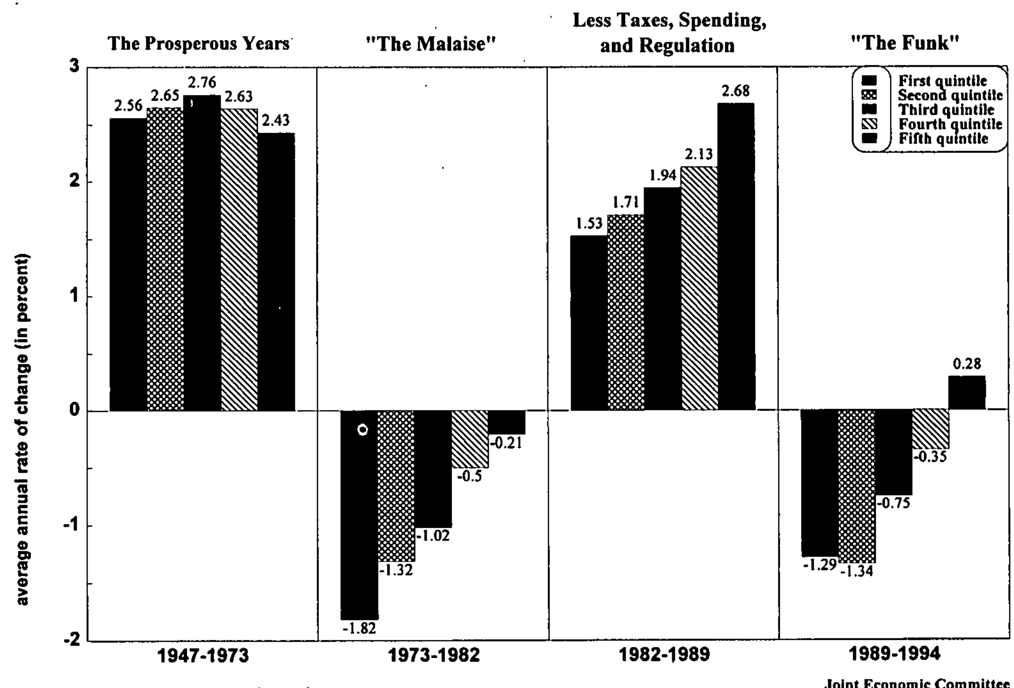


Source: Bureau of Labor Statistics / JEC calculations

Joint Economic Committee

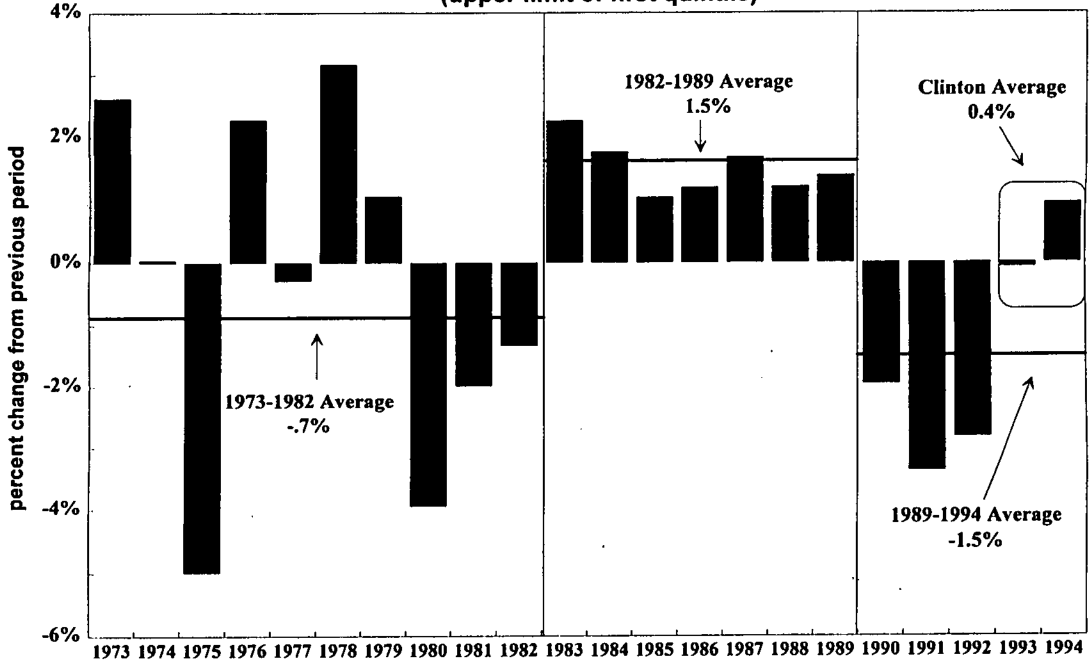
Average Annual Change in Real Family Incomes

by upper limit of each quintile



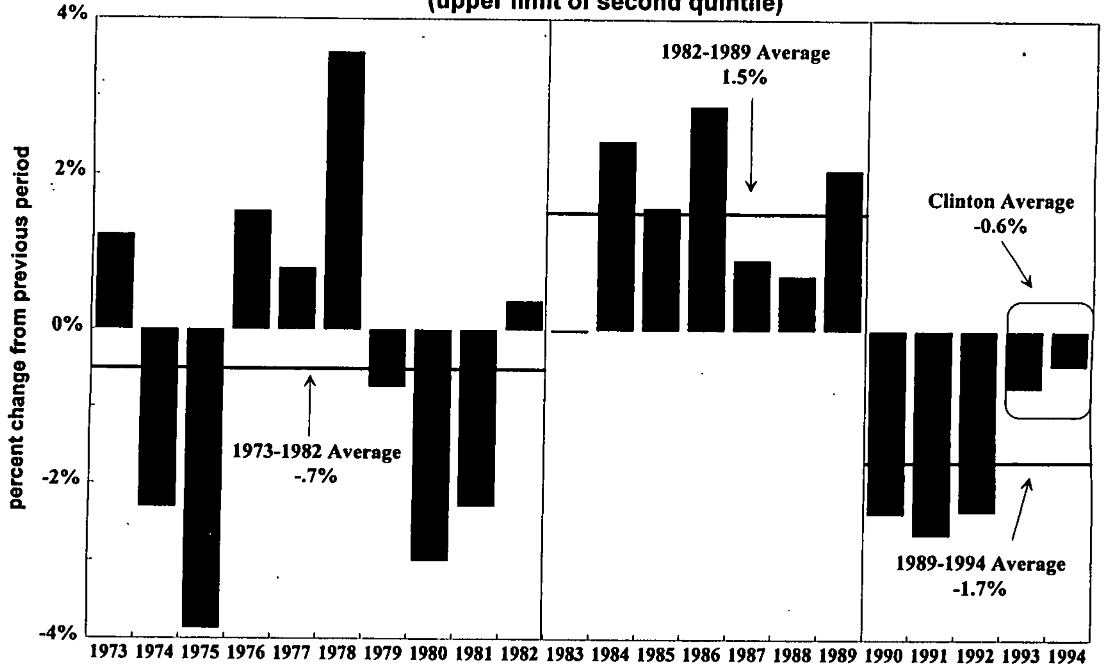
Source: Bureau of the Census

Average Annual Change in Real Income
Low-Income Households
(upper limit of first quintile)

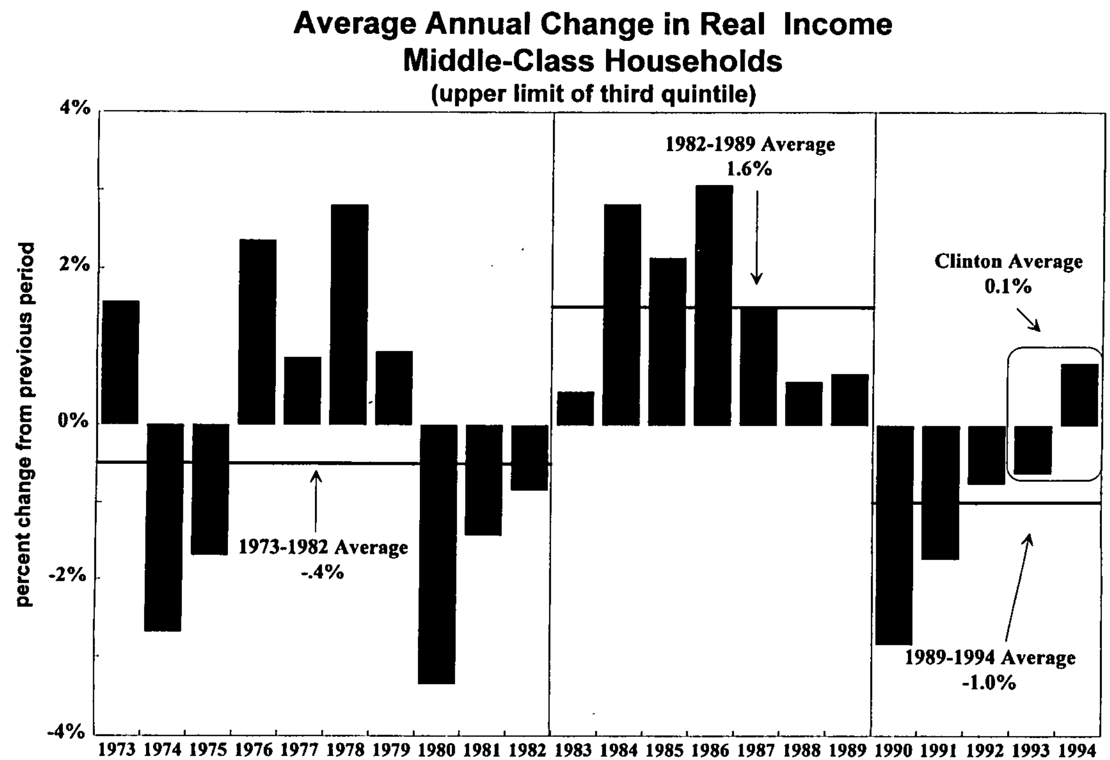


Source: Bureau of the Census

Average Annual Change in Real Income
Lower-Middle-Class Households
(upper limit of second quintile)



Source: Bureau of the Census



Source: Bureau of the Census

PREPARED STATEMENT OF SENATOR JEFF BINGAMAN

Thank you, Mr. Chairman, and thank you for holding this important hearing.

Let me first welcome our two new House Members of the Joint Economic Committee, Carolyn Maloney (D-14-NY) and Maurice Hinchey (D-26-NY). Thanks to both of you for joining these efforts. And of course, Senator Robb is a regular stalwart, and I want to recognize his presence.

I am very pleased to join with the Chairman in welcoming Dr. Joseph Stiglitz, Chairman of the President's Council of Economic Advisers, before the Joint Economic Committee this morning. Dr. Stiglitz is one of the nation's most respected economists and the President is fortunate to have him as one of his closest advisors. I am also pleased to see that the chairman has scheduled a second panel of distinguished economists this morning, all of whom have served on the Council of Economic Advisers and are eminently qualified to comment on the topic of today's hearing.

Although the question for this morning's session is whether the economy is giving its best performance in thirty years, there are in fact two distinct questions we have to consider -- how is the overall economy doing? and how are America's working families doing?

The answer to the first question is that the overall economy is doing well -- by many counts. This is now the third longest economic expansion of the post-war period and the longest expansion that has not depended on a military buildup. We have achieved levels of output, unemployment, inflation, and the budget deficit that are significantly better than projected in early 1993. In fact, they are decidedly better than outgoing President Bush projected would occur with adoption of his policies.

Since January 1993, when President Clinton took office, we have had very strong job growth. Over the last 37 months, nonfarm payrolls have risen by 8.4 million and that figure will be raised to roughly 9 million when the Bureau of Labor Statistics issues its annual revision of the employment figures in June. The unemployment rate has been cut from 7.1 % to 5.5%, and we now have an unemployment rate very near the lowest level in 25 years.

At the same time, inflation is now at its lowest level in 30 years and then federal budget deficit is down from $290 billion in 1993 to $165 billion this last year -- and we know we are an our way to knocking it down to balance in the next seven year, at least that is what we're all saying we are going to do.

But I think that no one can deny that there are still serious problems to confront in this economy. There are millions of American working families that are scrambling to pay the bills each month. They are working longer hours, taking home less money, and working more jobs just to stay in place. Yet the amounts they have to pay for education and health care increasingly higher and increasingly out of reach by the sector of the economy that most needs these. Economic anxiety is high and is undeniable.

So we do have a problem and it is two fold -- the problem is that our economy has grown too slowly in the last two decades; our long term economic growth for a century -- from 1870 to 1970 was 3.4% -- and since then our average growth has been running at 2.3%. That's a twelve trillion dollar loss for our nation. I propose to you that we would not be in debt and would not be struggling in Congress to cut health care, education and research and development programs if we had done a better job understanding the mechanics of long-term, steady economic growth.

Prosperity in recent years has been limited to those at the top of the earnings scale, while those in middle and bottom have been left behind. Low productivity growth, long recessions with high unemployment, corporate downsizing, decreasing unionization, technological change and the international supply of cheap labor have each contributed in some measure to the problem.

Some of you probably know William McDonough, President of the Federal Reserve Bank of New York. In November 1994, Mr. McDonough invited 35 academics, businessmen, and journalists to a day long conference at the New York Fed's headquarters. The Fed President, who is known to shun the press and watch every word he states extremely closely opened the session as follows:

...I am very pleased that all of you are here today to discuss what I feel is a critical issue facing our country. The issue is, of course, the growing disparity in wages earned by different segments of our labor force. It is deeply troubling that during the 1980s the real wages of low-skilled workers in the United States have fallen sharply, both in absolute terms and relative to the wages of highly skilled workers... These dramatic wage developments raise profound issues for the United States -- issues of equity and social cohesion, issues that affect the very temperament of the country. We are forced to face the question of whether we will be able to go forward together as a unified society with a confident outlook or as society of diverse economic groups suspicious of both the future and each other.

It seems to me that back in 1994 Mr. McDonough saw clearly what was happening in America -- and sounded an alarm.

We cannot turn back the clock nor should we isolate our economy. Instead, we have to make sure that every American has the training, skills, and job opportunities to earn a fair living and evolve with the economy rather than to become a victim of it. While the administration has made a positive difference in economic performance, there is more to be done.

I am very pleased to welcome Dr. Stiglitz and the other panelists here today to discuss the health or our economy and to reflect on what needs to be done.

Testimony before the Joint Economic Committee
Dr. Joseph E. Stiglitz
Chairman, President's Council of Economic Advisers
March 22, 1996

Thank you, Mr. Chairman. It is a pleasure to appear before the Joint Economic Committee today. My testimony this morning will focus on the performance of the U.S. economy over the past three years.

From a variety of perspectives, our performance has exceeded expectations. Throughout the 1970s and 1980s, our economy faced high inflation, high unemployment, and soaring budget deficits. Today, inflation and unemployment are low. Job growth has been strong: the American economy has added 8.4 million jobs over the past three years, 93 percent of which are in the private sector. We have also sharply reduced the budget deficit, from $290 billion in FY 1992 to $164 billion in FY 1995. And the budget submitted by the President on Tuesday would eliminate the deficit by 2002 using CBO's economic assumptions. To be sure, we still face many challenges, some of which I will discuss later. But in many ways, our economy is healthier and the fundamentals are stronger than they have been since the 1960s.

Inflation and unemployment

Figure 1 shows that the inflation rate, as measured by the consumer price index, has been lower over the past three years than in any three-year period since 1967. Figure 2 depicts the monthly unemployment rate, which is hovering around its lowest level in almost 6 years. But perhaps the most striking current feature of the economy is the combination of these two events: even at our low unemployment rate, inflation remains subdued. Figure 3 illustrates this accomplishment by plotting the combined rate of unemployment and inflation, which is at its lowest level since 1968.

I want to stress the importance of achieving low unemployment with low inflation. Excessive unemployment is not only a waste of our most valuable resource -- the human capital embodied in an American worker -- but it is also devastating for the individuals involved and their families. For the young, unemployment prevents the accumulation of work experience and impedes an attachment to the workforce -- with deleterious effects even years later. For more settled families, unemployment can mean losing a home or asking one's children to forgo a college education. In sum, unemployment imposes tremendous costs on the affected workers and their families. Our standard of living is undoubtedly higher if we can sustain a lower level of unemployment without inducing inflationary pressures.

Deficit reduction

The next macroeconomic indicator I want to examine is the budget deficit. Regardless of how it is measured -- in dollar terms, in real terms, or as a percentage of GDP -- the deficit soared in the 1980s (see Figures 4 through 6). Since the Administration took office, however, the deficit has fallen dramatically: from 4.9 percent of GDP in FY 1992 to 2.3 percent in FY 1995. And as the next chart shows, the debt-GDP ratio -- which measures the accumulation of past deficits relative to current output -- fell from 82 percent in 1950 to 27 percent in 1980. It then climbed dramatically throughout the 1980s and reached 50 percent in 1992. But as the chart also shows, the debt-GDP ratio has fallen slightly since passage of OBRA93.

Another way of viewing our remarkable progress on the deficit is to examine the primary budget -- the budget balance had we not inherited any government debt. The primary budget is now in surplus. In other words, if net interest payments are excluded, the Federal government is running a surplus.

Other features of the economy

Let me now turn to other indicators of the U.S. economy's underlying strength. Exports are up 31 percent over the past three years, providing about one-third of the cumulative growth in real GDP. This rapid export growth is testimony to both the competitiveness of American firms and the success of the Administration's efforts at opening markets abroad. We have signed numerous trade agreements, including 20 with Japan. And our exporters have succeeded in cutting unit labor costs and thus becoming more competitive. The results are impressive. The United States is now the world's leader in automobile production -- for the first time since the 1970s. And we are the world's largest exporter, with 13 percent of the world export market, compared to 8 percent for Japan and 9 percent for Germany.

Exports are not the only sector experiencing a boom. Investment in physical capital is also. We experienced double-digit equipment investment growth in 1993 (10 percent), 1994 (13 percent), and 1995 (11 percent). This rapid investment growth, which is at least partly the result of our deficit reduction efforts, should help to promote increased productivity in the future -- which is one of the challenges I will speak about later.

To be sure, not every category of investment is at an all-time record. In the early 1980s, commercial real estate enjoyed an artificial boom, spurred on by distortionary tax provisions -- for example, depreciation allowances far larger than true economic depreciation. This artificial expansion could not -- and did not -- last. The collapse contributed in no small measure to the S & L debacle which, in turn, was a driving force in the economic recession of 1991, and which cost the American taxpayers over $150 billion to resolve. Let me put that number in perspective: it is approximately equal to the proposed 7-year savings in both Medicaid and welfare under the Republican proposal to balance the budget.

U.S. performance relative to Japan and Germany

The healthy state of the U.S. economy is highlighted by comparisons with Japan and Germany. Over the past three years, the U.S. has grown twice as fast as Germany, and five times as fast as Japan. Employment in the United States has risen by over 2 percent per year, whereas it has stagnated in Japan and actually declined in Germany. Japan faces serious problems in its banking sector, and Germany has a significant unemployment problem. Furthermore, as Figure 8 shows, our budget deficit is a smaller share of GDP than in either Japan or Germany. Relative to other industrialized economies, the U.S. economy appears remarkably dynamic.

Other indicators of progress

Before moving on to discuss some of the challenges we face, I want to take a broader look at living standards relative to 1960. In that year, the civilian unemployment rate averaged 5.5 percent -- precisely its current level. Along a variety of dimensions, our quality of life has improved dramatically since then. For example, infant mortality has fallen from 26 per 1,000 live births to 8 per 1,000 live births. The elderly poverty rate, in those days before Medicare and the expansion of Social Security, hovered around 30 percent; it is now below 12 percent. The overall poverty rate has fallen from 22.2 percent in 1960 to 14.5 percent in 1994. The percentage of the population aged 25 and over with a college degree was 8.4 percent in 1960; it is now over 22 percent. Life expectancy at birth was 69.7 years in 1960; it has now risen to over 75 years.

Remaining challenges

Despite the encouraging economic and social indicators I have described, America still faces several crucial challenges. The two most important are raising productivity growth and ensuring that all Americans have the opportunity to participate fully in the success of our economy.

In manufacturing, annual productivity growth has averaged a robust 3.5 percent since the first quarter of 1993. But for the economy as a whole, productivity growth continues at the same pace as in the 1970s and 1980s -- which is slower than in the 1950s and 1960s. Most economists date the beginning of the productivity slowdown to the early 1970s, and there appears to be no simple, agreed upon explanation. Figure 9 shows the historical record over a relatively long period of time, in which the period immediately surrounding World War II appears as an historical aberration.

Could it be that the unique events of the 1930s and 1940s induced this aberration? Restrained levels of private investment meant that many new innovations were not embodied in new machines. The heavy investment by the government in research during the war -- from innovations in airplanes to the development of the nuclear industry -- paid dividends to the economy in the years after the war.

Another factor explaining the slowdown in measured productivity growth may be shifts in the sectoral composition of output. Most economists believe that there are serious problems in the measurement of productivity in services. And the service sector is clearly becoming an increasingly important part of the economy. Any downward bias in measured productivity growth in services therefore implies an increasingly large downward bias in aggregate productivity growth over time. But both of these explanations -- that productivity growth was abnormally high in the immediate post-war period, and that measured productivity is increasingly biased downward -- leave us wondering why productivity decelerated so abruptly in the early 1970s. Why then?

Measurement problems arise not only with respect to productivity. They also complicate analyses of real wage trends. Typically, real wages are calculated by dividing nominal wages by consumption prices. But the choice of deflator is crucial. For example, as Figure 10 shows, the real product wage -- nominal wages deflated by the nonfarm business GDP deflator-- has increased much more rapidly than the conventionally-cited real consumption wage (defined as nominal wages deflated by the consumption deflator).

The point of this chart is not to gloss over the wage issue. Indeed, real wages tend to track productivity over long periods of time, and therefore the slower pace of productivity growth since the early 1970s would be expected to manifest itself in a slower pace of real wage growth. While the chart reminds us that we must be very careful in deciding how to measure the "real" wage, it also reminds us that productivity growth remains relatively slow. This is a crucial challenge for American workers and policy-makers.

Raising productivity growth requires productivity-enhancing policies: investments in education, and in research and technology; deficit reduction done the right way, that is deficit reduction that preserves investments; and, finally, a strategy for raising productivity in the public sector, by reforming, streamlining, and where necessary, eliminating, government programs and regulations. The Administration's strategy for raising productivity growth include all these elements. But we are realistic about the immediate impact of such policies. Problems that have been allowed to fester for two decades can not be rectified overnight.

A second major challenge is enhancing opportunity for all Americans. The disparity in incomes between high school graduates who do not go onto college and those who complete college has widened sharply over the past fifteen years. Figure 11 shows that in 1979, mean earnings for a male college graduate were 49 percent higher than mean earnings for a male high school graduate. By 1993, this ratio had widened to 89 percent. In other words, our high technology economy has been putting an increasing premium on skills.

Those at the bottom of the income distribution have actually seen their real income fall -- with the turning point again in the 1970s. Between 1950 and 1979, mean family income for the bottom quintile of the population rose 141 percent in real terms. Between 1979 and 1993, that same portion of the population experienced a 15 percent real income decline. Again, we can't expect these long term trends to be reversed overnight. And it is too soon to tell for sure, but there may be some initial, encouraging signs. For example, in 1994 (the most recent year for which we have data), the poverty rate fell and real median family income rose (by 2.3 percent) for the first time in five years. Before moving on, let me stress that we should not become complacent, even with such initial signs of progress. Now is not the time to be cutting back on policies that share the benefits of growth more widely. It is not the time to reduce the EITC, to cut back on education and training, or to decimate crucial social safety net programs.

I want to stress the importance of education and training, which offer perhaps our best hope of raising productivity while also reducing inequality. Indeed, our most important type of investment is in people, our most valuable resource. Over the past 30 years, increases in education added as much as 0.3 percentage point per year to our growth rate – roughly 20 percent of the average annual growth rate. And recent evidence suggests that education may be becoming an even more important component of growth.

The Administration recognizes the benefits of investing in human capital. It has improved access to education and training through policies such as School-to-Work, Americorps, and the direct lending program. It has also proposed tax deductions for post-secondary education and training, further increases in the maximum Pell Grant, and an expansion in the Head Start program. And it has pushed to improve our training system, through the creation of one-stop career centers, skill grants, and a consolidation of existing job training programs.

Two labor market issues

Finally, I'd like to turn to two issues that have received considerable attention recently: the quality of jobs being created and the reduced sense of economic security felt by many American workers. The data suggest that a disproportionate number of the new jobs being created are in the service sector, conjuring up images of hamburger flippers. But the "service sector" embraces far more than that – it includes the dynamic financial sector, many high-technology sectors such as computer programming, and a host of other high-paying industries. If we break down industries more finely, the data show that more than half of all the jobs created in 1995 were in high-paying industries – those whose wages were above the employment-weighted median in

1993. And the other way of classifying jobs, by occupational categories, also indicates that it is the higher-paid categories that have grown most rapidly (see Figure 12).

Another aspect of job quality is whether the position is full-time or part-time. There is no evidence of disproportionate increases in part-time work from the payroll survey data. A simple calculation using data from that survey suggests that the economy created about 7 million full-time equivalent jobs between January 1993 and December 1995 -- the vast majority of the increase in the number of jobs during that time period. And if most new jobs were part-time, we would expect average hours per worker to decline. But there has actually been a very slight increase since 1992.

To be sure, some people prefer to work part-time. The question is therefore whether those who would prefer to work full-time are denied the opportunity to do so. We can find no empirical support for such a hypothesis. According to data from the Bureau of Labor Statistics' household survey, part-time employment for economic reasons has actually fallen slightly since January 1994 (see Figure 13).

Now let me turn to the issue of job security. Many Americans are feeling less secure. Unfortunately, we do not have the data to make meaningful comparisons between the economy of the 1950s and 1960s and that of today, but we can analyze what has happened over the past fifteen years. While there is no strong trend in the overall displacement rate since the early 1980s, the characteristics of displaced workers have changed somewhat. Displacement rates for older,

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better-educated, and white-collar workers have risen, although they remain low relative to those for younger, less-educated, and blue-collar workers. Job displacement rates in manufacturing have fallen, although they remain higher than in services.

These ongoing shifts are due partly to our more competitive global economic environment. Schumpeter described dynamic capitalism as entailing a process of creative destruction. This is what we have seen in recent years: while many jobs have been eliminated, many more new jobs have been created. The new jobs are in areas of America's strength, such as in our merchandise export sectors, which pay on average 13 to 15 percent more than the national average.

I want to stress that when we say that the economy has created more than 8 million new jobs, that is a net figure. The gross job creation is far greater -- we have created jobs for new labor market entrants, we have created jobs to replace those lost in declining industries, and in addition we have created enough new jobs to bring the unemployment rate down from over 7 percent in 1992 to 5.5 percent today.

As I said earlier, the overall performance of the economy has been impressive. But we recognize that this is not particularly comforting to an individual who is dislocated. Dislocated workers do face significant economic losses. Although experiences vary widely, workers displaced from a full-time job who are re-employed in another full-time job suffer, on average, a 10 percent decline in real earnings. And although these costs are little different today than they were ten years ago, our job is to make job transitions less painful.

Easing the adjustment costs associated with a dynamic economy has therefore been another focus of the Administration's policies. Studies show, for instance, that more educated workers experience fewer difficulties in transitions between jobs -- providing an additional motivation for boosting investments in education. And since we have an employment-based system of health insurance, one of the real anxieties that Americans face when they lose a job is the loss of health insurance. Portable health insurance, as embodied in the bi-partisan Kennedy Kassenbaum bill, would be a significant improvement over the current situation. We also need to provide health insurance as a component of unemployment insurance, as we proposed once again in the Budget released on Tuesday. Other elements of that Budget are intended to improve the efficiency of the labor market, for example by making other benefits -- especially pensions -- more secure and more portable.

Conclusions

Mr. Chairman, let me conclude by noting that this is the 50th anniversary of your committee and of the Council of Economic Advisers, both of which were established by the Employment Act of 1946. We should recall the circumstances and anxieties that motivated the passage of that act. In 1929, the economy went into the worst depression that it had ever experienced, with one of every four workers unemployed. It was not until World War II that the economy fully recovered. As the war ended, there was great concern that economic performance would revert to the dismal experience of the pre-war years. The Employment Act committed us to pursuing policies to "promote maximum employment, production, and purchasing power." I would like to think that the guidance provided by your committee and our Council to the legislative and executive branches has contributed in some small measure to the economic successes of the intervening 50 years. From our perspective, the combination of low unemployment and low inflation, which has eluded us now for almost three decades, is at last within our grasp.

Thank you. I would welcome any questions.

Figure 1.

Consumer Price Inflation

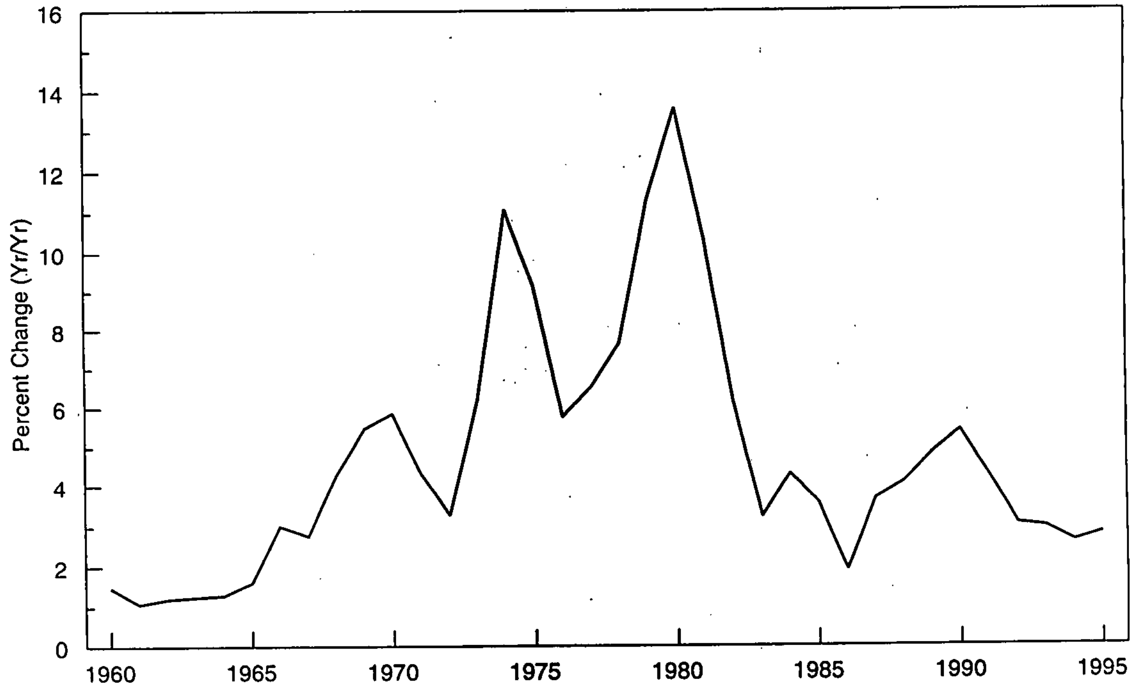


Figure 2.

Unemployment Rate

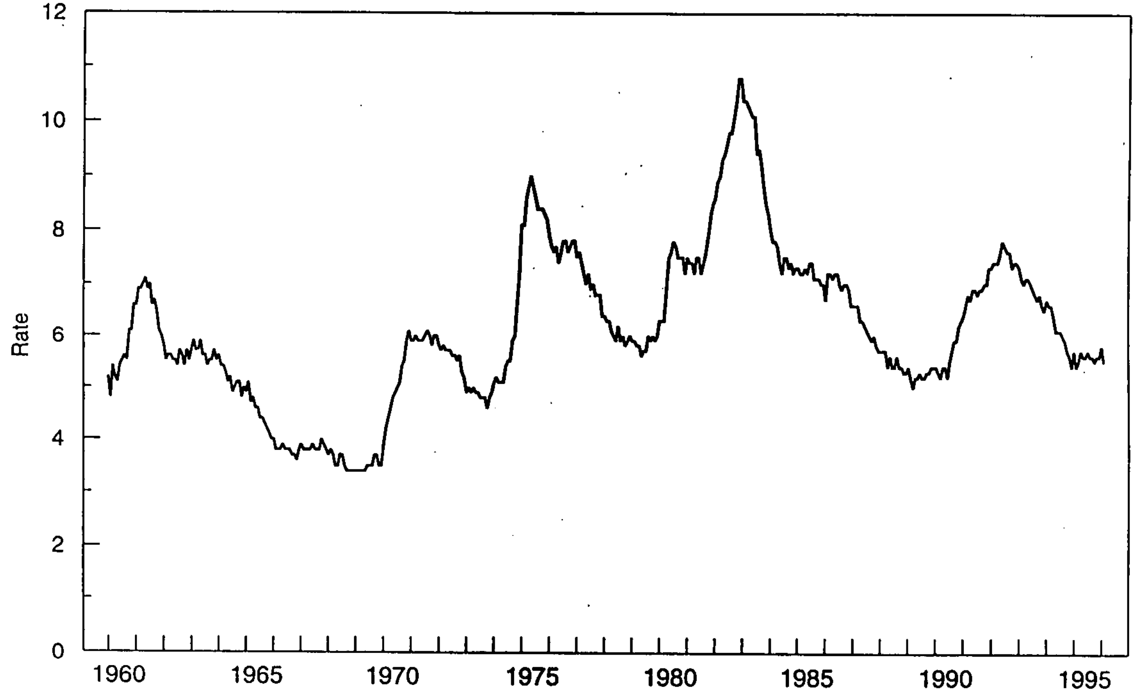


Figure 3.

Misery Index

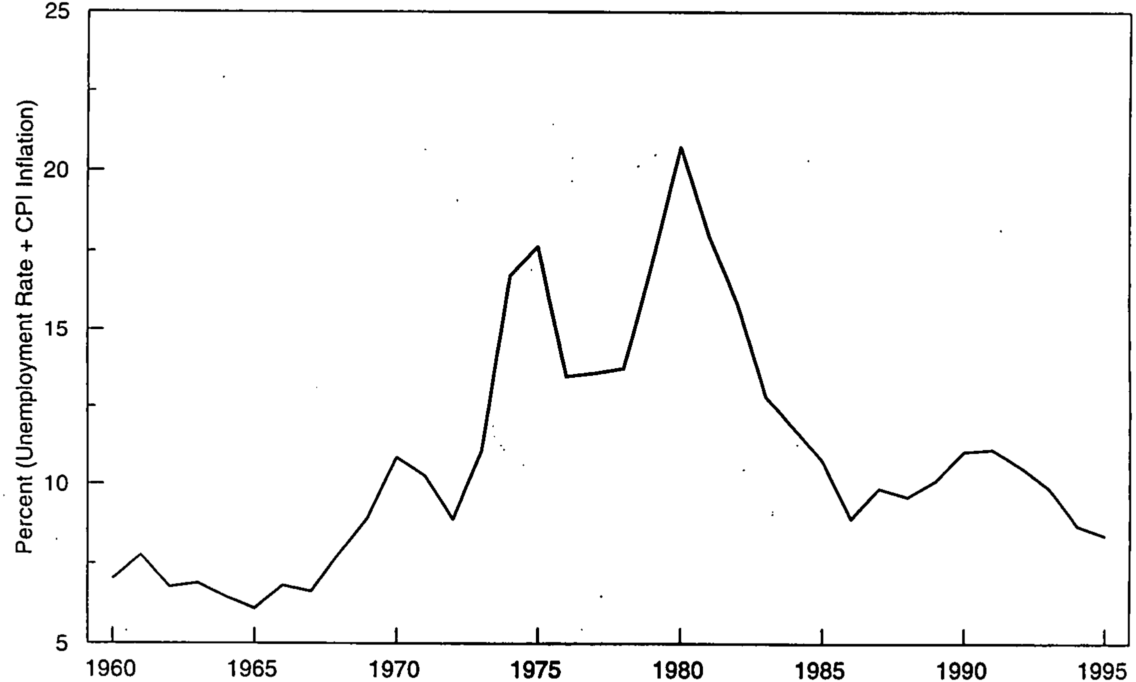
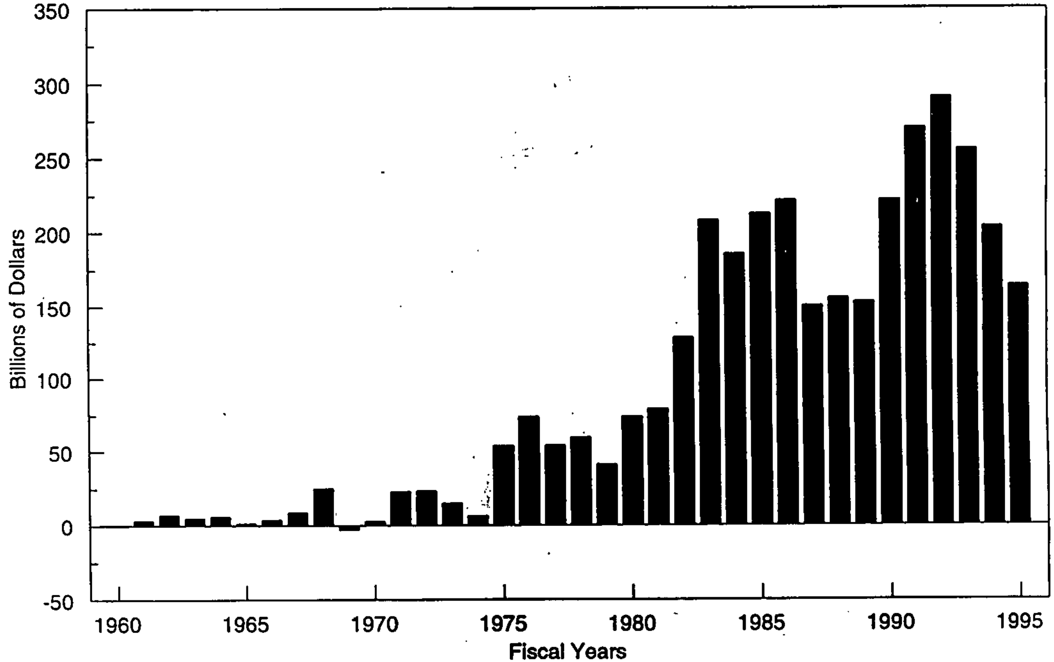


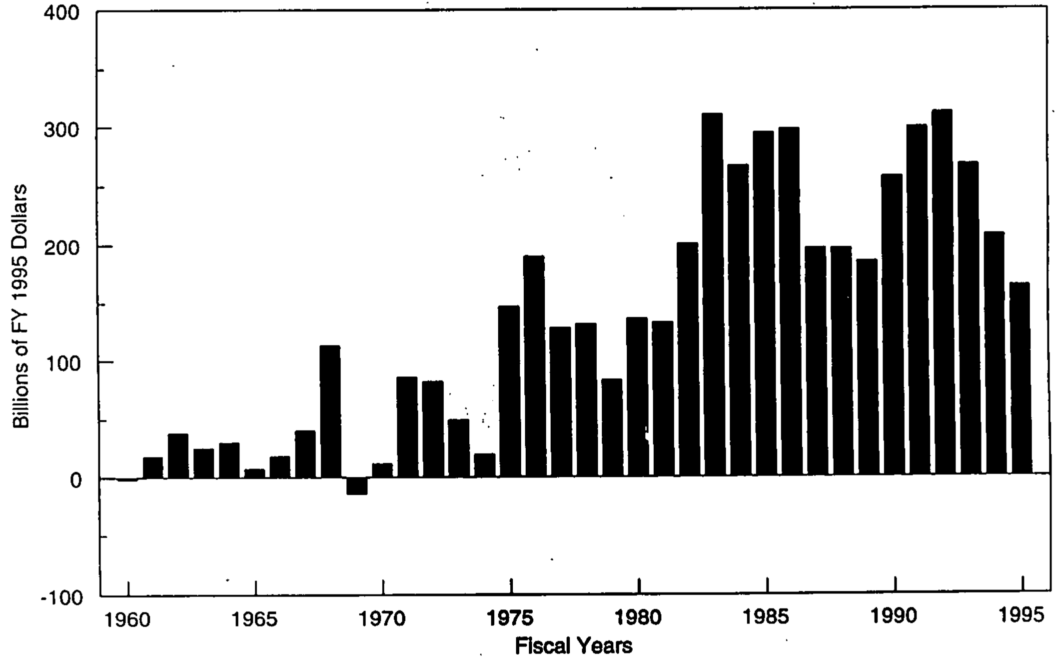
Figure 4.
Federal Deficit



Note: The GDP measure used is pre-January 1996 benchmark revision.
Source: Office of Management and Budget.

Figure 5.

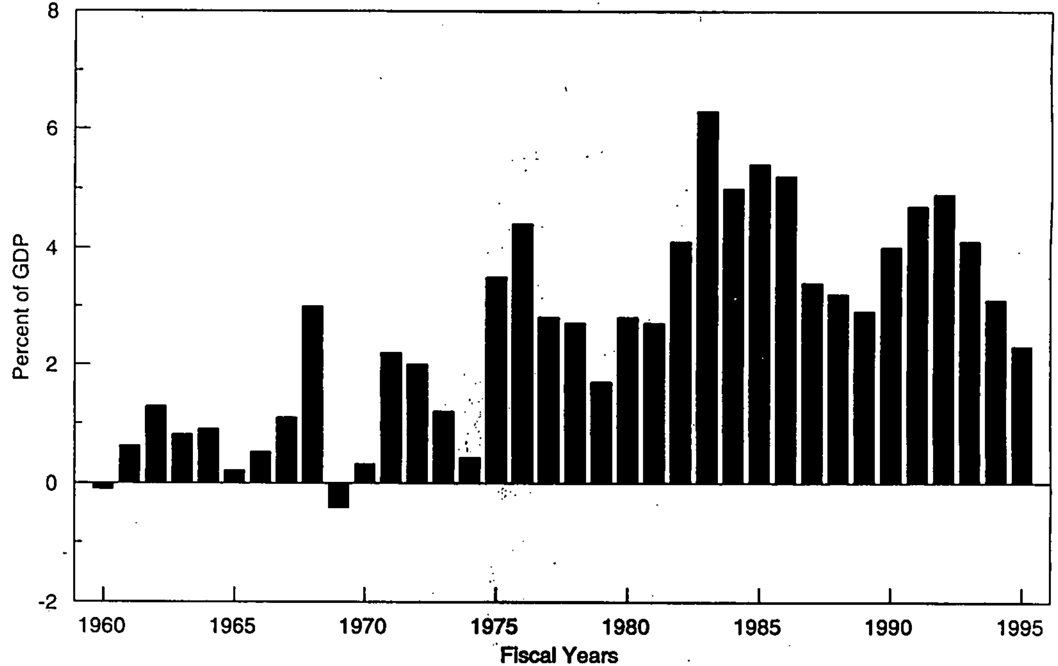
Federal Deficit



Note: The GDP measure used is pre-January 1996 benchmark revision.
Source: Office of Management and Budget.

Figure 6.

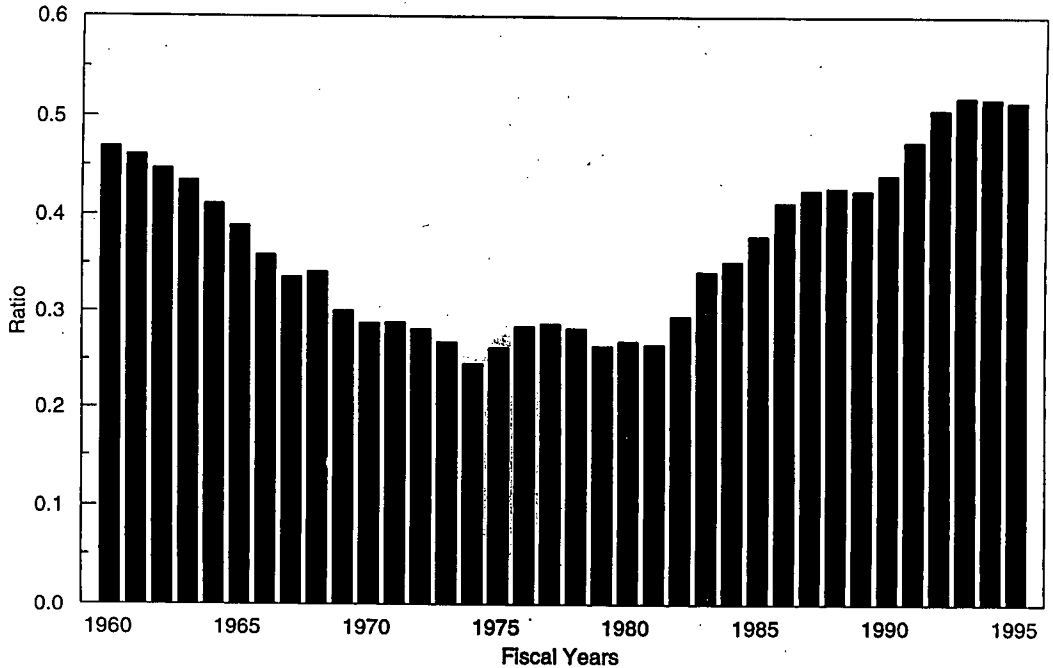
Federal Deficit as a Percent of GDP



Note: The GDP measure used is pre-January 1996 benchmark revision.
Source: Office of Management and Budget.

Figure 7.

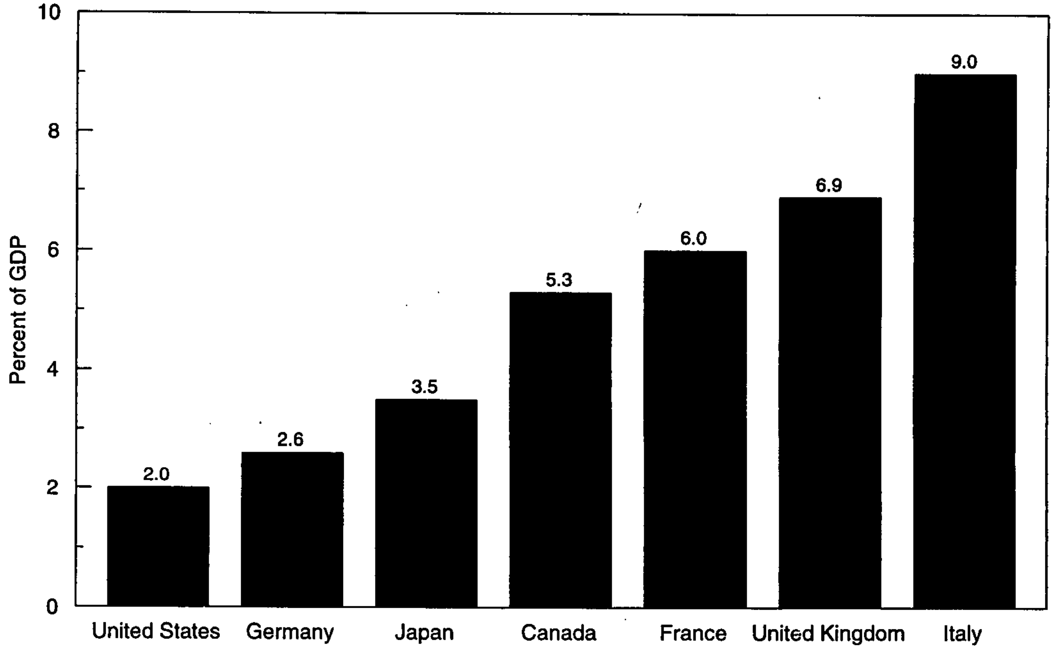
Federal Debt-to-GDP Ratio



Note: The GDP measure used is pre-January 1996 benchmark revision.
Source: Office of Management and Budget.

Figure 8.

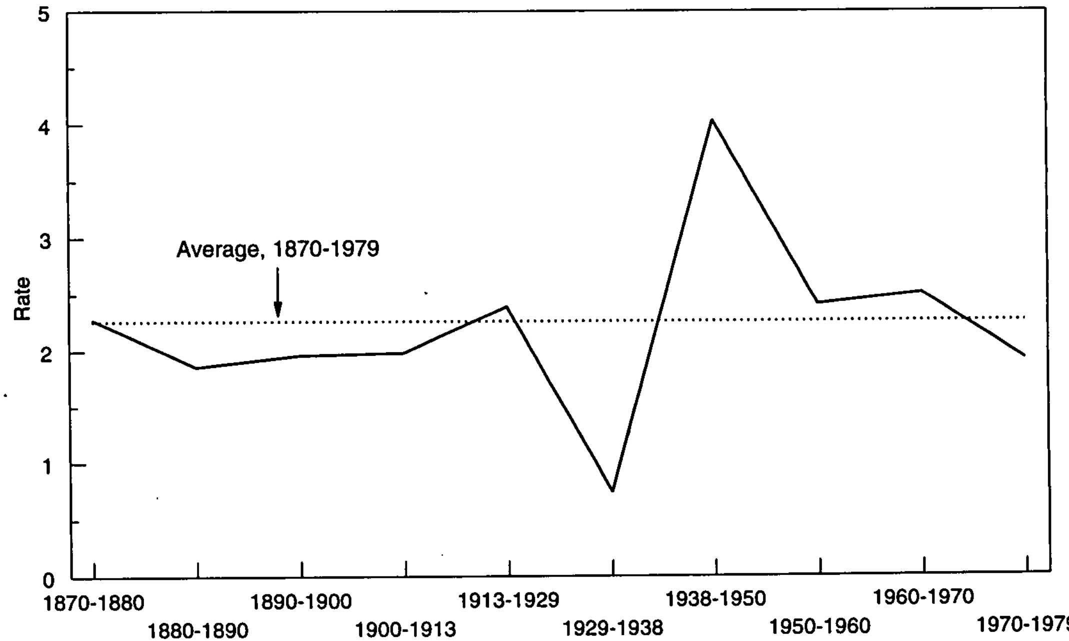
General Government Deficits in 1994



Note: General government includes Federal, State and local.
Source: Organization for Economic Cooperation and Development.

Figure 9.

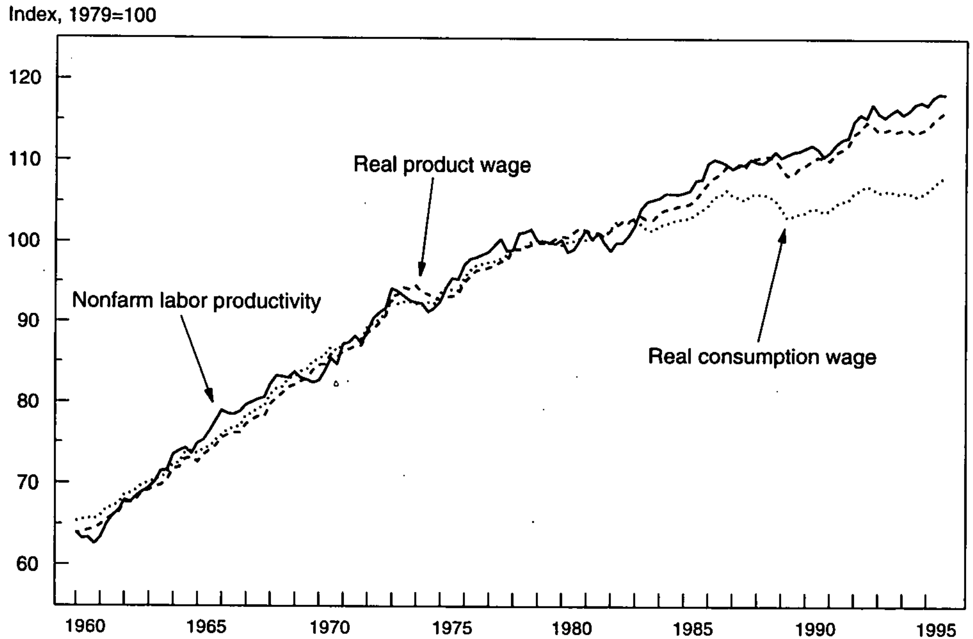
Growth Rate of GDP per Hour



Source: Maddison, Angus (1992). Phases of Capitalist Development. Oxford: Oxford Univ. Press.

Figure 10.

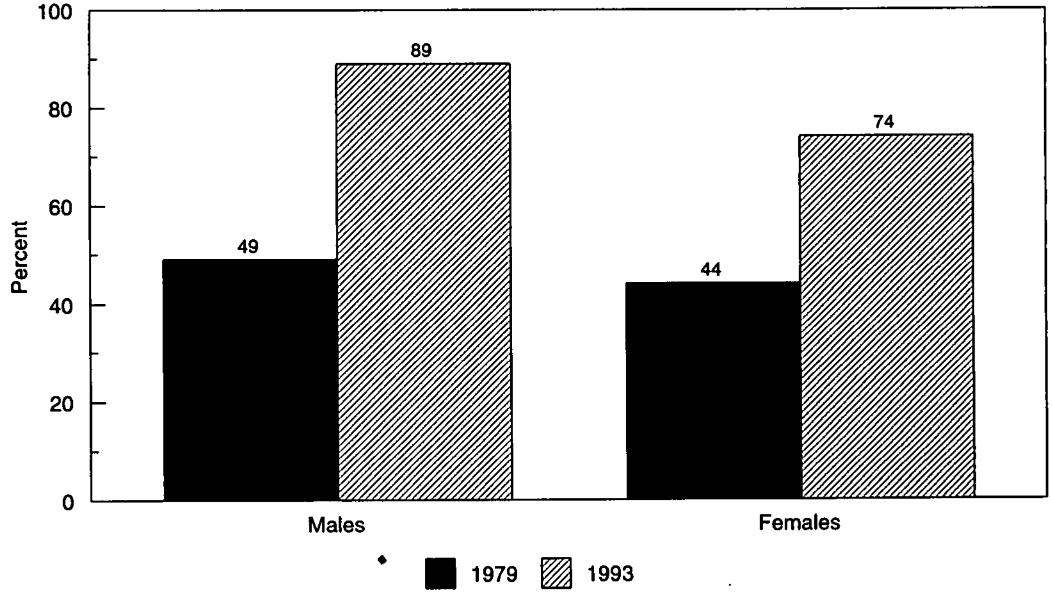
Measures of Real Compensation and Labor Productivity



Note: Wages are compensation per hour in the nonfarm business sector divided by the consumption deflator for the real consumption wage and by the nonfarm business deflator for the real product wage.
Sources: Departments of Commerce and Labor, and Council of Economic Advisers.

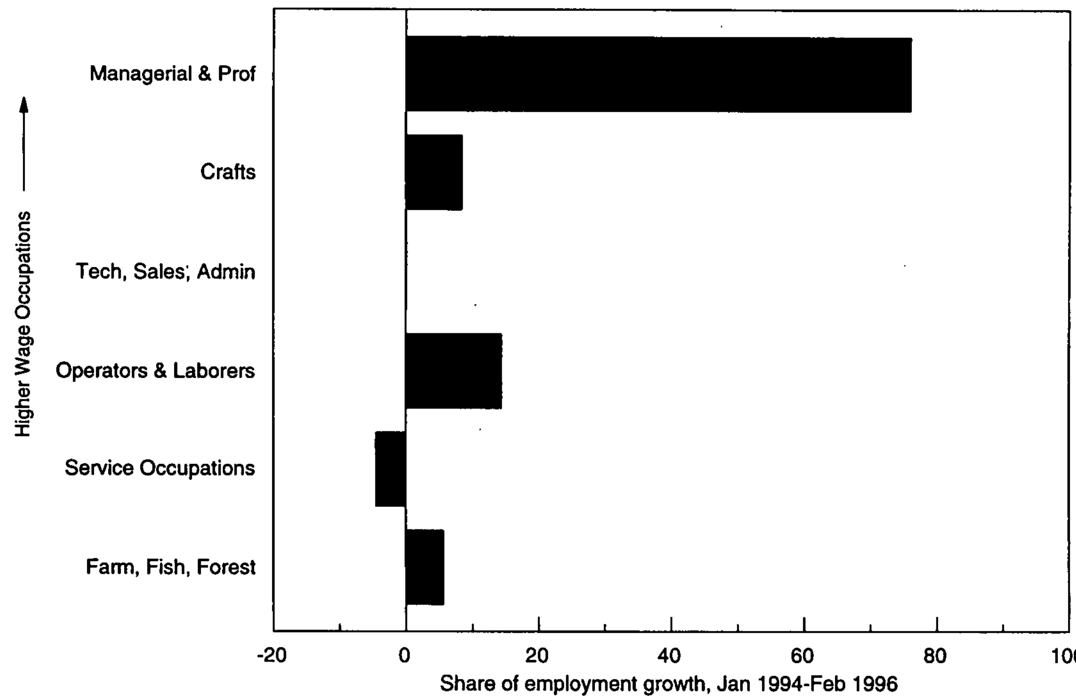
Figure 11.

Percent Difference in Annual Earnings for College and High School Graduates



Note: Data are for year-round, full-time workers, age 25 and over.
Source: Department of Labor.

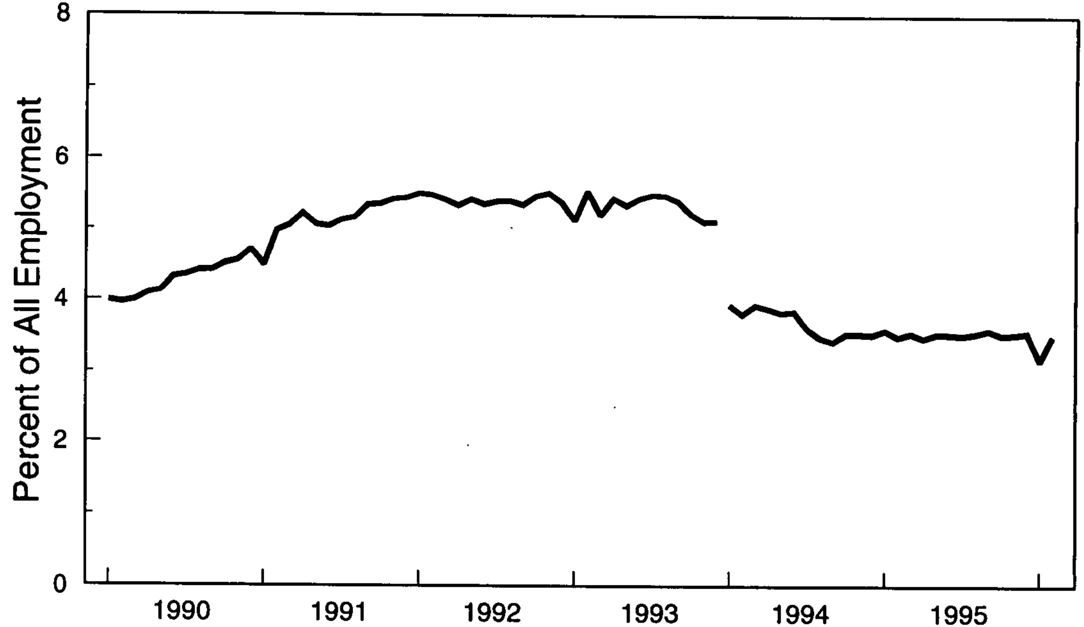
Figure 12.
Job Growth by Occupation



Source: Department of Labor.

Figure 13.

Part-time Workers for Economic Reasons



Note: Workers in all nonagricultural industries. Series discontinuity reflects redesign of the CPS. No direct comparison is possible
Source: Bureau of Labor Statistics.

PREPARED STATEMENT OF WILLIAM A. NISKANEN

Mr. Chairman and members of the Joint Economic Committee: I am pleased to testify again on the state of the U.S. economy.

As is often the case, I have some good news and some bad news:

The good news is obvious. The American labor market is a marvelous jobs machine. The employment rate is near an historical peak, and the percent of those employed part time for economic reasons is unusually low. The unemployment rate is about as low as in any year in the past two decades. Although job turnover has increased slightly, the median duration of unemployment is only eight weeks. The economic insecurity theme of this year's election stories seems largely a creation of the press.

Similarly, the inflation rate is about as low as in any year in the past three decades. Although the stock market has been quite volatile, the major stock price indexes have registered a new historical high almost every month. April will be the start of the sixth year of economic recovery, and the pattern of leading indicators provides ample reason to expect the recovery to continue.

President Clinton, as would any incumbent, will take credit for the good news. But he is more like an agile surfer on a long smooth wave. Clinton's timing and balance are superb, but he did not create the wave.

But good news should not divert your attention from the several important problems of the American economy.

1. The one most important problem is that the average productivity growth rate has declined somewhat unevenly for 30 years. Since 1979, productivity has increased at only 1.2 percent annual rate, about half the annual rate of the prior 15 years. My profession is not of one mind about the relative contributions to this decline in productivity growth, but the following conditions are at least partly responsible:

a) We have had a slow growth of the human capital per worker, despite an increase in real spending per student by about 30 percent a decade. The composite SAT score peaked in 1963 and declined almost continuously through about 1980.

b) Taxes have increased by about 5 percentage points of GDP beginning with the expansion of the welfare state and the Vietnam War in the late 1960's.

c) The cost of regulation and litigation have increased sharply beginning in the early 1970's.

d) The net saving rate declined sharply in the 1980s, reflecting the combination of a sharp decline in the private saving rate and a sharp increase in the federal deficit. The private sector has been able to maintain a somewhat higher investment rate only by a substantial increase in net borrowing abroad..

2. The slow growth in productivity has led to a correspondingly slow growth in average real compensation. The rapid increase in nonwage compensation, mostly for social security taxes and health insurance, moreover, has led to some decline in average real wages. Most male workers have experienced some decline in real wages since 1973, with the largest decline among those with the least skills. Most females workers have experienced some increase in real wage sin this period, with the largest increase among those with the most skills.

Again, my profession has not yet sorted out the reasons for the increased variance of real wages. Some part of this development must be attributable to the rough doubling of the trade share of GDP in this period. Skilled labor is more scarce in the world economy than in the United States, so increased trade increases the demand for our skilled labor. Unskilled labor is more plentiful in the world economy than in the United States, so our unskilled labor is increasingly in competition with unskilled labor in other countries. In general, increased trade will create problems for low-skilled labor in high-wage countries. In the United States, this has reduced their real wages; in Europe, this has sharply increased unemployment. This is an awkward conclusion for economists, because reducing trade barriers clearly increases productivity and average real earnings. The best response to this condition, however, is to focus on increasing labor skills, not on increasing trade barriers.

Many economists have attributed the increased variance of wages to changes in technology, but I am skeptical of this explanation. The evidence for the effect of technology is largely anecdotal. And technology is most likely to be commercially successful if it substitutes for high priced resources. Another plausible explanation, I suggest, merits more attention: the level of job skills at the bottom of the skill distribution has probably declined. One does not need to look far for an explanation: a rapidly increasing share of young workers have grown up without a father and were poorly served by our public school system.

3. The third major problem of the U.S. economy is the fiscal threat to our children. The federal government continues to make

huge promises to the current generation that will either be broken or will require a huge increase in future taxes. The current federal deficit is only a small part of this problem and the part that is likely to be reduced soonest. The larger, less transparent, threats to our fiscal future are the promises for future social security benefits, medicare benefits, and federal employee retirement benefits. The sooner these problems are addressed, the better. You must not allow those who refuse to address these massive intergenerational transfers to claim the mantle of compassion. In fact, they are being generous with other people's money -- in this case, that of their children and our children.

In summary, the quality of political rhetoric would be improved if we were all more careful about attributing credit and blame. President Clinton did not create the major problems of the U.S. economy, but he would be properly judged by what, if anything, he has done about them.

"How Healthy is the U.S. Economy?"

Testimony of

Alan S. Blinder

Gordon S. Rentschler Memorial Professor of Economics

Princeton University

to the

Joint Economic Committee

U.S. Congress

March 22, 1996

Mr. Chairman, members of the committee, I would like to thank you for the opportunity to testify here this morning on the health of the U.S. economy. I propose to spend just a few minutes reviewing the current cyclical situation, which is very good indeed, and then move on to the two long-run problems that have bedeviled our country for about two decades now: sluggish productivity growth and widening income inequality. There, the record is not so good.

The Current Macroeconomic Situation

Both the CEA and the JEC were founded 50 years ago to assist the government in its pursuit of macroeconomic stability. Viewed from this perspective, the last few years must be viewed as a stunning success. The unemployment rate has now remained below 6% for 18 consecutive months. It has also been extraordinarily steady; during that time, it has never risen above 5.8% nor fallen below 5.4%. Inflation has also been low and steady. The core CPI inflation rate has averaged a bit below 3% over the last three years, during which time the 12-month moving average never rose above 3.5% nor fell below 2.6%.

When I joined the government in January 1993, I believe you could have gotten 1,000 to 1 odds on a bet that, three years later, the unemployment rate would be below 5.5% and the inflation rate below 3%. Yet that is where find ourselves today. America should congratulate itself on this achievement, which is the envy of the industrialized world.

How did it happen? Most of the "action" was, as always, in the private sector. Credit American business and labor. But government policy also played a constructive role. Traditionally, the government has been viewed as having two tools with which to pursue price stability and full employment: monetary policy and fiscal policy. But for the last dozen years or so, the fiscal arm of stabilization policy has been paralyzed by the need to reduce the budget deficit. So monetary policy has had to carry the ball alone. And it has, very well. I was privileged to play some role in this monetary policy while at the Federal Reserve.

However, since the 1993 budget agreement, responsible fiscal policy has played an important supporting role. By reducing the structural budget deficit, fiscal policy has helped create more favorable conditions for monetary policy to do its work. As you know, we now have the smallest budget deficit, relative to GDP, in the G-7. If fiscal responsibility is graded on the curve, the U.S. government has already earned an A. And this good record has helped pave the way to lower interest rates.

But there is more to do, and almost all economists applaud the resolve in Congress and in the White House to reduce the deficit still further. I want to make an important point, however. It is one thing to pass a multi-year budget plan that will lead to a balanced budget under specified economic assumptions. But it is quite another to pass a constitutional amendment requiring an annually balanced budget irrespective of the macroeconomic situation. By short-circuiting the automatic stabilizers, such an action would, in my judgment, gravely threaten the economic health of the nation. As you well know, Congress came within a whisker of passing such a balanced-budget amendment to the Constitution in 1995, and I imagine the issue will arise again in 1996 or 1997. I would urge members of this Committee to oppose it strenuously.

Unresolved Long-Run Problems

While the United States is cyclically healthy today, little has been done in recent years to address what I believe are its two lingering, long-run maladies: slow growth in productivity and real wages, and inequalities that are too large and may still be rising.

I cannot overemphasize how important these two problems are. Productivity growth is the main source--and ultimately the only source--of increases in standards of living. And democratic institutions get stretched to the limit when economic growth becomes, for the majority of a nation's citizens, a spectator sport rather than the participant sport it was meant to be. You have heard about these problems many times before, so I will be brief. My main point is that current political trends offer approximately nothing that would cure, or even alleviate, these problems. In fact, some recent policy proposals could even exacerbate them. I view this as a potential tragedy in the making.

Let me start with slow productivity growth and, especially, its implications for real wages. Since the recent Economic Report of the President ("ERP") is being highlighted by this hearing, I will use a few charts from that document to illustrate my points.

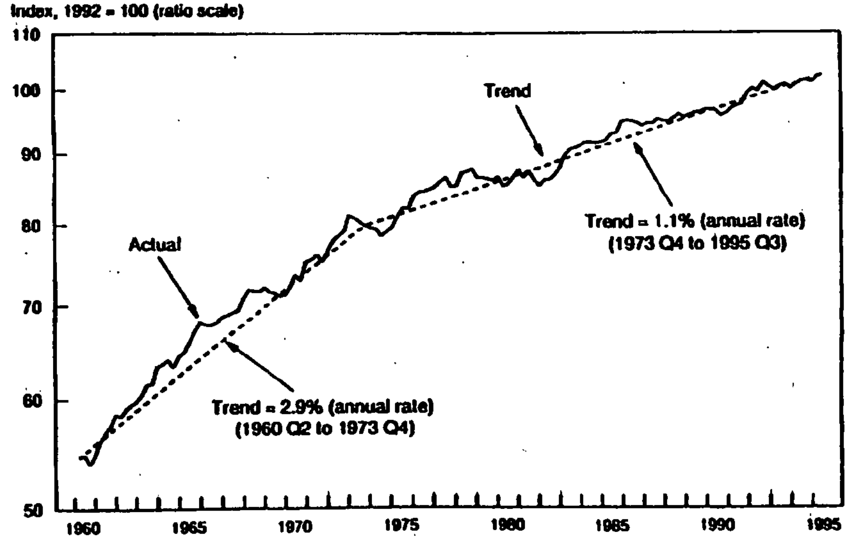
Chart 1 (which is Chart 2-5 from the ERP) shows vividly that the trend in productivity growth took a sharp turn for the worse around 1973-74 and has shown no signs of improvement in recent years. You can see a snap-back of the level of productivity from its recessionary low in 1991 and 1992. But that always happens after recessions; the chart shows similar rebounds in 1975-77 and 1982-83. Unfortunately, the chart displays not a shred of evidence that the trend in productivity growth has accelerated in recent years.

The implications of this secular stagnation are serious, and are depicted in Chart 2 (which is Chart 2-6 from the ERP). What is called here the "real product wage" is total labor compensation deflated by a price index of the things American businesses produce. That it closely tracks productivity growth over this 35-year period is unsurprising since elementary economic theory suggests that the two should move together. That is bad enough, for it means that sluggish productivity growth translates directly into sluggish real wage growth; and most Americans rely on labor income for their livings.

But, as the chart shows, the story has grown even worse in the last 12-15 years, as what is called the "real consumption wage" has sagged relative to the real product wage. The CEA defines the real consumption wage as labor compensation deflated by a price index of the things people buy. It, rather than the

Actual and Trend Labor Productivity

Smoothed for cyclical fluctuations, labor productivity has grown at a steady 1.1 percent average annual rate since 1973.

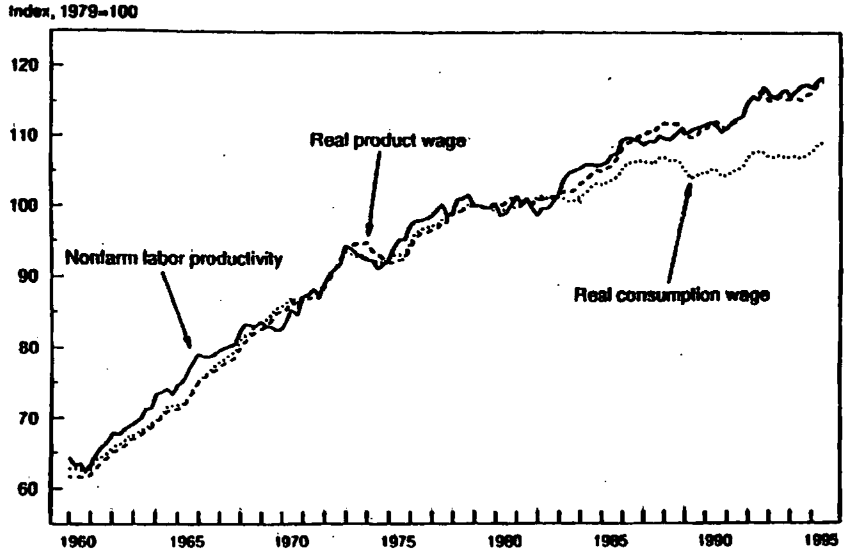


Note: Data are for the nonfarm business sector.
Source: Provisional estimates calculated by the Council of Economic Advisers from data provided by the Departments of Commerce and Labor.

Chart 1

Measures of Real Compensation and Labor Productivity

The real product wage has kept pace with productivity, whereas the real consumption wage has not.



Note: Wages are compensation per hour in the nonfarm business sector divided by the consumption deflator for the real consumption wage and by the nonfarm business deflator for the real product wage.
Sources: Departments of Commerce and Labor, and Council of Economic Advisers.

Chart 2

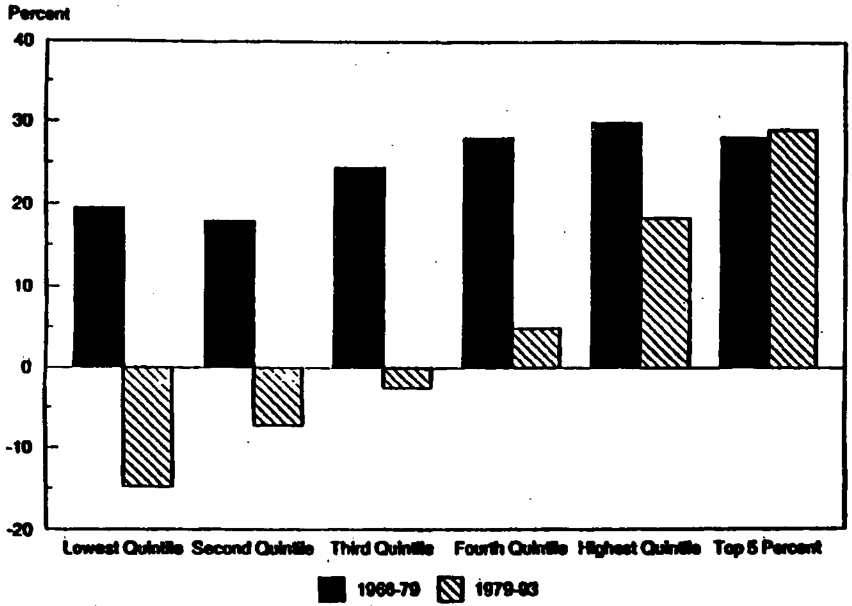
real product wage, measures increases in the standard of living for ordinary families. And, tragically, it has increased only about 7% in the last 14 years.

As a matter of simple arithmetic, the discrepancy between these two measures of real compensation means that the prices American workers pay for the goods and services they buy have grown faster than the selling prices of American businesses. How can this be? Exports and imports are not the answer. Rather, the two bundles of goods and services are different. One major difference is that services--including some high-inflation services not produced by the business sector--bulk larger in the consumption bundle than in the production bundle. Health care and college tuition are two pro minent examples. A second major difference is that consumers purchase few of the investment goods produced by American industry, and those prices have risen very slowly or even fallen in the recent decades. The most spectacular example, of course, is computers.

The consequence, shown in Chart 2, is that a gap of roughly 7 1/2% has opened up between consumer prices and producer prices since the end of 1981.

The second long-run problem is that, while average incomes and wages have grown slowly in real terms, the distributions of incomes and wages have become more and more unequal. There are many ways to illustrate this indisputable fact, and one is shown in Chart 3 (which is Chart 1-4 from the ERP). It shows, for two historical periods, the percentage gains in real family income for different income groups, ranging from the lowest 20% to the highest 5%.

Changes in Average Real Family Income by Quintile
Real incomes have fallen or stagnated for most American families since 1979.



Note: Family income is deflated by the CPI-U-X1.
Source: Department of Commerce.

Chart 3

Over the period from 1966 to 1979, shown by the black bars, there is a rough equality: the percentage gains are comparable across income groups. (Although even here there is a tendency for higher income groups to do better.) But things change dramatically in the period from 1979 to 1993, shown by the striped bars. The top 5% does about as well as it did in the first period, but all other groups do less well, and the lower 60% loses absolutely. Furthermore, there is a perfect--and distressing--correlation between real income gains and position in the pecking order: the rich got richer, but the poor got poorer. This is what I meant when I said earlier that economic growth has become a spectator sport for most Americans: On average, the lower 80% of the income distribution has not participated in real income growth for something like 15-20 years. That, I would say, is hardly a signal of economic health.

Solutions?

The causes of the productivity slowdown and of the rise in inequality are not entirely clear, and so the appropriate remedies are far from apparent.

In the case of productivity growth, it is useful to break the total into two parts: the part contributed by equipping workers with more capital, and everything else--what economists call "total factor productivity."

We understand the capital problem pretty well and, up to a point, know what to do about it. Indeed, the prime rationale for deficit reduction, both in 1993 and now, is to lower real interest rates and thereby to spur capital formation. The argument is correct; I believed in 1983, I believed in 1993, and I believe now that deficit reduction is the most reliable government policy we have for raising business investment. But the productivity enhancements you can reasonably expect from deficit reduction are modest. Perhaps the simplest evidence is what has happened in recent years: while the deficit has fallen as a share of GDP, and the share devoted to business fixed investment has soared, there has been no detectable pickup in productivity.

What about total factor productivity? The truth is that no economist can provide you with a reliable recipe for raising total factor productivity. I continue to emphasize, as I have for years, a wide array of human capital investments--ranging from early childhood education to industrial training. But these are all boringly familiar ideas, none of which constitutes a magic bullet. Still, they have two important advantages. First, there is real evidence that investments in education pay off. Second, properly targeted educational investments should lower, not raise, wage differentials by education and skill.

That brings me to inequality. Over the last 15 years or so, labor markets around the industrialized world seem to have changed in ways that disadvantage low-skill labor relative to high-skill labor. The prime suspect is technological change, although that is often a euphemism for things we cannot measure and do not understand. Put simply, it appears that the skill requirements of American jobs have grown faster than the skills of the American workforce, leading to larger wage premiums for highly-educated workers. If this is what happened, then two basic policy responses are suggested--neither of which amounts to opposing market forces.

First, the nation should spend more on education and training to raise the quality of our labor force. And, in doing so, it should give special emphasis to those near the bottom of the economic ladder.

Second, it seems to me singularly inappropriate to weaken and lower the social safety net just when the market is turning so ferociously against the poor. To my way of thinking, circumstances like that increase the urgency of government policies--like the EITC, Medicaid, and welfare--that mitigate income inequalities. But it is precisely such programs that are under attack in Washington these days.

Thank you for listening.

HOW TO ACHIEVE A STRONGER U.S. ECONOMY

Statement by Murray Weidenbaum

Prepared for the
Congressional Joint Economic Committee
Washington, DC, March 22, 1996

Page

I. Introduction and Summary

To paraphrase Charles Dickens: This may not be the worst of times, but it surely is not the best of times. The U.S. economy has performed better at times in the past and, as shown in this statement, it can do so again.

The American public desires a stronger economy. In early March 1996, the *Wall Street Journal* reported the results of its national survey: only 31 percent of the adult population is satisfied with the economy. Over one-half of the people believe that the country is "headed in the wrong direction." The data tell us why.

What the Numbers Show

The gross domestic product, the most comprehensive measure of the economy, grew a modest 2 percent in 1995. The prevailing forecast for 1996 by experienced forecasters is a bit more anemic — 1.9 percent (even the inflation rate is higher, at 2.3 percent).

In the past, the U.S. economy has experienced periods of far more rapid growth, while inflation was held in check. In 1984, GDP grew 6.8 percent and the GDP deflator (measuring inflation) rose 3.8 percent. In 1966, economic growth was 6.4 percent and the deflator rose a modest 2.8 percent. Even in 1992, GDP increased by 2.1 percent (and inflation 3.0 percent).

When we dig below the surface, we find a number of economic concerns. Those worries are not limited to Republicans and independents. Robert Reich, the Secretary of Labor, has noted all sorts of deficiencies in the economy, especially worker insecurity and slow growth in employee compensation. Moreover, the growth of productivity, a key to rising living standards and international competitiveness, has dipped from 3 percent in 1992 to an average of 2 percent since. Not all sectors of the economy are participating in the recovery. Real farm income is down from $40 billion in 1992 to an average of $33 billion more recently.

The Economic Outlook

But, as noted at the outset, this is not the worst of times. Unemployment has been declining, as has the budget deficit. The American economy is neither going down the tube nor is it a candidate for the Guiness Book of World Records. Nevertheless, we can do better. The sharp rebound in Southern California is an especially heartening indicator of future potentials. The rapid increases in jobs in computers, software, entertainment, and biotechnology are not a response to

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governmental initiatives, but to the resourceful of the private sector. In retrospect, we should be glad that the pressures for expensive federal military "conversion" initiatives were in the main ignored.

Recommendations

A few policy prescriptions to achieve a stronger economy are presented below and augmented in the sections that follow:

1. *Policymakers should take an economic equivalent of the Hippocratic oath: First, do no harm.* The economy will only suffer from brave new government spending programs or tax increases or regulatory expansion. A significant amount of today's unemployment results from the phenomenon of "the discouraged employer" — discouraged from hiring more people by a thicket of byzantine workplace regulations and costly mandates.

2. *My standard advice to the Congress is still pertinent: Don't just stand there, undo something.* The performance of the economy will improve if the Congress undoes complicated taxation and burdensome regulation and reduces the growth of federal expenditures. Such structural reforms will increase the flow of saving for new investment and encourage the creation of new and improved products and production processes. That healthier economy will reduce the pressure for new government programs. The result will be an economy with greater productive capacity that can grow 3 percent a year or faster — and thus provide a higher level of sustained employment.

3. *Policymakers need to take account of the fact that the United States is part of an increasingly global economy.* It is futile to say, "Stop the world, I want to get off."

II. Reforming Government Regulation

No regulatory agency has a mission to depress the economy or to raise the unemployment rate. However, many of their actions have those undesirable effects. The barriers to economic growth imposed by regulatory agencies are numerous and growing. Regulatory costs are a hidden tax reducing the competitiveness of American business and the availability of employment in the United States.

The Many Costs of Regulation

The popular view of regulation is wrong. It is not a contest between the "good guys" (government and the consumer) and the "bad guys" (business). The reality is that the consumer is at the receiving end of the benefits as well as the costs generated by government regulation. Business is the middleman (or woman).

The nature of regulation becomes apparent when the reader looks at the subject from the viewpoint of the average company. For each box on its organizational chart, there are one or more government agencies that are counterparts to that box: Environmental Protection Agency (EPA) and construction of new facilities, Occupational Safety and Health Administration (OSHA) and the workplace, Equal Employment Opportunity Commission (EEOC) and human resource policies, etc. Each of those alphabet soup agencies is heavily involved in the company's internal decision making.

The impact of governmental rule makers is in one predictable direction: to increase the firm's overhead and operating costs, and to reduce the resources available to perform its major task of producing goods and services for the customer. Government regulation results in the higher prices that consumers pay to cover the cost of compliance. But that characteristic makes regulation especially attractive to government officials. The costs do not show up in the government's budget, and thus do not have to be paid for by taxation. But citizens-consumers do not escape paying those costs — in the form of higher prices.

The EPA says that the cost of complying with environmental regulations came to $130 billion in 1994. That is not a static figure. Recently enacted legislation will add new costs in terms of billions of dollars a year. When Professor Thomas Hopkins of the Rochester Institute of Technology added in the costs of meeting the rules promulgated by several dozen other regulatory agencies — ranging from the Food and Drug Administration (FDA) to the National Highway Traffic Safety Administration — he came up with an aggregate hidden tax of regulatory costs of more than $500 billion a year. If Congress had to appropriate another $500 billion a year to cover those costs, it is most unlikely that they would approve so much regulation.

Going beyond the dollar signs, more subtle and even more serious burdens result from the tremendous amount of regulations that are promulgated. Central among these are the adverse effects on research and development, productivity, and capital formation. According to Professor Dale Jorgenson of Harvard University, by the time that the Clean Air Act is fully implemented in the year 2005, its impact (combined with that of previous environmental regulations) will reduce the nation's capital stock by 4.3 percent, increase the cost of capital by 5.5 percent, and reduce real gross national product by more than 3.0 percent annually.

Regulation also reduces the flow of innovation and the production of new and better products because so many government regulatory agencies have the power, which they frequently exercise, to decide whether or not a new product will go on the market at all. For example, the major obstacles to the development of a new biotechnology industry are not financial or technological. They are regulatory.

The rising paperwork requirements of government agencies inevitably produce a lengthening regulatory lag. This delay often runs into years and is a costly drain on the time and budgets of private managers as well as public officials. In Mercer County, N.J., before work can begin on a new housing subdivision, the project must clear 11 separate reviews from nine different agencies, including seven on storm drainage. Developers estimate that, in New Jersey, government regulations add as much as 25 to 35 percent to the cost of every house they build.

Some of the regulations are just silly. An obscure 1992 federal law prohibits home builders from installing toilets that hold more than 1.6 gallons of water. The idea was to help conserve water. In practice, it often takes two or three flushes to do the job. We have to wonder why the federal government has to become involved in such nonsense!

Higher regulatory costs also have eroded the competitiveness of American companies struggling in an increasingly global marketplace. More stringent regulation of production in the United States quickly translates into fewer jobs and lower incomes to residents of the United States. Moreover, American companies facing world competition are influenced to seek lower cost locations overseas with more benign regulatory systems.

The growing internalization of production is regretful — *when* it is caused by coercive government in the United States. Consider the energy company that explores in faraway Kazakhstan, or the mining enterprise that moves to Bolivia, or the medical devices firm that sets up a lab in the Netherlands, or the manufacturing corporation that builds a new factory in Guangdong. Those companies are not the villain, but the governmental officials in the United States who lock up much of the nation's natural and labor resources for fear that somebody somewhere may make a profit.

The justifications for the government's awesome regulatory power are numerous: federal rules promote a cleaner environment, a healthier work place, and keep unsafe products off the market. Unfortunately, the reality is often different. Consider drug regulation by the FDA.

Of the new prescription drugs actually approved as safe and effective, in case after case, the United States was one of the last countries to permit their introduction. During the period 1990-1994, 92 of the 150 new drugs and vaccines approved by the FDA were approved first in other countries, including products for kidney cancer, partial epileptic seizures, migraine headaches, and fungal infections in AIDS patients.

The benefits of regulation should not be overlooked. The serious question is what benefits regulation produces and whether they are worth the costs. Society's bottom line is not the impact of regulatory actions on the government or on the business system, but the effect on the consumer, and on the citizen.

Approaches to Regulatory Reform

What can be done to reform government regulation? Most economists would rely primarily on competition in the marketplace to protect the consumer. Deregulation of interstate trucking, for example, has resulted in thousands of new businesses entering the business. The heightened degree of competition has forced sizable reductions in the cost of trucking which ultimately shows up in lower prices of all the items that move by truck.

When government does regulate (as in the case of environmental pollution), economists prefer that government policymakers make the maximum use of economic incentives. Thus, to an economist the environmental pollution problem is not the negative task of punishing wrongdoers. Rather, the challenge is a very positive one: to change people's incentives. People do not pollute because they enjoy messing up the environment, but because it often is cheaper or easier than not polluting.

What about the existing array of command-and-control regulation? Benefit/cost analysis can help to make sure that any given regulation does more good than harm. Benefit/cost analysis has been used for decades in examining government spending programs. It is neither a revolutionary, new idea nor an invention of the far right. In fact, such analyses have been attacked by both ends of the political spectrum. The far left does not like using economic analysis because not every proposal for government intervention passes a benefit/cost test. Many libertarians do not like it either, because benefit/cost analysis can be used to justify government intervention.

Benefit/cost tests compensate for the fact that government decision makers on regulation do not face economic constraints. If the costs to society of a governmental agency action exceed the benefits, that situation does not have an adverse impact on the agency. The administrators may not even know about it. Under the traditional approach they can crow about the benefits and ignore the costs — because the costs are transmitted to the consumer not by the government but by business. To an economist, "overregulation" is not an emotional term. It is merely shorthand for government rules for which the costs to the public are greater than the benefits.

In cases where dollars are an inappropriate measure of the impact of government regulation, there still may be opportunity for analysis in the decision-making process. For example, the drug that cures Rocky Mountain spotted fever also causes fatal anemia in one out of every 10,000 people who use it. A simple-minded approach would prohibit the use of this "dangerous" drug. Yet, the fever itself kills about eight out of every ten people who contract the disease. Thus, the benefits of the drug greatly outweighs the costs — measured, not in dollar terms, but in human lives.

Critics who are offended by the notion of subjecting regulation to a benefit/cost test unwittingly expose the weakness of their position. They must fear that their pet rules would flunk the test. After all, showing that a regulatory activity generates an excess of benefits is a strong justification for continuing it. The painful knowledge that resources available to safeguard human lives are limited causes economists to become concerned when they see wasteful use of those resources because of regulation.

With hundreds of regulatory statutes on the book, it is not feasible to review and revise each of them. Instead, Congress should write one new law which will reform regulation across-the-board. Five key provisions would be especially helpful:

1. *A requirement for benefit-cost analysis in each key stage of the regulatory process — from writing the statutes to issuing regulations and reviewing the operation of regulatory programs.* Congress and the regulatory agencies should avoid an "at-any-cost" approach to achieving regulatory goals.

2. *When a statute requires citizens or organizations to obtain a permit, a fixed timetable should force the agency to act in a timely fashion.* If the agency is not able to process an application by the deadline, the permit should be granted automatically. The private sector should not be punished for the shortcomings of the public sector.

3. *Legislation should emphasize objectives sought rather than precise methods to be used for each regulatory program.* Detailed laws that place "legislative handcuffs" on agency administrators prevent the adoption of more cost-effective solutions. Congress should also refrain from passing regulatory statutes with requirements that they know are not reasonably attainable. The notion of writing laws that are "technology-forcing" is wasteful of economic resources.

4. *The federal government should use risk assessment to help set priorities for achieving greater protection of health, safety and the environment in the most cost-effective manner.* All risks are not equally serious. Government should focus on the most serious hazards. Sound science and comparative risk analysis should be drawn upon during the legislative drafting process. Regulating trivia harms the society by diverting resources away from more productive use.

5. *Congress should promote true regulatory justice.* Legislators and regulators should avoid imposing costs on innocent parties. Where regulation substantially reduces property rights, compensation should be paid. Retroactively applying laws to parties who met previous legal requirements should be avoided.

III. Reforming Taxation

The debate on tax reform in the United States is focused too narrowly. The key disagreement now is on promoting economic growth versus maintaining fairness via a progressive tax structure. Indeed, most of the reform proposals which have gained attention eliminate the progressivity which has been a long-term hallmark of the federal income tax system. It is possible to achieve both objectives while making basic improvements in the revenue structure.

Shortcomings of Popular Proposals

The most radical reform proposal is to eliminate the federal income tax entirely and to replace it with a transactions-based consumption tax, either a national retail sales tax or a value-added tax (VAT). Either of those two consumption taxes would lift the present heavy tax on saving and would create a powerful incentive to invest and thus spur economic growth. In the process, the burden of preparing returns would be eliminated for individual taxpayers (but not for business). However, the resultant tax structure would be regressive, with lower-income people paying to Uncle Sam a higher percentage of their incomes than higher-income taxpayers.

In contrast, the proposed flat tax would not be quite as extreme, as it would simplify rather than eliminate the federal income tax. It, too, would constitute a strong economic incentive by reducing the tax burden on the high-saving groups of our society. However, it also would move much closer to a proportional tax structure — where all taxpayers pay the same percentage of their income — than the United States has experienced in modern times.

When we examine each of these proposals in more detail, however, none of them is as simple as it looks. By eliminating withholding, the flat tax imposes a monthly return requirement on every taxpayer. The prospect of the Internal Revenue System having to process and audit tens of millions of monthly "postcard" returns — each with a check attached — is staggering. As for the postcard, the taxpayer will have to place it in an envelope in order to mail the check accompanying it — aside from any privacy considerations.

As for sales and value-added taxes, most of the proponents would soften their regressive nature by means which entail new complexity. Providing a refund, for example, means that many millions of low-income taxpayers would still have to file returns reporting their incomes and tax payments. The alternative of exempting food, medicine, etc., or levying lower rates on selected categories of purchases, is a very rough and not fully satisfactory method of maintaining progressivity in the revenue system.

A third approach is to provide an automatic refund of a fixed amount to each taxpayer. That, too, would require a bureau of the federal government to maintain an up-to-date roster of names and addresses and to mail out the refunds. In addition, a mechanism would still be required to collect the social security and medicare payroll taxes. The longevity of the Internal Revenue Service seems assured, whatever title is given to that bureau.

A Fourth Alternative

There is a fourth alternative for comprehensive tax reform which would simultaneously provide a strong growth incentive, reduce the complexity of the Internal Revenue Code, and maintain fairness by keeping the progressive nature of the federal individual income tax. Like the other three tax reform proposals, it would maintain "revenue neutrality" — generating the same flow of revenue to the Treasury that would be provided by the current federal income tax system.

How do we achieve all these good things? Not by tinkering with the details of the Internal Revenue Code. Instead, we must overhaul the present federal income tax so that it exempts all saving, which is the seedcorn for economic expansion, but retains a progressive rate structure. Such a departure would not constitute a new tax, but it would be a sea change in the existing income tax structure insofar as the tax base would shift from income to consumption. This fourth approach to fundamental tax reform has been introduced by Senators Sam Nunn and Pete Domenici as the USA Tax.

The Nunn-Domenici USA Tax Plan consists of two parts: a revised individual income tax and a new business tax. The latter replaces the existing corporate tax as well as the individual tax treatment of unincorporated businesses. The combined structure is designed to be "revenue neutral" in that it raises the same amount of revenue as the existing tax system. This is so, at least initially, in its static form. In a dynamic sense, the future revenue flow is likely to be higher than that generated by the current tax law because of the positive effects on the economy (the same is true for the other three reform proposals).

The USA individual income tax is a progressive tax with an unlimited deduction for saving. The term USA refers to this latter feature as an "Unlimited Savings Allowance." Progressivity is achieved through a progressive rate table, although it is not necessary to maintain the current degree of progressivity. Simplicity is attained by eliminating a great variety of special treatments of transactions and taxpayers.

In contrast to the current individual income tax, the USA version possesses the following characteristics:

- It permits a full and unlimited deferral on the portion of income that is saved, regardless of the form or amount of saving. The tax is paid only when the principal and earnings are withdrawn from savings and devoted to consumption.

- It treats all spent income equally for tax purposes. No distinction is drawn on the source of income.

- It allows wage earners a full credit for the regressive payroll taxes (the employee portion of the social security and medicare taxes).

In the Nunn-Domenici USA Tax Plan, all businesses, whether incorporated or not, are taxed at the same flat rate of 11 percent on their annual gross profit. There is no tax advantage from shifting to or from the corporate form. Immediately expensing all investments in capital equipment is a substantial simplification. It also encourages investment in durable business assets. Coupled with the new saving incentive contained in the individual income tax, the result is a substantial boost to the entire capital formation process.

Financial transactions are excluded from the calculation of gross profits. The business' tax return neither includes interest and dividends received nor deducts interest and dividends paid. A credit is allowed for the employer portion of the payroll taxes on the wages paid to employees.

This new type of cash-flow tax is similar to a VAT because both use a tax base of sales minus purchases. However, the business cash-flow tax lacks the administrative complexities of a VAT, which requires firms to track on an invoice-to-invoice basis the amount of tax attributable to each transaction. The Nunn-Domenici plan simplifies current business tax procedures. Firms will devote fewer resources to complying with tax regulations (and to devising creative methods to minimize their tax burden), and more resources to productivity increasing investment.

Like the other proposed consumption-based taxes, the USA tax puts the fiscal burden on what people take from society — the goods and services they consume — rather than on what they contribute by working and saving, as do income taxes. Over a period of time, society is likely to achieve higher levels of both saving and consumption because the added investment, by generating a faster growing economy, will lead to a bigger income "pie" to be divided among the various participants in economic activity.

This argument becomes more compelling when we examine the historical record. The data show that the United States consistently devotes a smaller fraction of its national output to saving and investment than do the other major industrial nations. The correlation between the investment share of gross domestic product and the growth rate of national economies is striking and positive for the major industrialized economies over the last three decades.

A faster rate of economic growth also generates two favorable budgetary consequences. It enlarges the tax base without any change in the tax ground rules, creating a faster flow of revenue into the Treasury, reducing the government's need to borrow. Likewise, a stronger economy means lower payments for unemployment benefits, welfare, and other transfer payments. This process is the most painless way of bringing down high budget deficits.

We may never again achieve the level of simplicity offered by the original 1913 income tax. Its 1040 form, three pages long and accompanied by one page of instructions, was filed by only 1 percent of the population. In this spirit, the Nunn-Domenici plan eliminates over 60 percent of the current income tax provisions in the Internal Revenue Code. The several thousands of pages of the tax code would be reduced to approximately three hundred.

By making saving generally deductible from gross income, there would be no need for the paperwork and other transaction costs now required to establish and maintain IRAs, Keoghs, and other "tax-favored" accounts. Nor need the taxpayer be concerned with staying within the arbitrary limits now required under these specialized savings incentives. Moreover, consumption-type taxes do not require complicated corrections for inflation because the tax base is inherently based on current cash flows.

Similarly, by expensing all real investment, the taxpayer no longer has to estimate the useful life of assets nor choose from an array of complicated depreciation systems. There is little incentive to fuss with the conversion of ordinary income into capital gains, because only the income actually consumed winds up in the tax base. Tax is deferred on capital gains, dividends, interest, and other forms of income as long as they remain in the pool of savings.

Because all businesses — whether incorporated or not — are subject to one and the same tax system, there is no longer any incentive to go through the expense and bother of repeatedly changing the legal form of the enterprise merely to take advantage of shifting differentials between individual and corporate income taxes.

Likewise, because interest and dividends are subject to the same tax treatment, there is no longer any tax incentive to leverage a company's financial structure or to convert dividend payments into interest payments. The result will not be an end to the current merger and acquisition boom. Rather, business decisionmakers will make such choices on the basis of underlying economic advantage rather than responding to tax considerations.

In one key aspect, the Nunn-Domenici Plan is deliberately more complicated than any of the alternatives: the designers of the plan deal with the many painful transitional effects that arise in a move from an established revenue system to a new one. Thus, people who made financial commitments based on the old tax system will not find that a new set of ground rules is suddenly being applied to them.

The fairness of a tax system, like beauty, is mainly in the eye of the beholder. Economists view the subject in terms of horizontal equity and vertical equity. Horizontal equity is our jargon for "equal treatment of equals." The idea is that taxpayers with similar incomes should generally pay the same tax.

The Nunn-Domenici USA Tax Plan moves to greater horizontal equity in many ways. For individual and family taxpayers, virtually all types of income are treated the same. Likewise, virtually all forms of saving face identical rules. This is even more apparent in the case of businesses, where all enterprises — corporations, partnerships, and individual proprietorships — become subject to a single tax system. Likewise, virtually all capital investment is treated equally, as is the return on financial investment (e.g., interest versus dividends).

As for vertical equity, a progressive rate structure is usually — but not universally — chosen as the appropriate way to achieve this aspect of fairness. Some esoteric assumptions underlie the proposition that it is fair for taxpayers with higher incomes to pay a higher *percentage* of their income than do those with lower incomes. A considerable literature is devoted to such questions as the diminishing marginal utility of income as the individual ascends the income scale and the difficulties in making interpersonal utility comparisons.

Quite a few public finance specialists, however, believe that the case for a progressive income tax structure is questionable or "uneasy." That line of reasoning supports a proportional tax system, whereby the government assesses all taxpayers the same percentage of their income. In contrast, there is no professional support for the adoption of a regressive tax structure — whereby the upper brackets pay a smaller percentage than the lower brackets. If the case for progressive taxation is "uneasy," surely the case against regressive taxation remains "easy."

A New Proposal

In their fundamentals, the USA and flat taxes are closely related because both build on the traditional revenue system. Both soften the progressive nature of the federal income tax, promote capital formation and economic growth, and move toward simplification of the tax system. In contrast, value-added and sales taxes, by substituting a new tax, produce a new array of problems, ranging from generating new paperwork requirements to imposing a regressive tax structure.

None of the four reform alternatives is likely to be enacted quickly. It usually takes several years for a comprehensive tax-reform effort to go through the lengthy process of separate congressional hearings in the House of Representatives and the Senate, separate committee markups of the bill, reconciling the House and Senate versions, and surviving a possible presidential veto. During that extended period, the two tax writing committees typically make major modifications by adding numerous provisions reflecting their own experienced views of what is desirable tax legislation.

What is likely to emerge is a "Chinese menu" approach (some from Column A and some from Column B). A combination of key features of the flat tax and the USA tax might be the most reasonable possibility for ultimate enactment. Such compromise legislation would have four major characteristics:

1. Encouragement to economic growth by exempting saving and expensing investment.

2. A flatter structure of tax rates, but one that is still progressive.

3. Retention of a few itemized deductions, such as charitable contributions and interest on home mortgages.

4. Several transition provisions to avoid large windfall losses, especially to avoid double taxation of income already taxed.

IV. Controlling Federal Spending

Voting to approve the general idea of a balanced budget is an important start on the path of fiscal sensibility, but only a start. The really tough job is to make the many specific spending cuts. The basic problem is that each of us wants to cut the other guy's pet projects. Powerful interest groups push very hard for the particular spending programs that benefit them. Few legislators — or presidents — want to stand up against a strong one-issue group of voters that promises to have a long memory. And for good reason. Cutting or even eliminating any specific program will not close the gap between federal revenues and expenditures. Yet the attempt to do so could well result in the defeat of those identified with the foolhardy effort.

Is there a way out? Perhaps. The solution may lie with developing a comprehensive array of federal spending program reductions and terminations. There would be a great deal of practical advantage to the comprehensive budget-cut approach. It appeals to our basic sense of fairness. When everybody's ox is getting gored, nobody can say that they are being picked on. To put it somewhat more elegantly, we can cite an old Budget Bureau maxim: good budgeting is the uniform distribution of dissatisfaction.

Let us assume that we have the assignment of preparing guidelines to assist the Congress in its arduous task. The most popular formula — eliminating waste, fraud, and abuse — is not adequate to the task. Of course, there are numerous individual examples of fraud, waste, and abuse. The reports of prisoners who illegally receive social security checks are surely upsetting. Some companies try to sell the government shoddy and dangerous products. These situations should be dealt with severely, but that is just a start.

Here are some fundamental guidelines for budget cutting:

For a nation with the low saving and investment levels of the United States, reductions should focus on the large consumption part of the federal budget rather than the small investment component. Such an emphasis would curb the present tendency for federal deficit financing to be a powerful mechanism for converting private saving into public consumption. There is no need, however, to give a free ride to every item labeled "investment;" the fifth guideline provides help on that score.

A second guideline is to target the many subsidy programs that provide special benefits to limited — and not especially worthy — parts of the national population at the expense of the national taxpayer.

A third guideline is to avoid funding expenditure programs designed to offset problems created by other federal activities, such as regulation. A more cost-effective way of dealing with the problem is to change the original regulation, etc., that created the problem. To maintain the status quo is to ensure fiscal perpetual motion.

A fourth guideline is to privatize activities which should properly be the responsibility of the private sector. The need here is to go beyond the useful notion of having the private sector produce items under government contract. Although an improvement over relying on government arsenals, this approach to privatization still leaves the activity in the federal budget. Many goods and services should no longer be paid for by the taxpayer no matter who produces them.

A fifth guideline for sensible budget cutting is to introduce basic economic efficiency considerations in the budget preparation and review process. The key to success is to enforce the use of this guideline. Benefit-cost analysis has often been used to sanctify the pork barrel. This has been done by overly generous estimates of benefits and niggardly estimates of costs.

Reducing Consumption Outlays

To this economist, deficit financing per se may not always be sinful. At least in theory and like private enterprises, governments can borrow to make useful investments with an attractive future payoff. On occasion, the federal government actually does make worthwhile investments. Many in my generation benefited from the post-World War II GI Bill. The federal government's outlays for our education helped us to achieve careers in which our added incomes generated added tax payments that more than repaid the government's original investment.

Alas, such examples of effective federal investment outlays are rare. Numerous public works projects barely show a favorable benefit-cost ratio even when an unrealistically low cost of capital is used in the estimation process. But that overlooks a more basic point. Virtually the entire increase in federal outlays since 1980 has been in the form of consumption-type spending — aside from interest on the national debt. As a result, consumption outlays dominate the federal budget. In 1992, federal civilian investment outlays were estimated at only $83 billion out of a total budget of $1,381 billion. Under these circumstances, large reductions in the budget deficit would seem to be economically beneficial. A lower deficit should foster economic growth by making more funds available for private investment at the expense of publicly financed consumption.

To carry out a comprehensive reordering of budget priorities, it is necessary to proceed from the general to the specific. By far, the dominant segment of federal consumption outlays consists of transfer payments. It is interesting to note that the layman's reference to these items has moved from handouts to entitlements.

It is perhaps too harsh to ask why anyone is entitled to a handout from the national Treasury. Unfortunately, in the largest such programs — social security and medicare — the recipients have been led (or rather misled) to believe that they have earned the money they receive. Each of them has a social security card supposedly representing their individual accounts in the U.S. treasury.

The truth is more complicated. The typical beneficiary has indeed contributed a substantial share of the monthly check issued to him or her by the Treasury. However — a fundamental but universally overlooked "however" — the total of such contributions plus matching employer payments plus interest does not begin to cover the monthly benefit payments. The balance is a gift from the working population. While I was still in the White House, I had the audacity to label that gift as the economic equivalent of welfare. There were immediately calls in the Congress for my impeachment. Ronald Reagan, bless him, ignored such ill-considered responses to telling the truth.

As a private citizen, I feel obliged to repeat that accurate point — that there is a large but hidden welfare component in the major middle class entitlements. There are many ways to proceed. In the long run, privatization may be the most effective response. Meanwhile, reformers need to face the hard fact that the annual cost-of-living increases (COLAs) which recipients now expect as a matter of right is nothing that they have earned. The COLAs violate the insurance principle that, on average, you get what you pay for.

As a practical matter, it seems impossible to eliminate the annual COLA payments. However, some reduction in their size would make a major contribution to bridging the long-term gap between federal income and federal outgo. A "diet COLA" could be limited to the annual inflation in excess of 2 percent. In explanation, we should note that the average working person is not protected as completely from the effect of inflation as are the beneficiaries of federal entitlements.

A more modest — but not trivial — way of curbing federal consumption-oriented entitlement spending is to eliminate the array of "income-in-kind" benefits, such as food stamps and public housing. It is fascinating to behold the inconsistent positions taken by advocates of these programs. On one hand, they vociferously oppose any attempt to slow down their growth. On the other, they attack any effort to include such income in kind in the official measurement of the number of people living in poverty. The advocates point out — quite accurately — that a dollar of federal spending for these social programs does not generate a dollar of benefits to the recipients who, if they could, would rather spend some of the money on something else.

One champion of these programs admits that food stamps "certainly aren't worth their face value in cash." He suggests that, if these items are included in any measure of poverty, they should be discounted by 20 percent or even 40 percent. For starters, why not give the beneficiaries the cash value and save the Treasury the difference?

Curbing Special Interest Subsidies

Contrary to widespread belief, especially in the business community, the word "farm" does not always precede the term "subsidy" in the federal budget. Subsidies to agriculture *are* the largest component of the subsidy category. Nevertheless, generous subsidies are also provided to business, labor, and other interest groups.

In the cases of direct payments to farm operators (including deficiency and conservation reserve benefits), the wealthiest group of farmers receives an average of more than $61,000 a year each while the poorest group receives less than $500 each. Despite the traditional justification of helping the family farm, 64 percent of farm operators do not receive any such payments. Similarly, 40 percent of the sugar price support program benefits the largest 1 percent of sugar farms; the 33 largest plantations each receive more than $1 million.

Large manufacturing companies also participate in federal subsidy programs. In 1991, taxpayers financed generous overseas advertising programs for selected products: $2.9 million for Pillsbury muffins and pies, $10 million for Sunkist oranges, $465,000 for McDonald's Chicken McNuggets, $1.2 million for American Legend mink coats, and $2.5 million for Dole pineapples, nuts, and prunes.

Labor unions are not exempt from the list of special interest subsidies. The Davis-Bacon Act is a multibillion dollar assist to construction unions which want shelter from competition with lower-cost non-unionized firms. As is true for most nonagricultural subsidies, the benefits are hidden in larger federal appropriations (public works construction, in this instance). The elimination of these subsidies, hidden and visible, would reduce federal spending substantially. Dropping subsidy programs from the federal budget would also raise the efficiency and productivity of the economy by widening the array of economic activity subject to competition in the marketplace.

Regulation Begets Expenditure

A major example of the shortcomings in one government activity generating pressure for an offsetting federal expenditure is regulation of the workplace. For years, economists have written about discouraged workers who drop out of the work force because they do not believe suitable jobs are available for them. Government has created a new category — the discouraged employer, discouraged by the host of government impediments to hiring people.

When they do hire, employers must be absolutely certain that the new employee will work out. If the company makes a mistake and then has to fire someone, it will face claims for wrongful termination and — if those dismissed are women, minorities, or over 40 — litigation is likely. The different ways in which government rule-making reduces employment constitute a long list.

Regulatory and mandated burdens on the employment process are rarely considered in relationship to the expensive array of government programs that offset their adverse affects by trying to increase the supply of workers or to reduce the direct labor costs to employers. Yet the record of these offsetting programs — ranging from job training to unemployment compensation — is not heartening. The society would be far better off with a combination of regulatory reform and expenditure reductions. Such a targeted and combined effort would help reduce the gap between federal income and outlay.

Truly Privatizing Federal Activities

National Airport (in Washington, D.C.) and Dulles Airport (in suburban Virginia) are two examples of the federal government's commercial activities which should be sold to the highest private bidder. There is no reason why the federal government should continue operating these airports, especially in view of the worldwide trend of privatizing airports. Likewise, the air traffic controller functions of the Federal Aviation Agency should be privatized. The commercial airlines are willing to pay the fees — likely higher than at present — in order to get more efficient service. The resultant reductions in congestion and airplane- and passenger-waiting time would more than pay for the transition.

Using Economic Analysis

The use of some basic economic efficiency tests would surely improve the overall effectiveness of federal spending and likely lower the aggregate level. Here are a few examples of what is possible:

Charge competitive, market interest rates for all federally provided credit. That one change will quickly reduce the many demands for federally subsidized lending. Under the status quo, numerous borrowers who could obtain credit on their own are given an incentive to seek federal aid simply because the federal government charges a lower interest rate than commercial banks and other private lenders. Such government competition with the private sector makes no sense.

Use the comparable market rates of interest when evaluating proposed federal investment projects. Unrealistically low interest rates are more than a statistical concern. They result in pulling potential investment funds from the private sector to lower-yield public projects. By definition, such federal spending is inefficient and a poor use of the taxpayers' money.

Include the government's generous fringe benefits in computing "comparability" of pay between federal employees and private workers. The compensation of state and local government employees should also be included in the estimates. The present system biases the calculation of pay standards against the taxpayer.

V. Isolationism Versus Global Realities

The simultaneous rise of a new spirit of isolationism and the increasing globalization of economic activity is a paradox. Viewed independently, each of the two trends possesses a certain logic. Analyzed together, however, isolationism and globalization are simply incompatible.

The end of the Cold War brought on a widespread expectation that the United States could safely and substantially shift its attention from foreign policy to the host of domestic problems that face the American people. Surely, there is no shortage of urgent national issues to occupy our attention. They are all inwardly oriented — welfare reform, health care, immigration, environmental cleanup, crime control, deficit reduction, and tax reform. The isolationist tendency is visible and apparent.

But, in a less dramatic way, it is also becoming clear that the rest of the world is not content with going its separate way. Overseas forces, institutions, and people increasingly affect the workers and managers of America's business and their families. The global marketplace has rapidly shifted from just being a simpleminded buzzword to a complex reality. International trade is growing far more rapidly than domestic production. That is true all around the globe. It is hardly a matter of a company or an investor deciding to participate or not. The days of agonizing over whether to go global are over. The following eight basic points, illustrating the changing external business environment, provide a detailed response to the isolationists:

1. *Americans do not have to do anything or change anything to be part of the global marketplace.* Even if a business does not export a thing and has no overseas locations, its owners, managers, and employees are still part of the world economy. The same goes for the many companies and individuals that supply it with goods and services. The issue has been decided by technology. The combination of fax machines, universal telephone service (including cellular), low-cost, high-speed copiers and computers, and speedy jet airline service enables money, goods, services, and people to cross most borders rapidly and often instantly. And that goes especially for the most strategic resource — information.

No American business of any consequence is insulated from foreign producers because of vast distances. Every American is subject to competition from overseas. Some of the international force may be indirect. Global standards — particularly for high-tech products — are being adopted very widely. This makes it difficult to sell, even in the United States, products that do not meet global requirements. Software must work on computers throughout the world.

It is too easy to ignore the role of U.S. exports. Americans readily see the multitude of foreign products in our homes, factories, and offices. However, we are not aware of the great many U.S.-made products used in foreign homes, factories, and offices. To compound our uneven vision of international trade, we do not directly see the improvements in the quality of domestic products forced by having to meet foreign competition. Nor do we realize the reductions in the prices paid by U.S. consumers — and those beneficial effects are real and substantial.

2. *Employees, customers, suppliers, and investors in U.S. companies are increasingly participating in the international economy.* That is not just a matter of sales or earnings originating from foreign operations. The pharmaceutical firm Pfizer is very blunt on this subject:

> Pfizer does not have a choice about whether to manufacture in the EC or not. If we are going to sell to Europe, we have to manufacture there.

A Conference Board survey of American manufacturing companies shows that becoming an internationally oriented company usually pays off. Sales by firms with foreign activities grow at twice the rate of those with no foreign operations. Firms with international operations grow faster in every industry — and profits are higher.

3. *The modern global enterprise is on the rise.* It is far more than merely a matter of which country to choose to locate a specific manufacturing or marketing operation. For the dominant companies, the locus of executive decisionmaking is shifting. "Think global but act local" is not just a slogan. It is a competitive necessity. The larger business firms operating in several regions of the world have been setting up multiple locations for decisionmaking.

For those domestic firms that sell goods or services to other American companies, increasingly their customers are located in one or more decentralized overseas divisions. That works two ways for Americans. DuPont has shifted the headquarters of its electronic operation to Japan. Germany's Siemens has moved its ultrasound equipment division to the United States.

Cross-border alliances have become commonplace. It is the rare business of any considerable size that has not entered into a cooperative arrangement with one or more overseas companies. The concept of strategic alliances has moved from the classroom to the boardroom. A new set of international business relationships has arisen: joint ventures, production sharing, cross-licensing agreements, technology swaps, and joint research projects. Sometimes our foreign competitors are also our alliance partners. Ford and Volkswagen cooperate in Latin America to produce automobiles and they now dominate that important market. The successful business has to look upon its entire operation in a global context. To stay competitive, it must hire people, buy inputs, and locate production, marketing, and decisionmaking centers worldwide.

4. *Some overseas markets are more profitable than domestic sales, but high risk and high rewards go together.* The attraction of overseas locations is increasing — and for good practical reasons. Southeast Asia is the fastest growing part of the world. Any observant visitor to Hong Kong, Singapore, Malaysia, or Thailand will see that the 8% real growth they have been reporting is no statistical mirage. Each of those economies is booming. Mainland China has been experiencing double-digit expansion year after year. Only the most modest slowdown is in sight.

Government policy in each of those countries welcomes foreign investment. With the inevitable exceptions, they encourage the formation of new private enterprises. The contrast with the United States is striking — and ironic. While these present or former communist and totalitarian countries are moving toward capitalism and trying to reduce the role of the public sector, we have been moving in the opposite direction. The United States is expanding government regulation of business. The result is to make it more difficult and certainly more costly for private enterprise to prosper. It s not surprising that so many American companies are doing their expansion overseas.

5. *The rise of the global marketplace provides vast new opportunity for Americans to diversify their investments and — of course — to broaden business risk.* Our exports are growing at twice the rate of the domestic economy. That is not a recent development, but the average experience since 1965.

U.S. companies investing and operating overseas buy more U.S.-made components and capital equipment than the local companies they compete against. Moreover, the great bulk (about nine-tenths) of that overseas production by U.S. firms is sold overseas. In a similar fashion, foreign companies investing and operating in the United States use far more U.S. labor and U.S.-made products than if they stayed abroad and exported from there. It is interesting to note that some of these "transplants" now export U.S.-made products back to their home countries.

6. *The rise of China and Southeast Asia is a new and durable force in the world economy that Americans have to recognize.* Depending how you measure national economies, China is in the top ten — or top 3, or top 2. That is an interesting range of variation.

Even the most experienced Asia experts do not know what will happen after Deng Xiaoping dies. There is considerable pressure in China to reverse course, to move back to a more authoritarian society with less opportunity for private ownership. China has a history of internal dissension, of splitting up into several regions — each the size of several major Western European countries. The ability of the economic reforms to create tremendous amounts of income and wealth is the best guarantee of their being continued. But, the many misunderstandings between China and the United States constitute a real dark cloud on the political as well as economic horizon.

The economies of several other countries in Southeast Asia are also growing rapidly — at about 8% a year, compared to China's 10-12%. They seem to be welcoming American and other Western businesses with more enthusiasm than the Chinese. A decade from now, Southeast Asia will be one of the major economic regions of the globe — along with Japan, North America, and Western Europe. Americans must face that fact that the economies of Southeast Asia are potentially both customers and competitors for our companies. To think of that area as just low-cost labor is misleading. The level of technology is high in Taiwan, Singapore, and Malaysia. The amount of education is also impressive. Intelligent and productive work forces are available in substantial quantities — and they also constitute a substantial and rapidly rising consumer base. As Southeast Asia continues to grow rapidly, it will be a major challenge to Western businesses to participate in that key market.

7. *Despite the military and political issues that divide Western Europe, the economic unification is continuing full bore.* With a minimum of fanfare, Sweden, Finland, and Austria are entering the European Union. The six nation European Common Market became the 12 nation European Community and now 15 member European Union.

As in every major change, there are winners and losers — for Americans as well as Europeans. With the elimination of internal trade barriers, the stronger European companies can now compete in a continent-wide market. They enjoy considerable economies of scale. American companies well established in Western Europe are included in that category. The losers are the high-cost European producers who were accustomed to the protections afforded by a restricted national market. The loser category also contains those American producers who have been taken by surprise by the reinvigorated European competition.

8. *The American economy is still the strongest in the world and our prospects are impressive.* We are not a weak or declining nation in the world marketplace. Legislation and political pressures to "buy local" may be popular, but they fly in the face of economic reality. Our concern for the losers in the domestic marketplace requires a constructive response: make the United States a more attractive place to hire people and to do business.

In many important industries, American firms are very much the leaders. U.S. firms rank number one (in terms of sales volume) in 17 major industries — aerospace, apparel, beverages, chemicals, computers, food products, motor vehicles, paper products, petroleum, pharmaceuticals, photographic and scientific equipment, soap and cosmetics, and tobacco. Within some high-tech industries, the U.S. lead is overwhelming. Five of the world's six largest computer manufacturers are headquartered in the United States. One U.S. firm leads the world's semiconductor business and another the PC software market. The lead of the United States in the service industries is even greater. This country has become the global marketplace for capital.

What about the future? The prospects for American companies being in the lead are very bright. There is a special reason for optimism. All through the 1990s, America will be benefiting from the upsurge of industrial research and development (R&D) during the 1980s. A key but undramatic crossover occurred in the early 1980s. For the first time in over a half century, the magnitude of company-sponsored R&D exceeded the total of government-financed R&D. That primary reliance on private R&D continues to this day.

Few people appreciate the long-term impact of that strategic crossover. The new and continued dominance of the private sector in the choice of investments in advanced technology makes more likely that there will be an accelerated flow of new and improved civilian products and production processes in the years ahead. A progression of innovation may be forthcoming comparable to the advent of missiles and space vehicles following the massive growth of military R&D in the 1950s and 1960s. Just consider how the fax machine has altered our customary work practices.

There is a positive macroeconomic aspect to continued technological progress. When the persistent trade deficit of the United States is disaggregated, we find some surprisingly good news: our exports of high-tech products steadily exceed our high-tech imports. This country does indeed enjoy a comparative advantage in the production and sales of goods and services that embody large proportions of new technology.

These are not laurels to rest on. The point is that there is no need to take the low road of economic isolationism — which is protectionism — to deal with foreign competition. Any serious discussion of the global marketplace has to confront the tension between domestic political pressures and international economic forces. Private enterprise is increasingly global, but government policy is still often very parochial.

Protectionism does not work. For a while, trade barriers can help maintain some vulnerable jobs in the United States. But — a fundamental but — American companies that buy those "protected" products are forced to pay higher prices. This, in turn, reduces their productivity and competitiveness, losing American jobs. More than twice as many jobs are lost in the steel-using companies (such as automotive production) by trade restrictions than are "saved" in the government-protected steel-producing companies.

There is another force that comes into play: the consumers who vote every day of the week, buying products and services made anywhere in the world. They think more about price and quality than country of origin. Consumers are adapting to the global economy without even realizing it.

We should not be cavalier toward those whose jobs are lost or incomes lowered due to foreign competition. Changes are needed, in both the public and private sectors, to make American business and labor more productive and hence more competitive in what is increasingly a globalized marketplace. The ingredients are well known — tax reform, regulatory reform, liability law reform, and a modern labor policy.

The basic initiative in the global marketplace has shifted to private enterprise. Individual entrepreneurs and individual business firms now make the key decisions that will determine the size, composition, and growth of the international economy. That makes for an extremely challenging external environment for the competitive American enterprise of the 1990s. It also requires greater degrees of understanding and forbearance on the part of U.S. public policymakers.

The rapidly growing business-oriented global marketplace is a source of great actual and potential benefit to American entrepreneurs, workers, and consumers. Because the international economy is changing so rapidly, Americans face both threats and opportunities. History tells us that trying to shut ourselves off from these "foreign" influences just does not work. When imperial China tried to do that some 500 years ago, it very quickly went from being the world's most advanced and powerful nation to becoming a very poor backwater of the globe. China is only now beginning to recover from that situation — and the adjustments are visibly painful and prolonged.

"Is the U.S. Economy the Healthiest it Has Been in Three Decades?"

Testimony by

Dr. Michael J. Boskin

T.M. Friedman Professor of Economics & Hoover Institution Senior Fellow,
Stanford University

for the

Joint Economic Committee

Congress of the United States

on

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1. While the American economy is the largest and most productive in the world, it faces serious short and long run challenges. The economy is not performing up to its potential. That potential could be improved substantially with sounder economic policy. Even a small improvement in the economy's growth potential when compounded over a number of years will lead to a dramatic improvement in future living standards. Finally, we have only a modest time window to begin to deal with the long run structural budgetary problems driven by the inexorable march of demography. If we wait, the changes that will be required in entitlement programs will be so wrenching to the economy and/or the beneficiaries as to dwarf the problems cited in recent discussions over balancing the budget.

2. Let's start with what is unambiguously good about the current state of the economy. First, inflation is low and stable. The Federal Reserve deserves enormous credit for the improvement in inflation and inflation expectations that have occurred over the last decade and a half. Recall 1980 when inflation was running in double digits again and many economists and politicians said let's just index everything and learn to live with double digit inflation. Since inflation had increased at the corresponding point of each successive post-war business cycle up to that point (whether measured at the trough, the peak, or the mid-point of the expansion), there was even some fear that the United States and other industrialized nations would experience still worse inflation episodes.

Further, many economists at the time believed in a simple inverse relationship between inflation and unemployment which suggested that to disinflate the economy from double digit levels would entail costs in lost output and higher unemployment that would be enormous. Fortunately, the Federal Reserve, generally backed by President Reagan, set about to disinflate the economy. While the early 80's recession was quite severe, it was nowhere near as severe as had been predicted by those who opposed the attempt to disinflate. For the remainder of the 1980's (with the exception of a blip up or down in energy prices), inflation (as somewhat overstated by changes in the Consumer Price Index) ran about 4½% a year. Recall, 4½% was the level at which a conservative Republican president, Richard Nixon, imposed wage and price controls on the economy in the early 1970's!

Starting in the late 1980's, the Federal Reserve, and most of the central banks of the other major industrialized economies, sought to engineer a soft landing from the long economic expansion which would disinflate the economy further. The reasoning went that 4½% had become something of a floor and it was important to get inflation down further or we would risk accelerating inflation from that level. I strongly supported this generic approach. The Fed by and large has been successful in disinflating the economy to the 2½% level, again as overstated by the change in the Consumer Price Index. Events subsequent to the second round of disinflation - the oil shock following the Iraqi invasion of Kuwait and the large and prospectively larger defense draw down, for example - lead to a softer economy than the Fed had originally intended. With the benefit of hindsight monetary policy might have been slightly - and I emphasize slightly - more expansionary in the early 90's, but generally it has been <u>the</u> star performer in economic policy. In fact, the Fed deserves a lot of credit not only for engineering less costs than had been predicted in two successful rounds of disinflation, but has also moved the center of gravity of opinion to the belief that low stable inflation is an important pillar of maximizing sustainable long term growth. Unlike the old style ephemeral Phillips Curve analysis, low inflation is not inimical to growth, but is actually an important input into successful growth performance. This occurs for many reasons, for example with low and stable inflation long run investment decisions are less uncertain, the relative price signals sent in our primarily market economy are less confused with swings in the nominal price level, etc.

3. On the positive side of the ledger, I would also cite the improvements in productivity throughout major areas of American industry. It is my own opinion that the productivity statistics are lagging behind reality here, and that there has been a bigger pick up in productivity than the data reveal. Part of this is the difficulty in measuring productivity in some important growing sectors of the economy, such as services. Responding to the long period of the over valued dollar, and intense international competition, deregulation, and other factors, American businesses in general are far more competitive on international markets than they have been in some time.

4. Finally, over the last quarter century the more flexible and dynamic market economy in the United States has generated far more employment opportunities than the more heavily taxed highly regulated economies of the world, especially the advanced industrial economies with which we compete and compare ourselves in Western Europe. Since 1970, there are about 30 million more working age people in Western Europe, but by the end of 1993, there were one million <u>fewer</u> private sector employees! In contrast, there are about 40 million more working age people in the United States, the overwhelming bulk of whom had found jobs in the private sector. Unless one goes to the even more stark comparison of, say, the former East and West Germany, there can be no more stunning indictment of an over-taxed, over regulated economic system than these telling statistics on Western Europe. Importantly, even the Western European's now admit that a large part of their problem comes from their very heavy tax burdens, their overly generous social

welfare systems relative to after tax wages for those who are working, and their stifling regulatory apparatus.

5. On the other side of the ledger, growth in the American economy slowed substantially starting in the late 1960's (although it is conventional to measure the decline in 1973 with the Arab oil shock). If we compare the Congressional Budget Office's long term growth projection of about 2.3% out for a generation, returning to the extremely rapid 3.8% growth in the American economy from 1947 to 1973 would lead to an economy which in 2030 was $10 trillion larger than baseline projections. While replicating the "golden era" of rapid economic growth from World War II to the late 1960's or early 1970's would be difficult, consider what just a half percentage point higher growth in actual and potential output would accomplish compounded over a generation. It would add to the economy we bequeath a generation hence an additional output of goods and services, above and beyond what is currently projected, equal to one-half of the entire existing American economy! That would make the difference between any society which deems itself to have been successful versus one that deems itself to have been sick. Thus, one does not need to make "optimistic" projections of improvements to the economy from sounder policies to generate a dramatic improvement in the future standards of living.

6. The slowdown in economic growth has led to a slower growth in standards of living. However, the usual measures overstate the picture. Among the important problems is the overstatement of inflation measured by changes in the Consumer Price Index, which leads to an understatement in the growth of real wages over this time when deflated by the CPI. There are other data problems with the measures usually used, but suffice it to say that a careful honest look would reveal that wages have continued to grow, but considerably more slowly since the early 1970's. They have neither stagnated nor declined for the population in general. For low skilled, less educated young workers, they have in fact deteriorated.

7. Economic performance can be separated into short-run cyclical and long-run structural components. The current cyclical recovery/expansion from the 1990-91 recession has lasted five years. However, compared to the average of previous post-World War II recoveries, it has been only about 2/3 as robust. The National Association of Business Economists' consensus of 36 professional forecasters predicts real GDP growth of just 1.9% in 1996 and 2.1% in 1997, with a one-in four chance of a recession in 1996 and a one-in-three chance in 1997. Also, a majority forecasts worse performance if a long-run balanced budget agreement is not implemented.

8. Perhaps the biggest set of problems confronting the American economy concerns the fiscal position of the Federal government. Despite all the talk about a balanced budget over the next seven years, CBO baseline projections show growing deficits through 2002. Worse yet, virtually none of the discussion has been about what happens after 2002. Here the story is potentially very bad indeed. First, understand that the United States has been on something of a demographic holiday for the last 15 years. The ratio of the elderly to the working age population is lower now than in the 1980's. It will soon start to increase, and then at an accelerating pace. The trustees of the Social Security Administration report that the Hospital Insurance (HI) program will be bankrupt by 2002 (perhaps sooner). In 2002 (see attached chart 1), the gap between outlays and receipts in HI is expected to be only one percentage point. The trustee's long run intermediate

projection shows a gap of about five percentage points of taxable payroll. While it occurs somewhat later, the same is true for Social Security (see chart 2). While it is running a cash surplus as conventionally measured now, the increases in life expectancy of the elderly combined with the baby boom generation's retirement will move the American population from a pyramidal or triangular demographic structure to a rectangular one. In fact, the fastest growing groups in the population are first, those over the age of 85, and second, those between the ages of 75 and 84. Life expectancy of a 65 year old woman today is almost 20 years, i.e. the average 65 year old woman will live to be about 85. Those increases in life expectancy are good news; the bad news is that somebody will have to pay for living costs in old age. There the story is far more serious. Social security will be running a deficit of 5% of taxable payroll too. Combine that with HI and we're at a deficit of 10% of taxable payroll. That means the payroll tax would have to be increased by two-thirds to European level rates in the mid-20% range to pay for these projected benefits. That would crush the American economy, and would contribute to a labor market situation similar to that mentioned above for Western Europe where it is so expensive for employers to hire workers that they simply do not do so. CBO long-run estimates budget deficits get up in the 15 - 20% of GDP range, dwarfing - 8 or 10 times as large - current levels.

9. Since America has low rates of saving and investment - relative to our own history and to the country's with which we compete (see charts 3 and 4) the preparation for the longer term needs and the financing of long term growth are serious problems indeed. The decline in national saving - the sum of what households, businesses and government units, Federal, state and local - save is about evenly divided between the decline in private saving and the increase in Federal deficits. Clearly, controlling the rate of growth of future government spending, especially entitlement programs, is necessary to get the budget into balance and if that is not done, the low rate of national saving is virtually certain to persist and perhaps worsen. Increasing private saving is also an important policy goal. There are a variety of policy routes to this end, from fundamental tax reform to changes in pension rules. It is important to understand that the reason to get the budget deficit under control is to reduce the drain on the modest supply of private saving available to finance domestic investment which is a major source of increases in productivity and future living standards. It is therefore particularly important that attempts to get the budget deficit under control do not harm private saving. Unfortunately, the 1993 tax increases clobbered private saving. Private saving declined at about a $60 - 65 billion a year annual rate in the several quarters following the 1993 tax increases. This is not surprising, as the higher rates hit 2 earner working couples in their peak earning and saving years, high income individuals who have a higher propensity to save, and millions of small businesses which are not incorporated or are sub-chapter S corporations and were subject to the higher tax rates.

10. It is clear then, that stronger non-inflationary growth should be our most fundamental economic priority. Getting the potential growth rate of the economy up, regardless of whether one believes that the CBO's 2.3% or a somewhat higher figure is correct, is an urgent national priority. The key to doing so involves increasing the rates of saving and investment and more efficiently allocating resources in the economy. This requires the following Federal policy mix:

1. Slowing the growth of spending to balance the budget and keep it balanced in the long term. This will require spending control far above and beyond anything discussed in the recent rounds of budget negotiations focusing on the year 2002;

2. Pro-growth tax reductions and reforms focusing on lower marginal tax rates and eliminating the double and triple taxation of saving and investment. Recall that the harm done by high marginal tax rates to the economy goes up with the square of marginal tax rates. Thus, getting tax rates down should be the highest priority in tax reform;

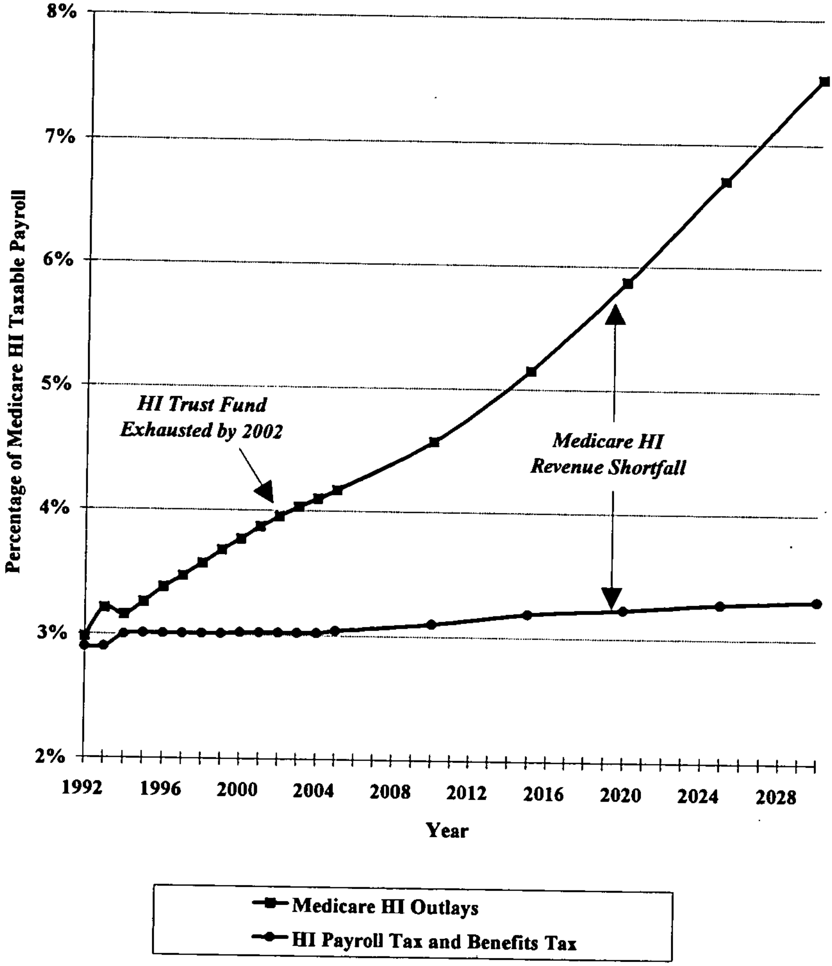
3. As the comparison with Western Europe shows, a highly regulated economy impedes the flow of capital and labor to their most productive uses. Regulation adds a huge hidden tax to the American economy, the price paid by America's consumers and the flexibility of our product, capital and labor markets. Fortunately, Congress has begun some deregulation - witness the landmark telecommunications reform. However, much of the economic and social regulation stems from an era when the problems were different and more flexible solutions were not as readily apparent as they are today. The fundamental overhaul of the regulatory apparatus strengthening cost benefit analysis and replacing burdensome command and control type regulation with more flexible market based incentives, such as the emissions trading in the Clean Air Act Amendments, would be a major improvement and could lead to major improvement in resource allocation in the American economy. The same is true in litigation reform. Congress has moved in the right direction, but has only been able to get a small amount of the sensible balanced legal reform agenda passed into law;

4. Let me reiterate, especially in view of the recent public discussion and debate, that an open, rules-based (with the rules enforced) regional and world trading system enhances productivity and real incomes. While some individuals and/or sectors may suffer during transition, there is no doubt whatsoever that expanding international trade opportunities on balance works to the improvement in living standards in the American economy. There is no more certain way to cause a serious recession in the United States than to retreat into a protectionist trade policy;

5. Finally, let me note that there have been some who have said the Federal Reserve has pursued a monetary policy which is the major reason for slow growth in the American economy. As mentioned above, I believe the Federal Reserve has done a remarkable job in its two rounds of disinflation and has put the American economy in a situation which, driven by productivity enhancement in the private sector, is poised for stronger growth if sensible tax, budget and regulatory forms are enacted soon. While, especially in hindsight, one can always argue the Fed should have moved interest rates up or down a little sooner, a little faster, overall monetary policy has been excellent. Those who seek to blame the Fed for the

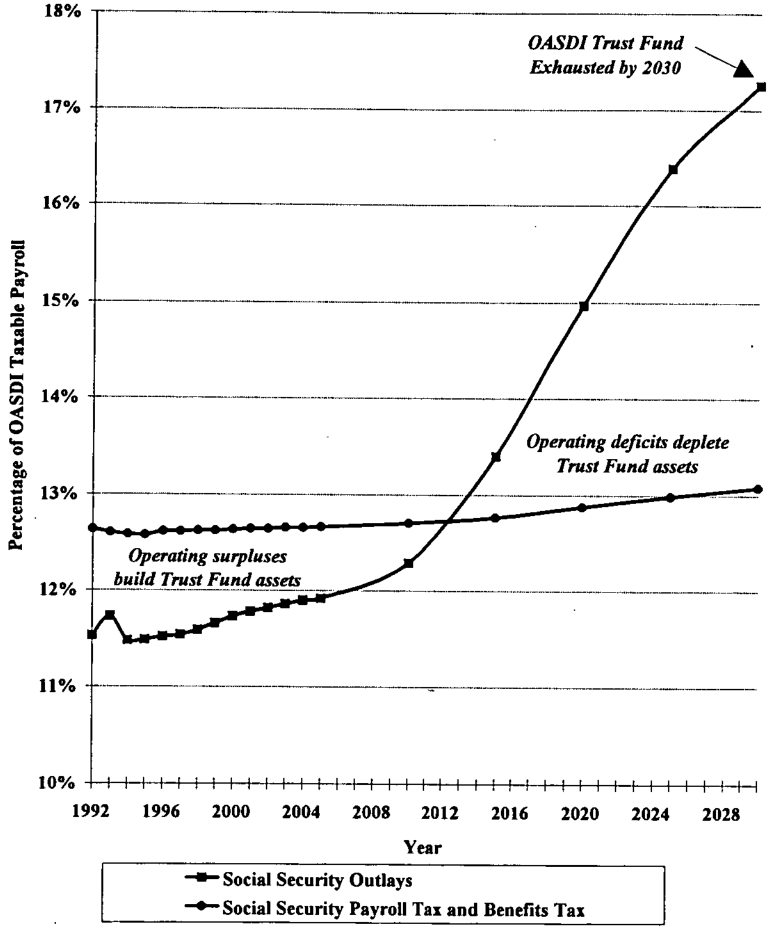
economy's sluggish performance are, in my view, looking in the wrong place. They should be focused on the budget, the tax code, and regulation.

Chart 1
Medicare HI is Projected to Be Insolvent by 2002



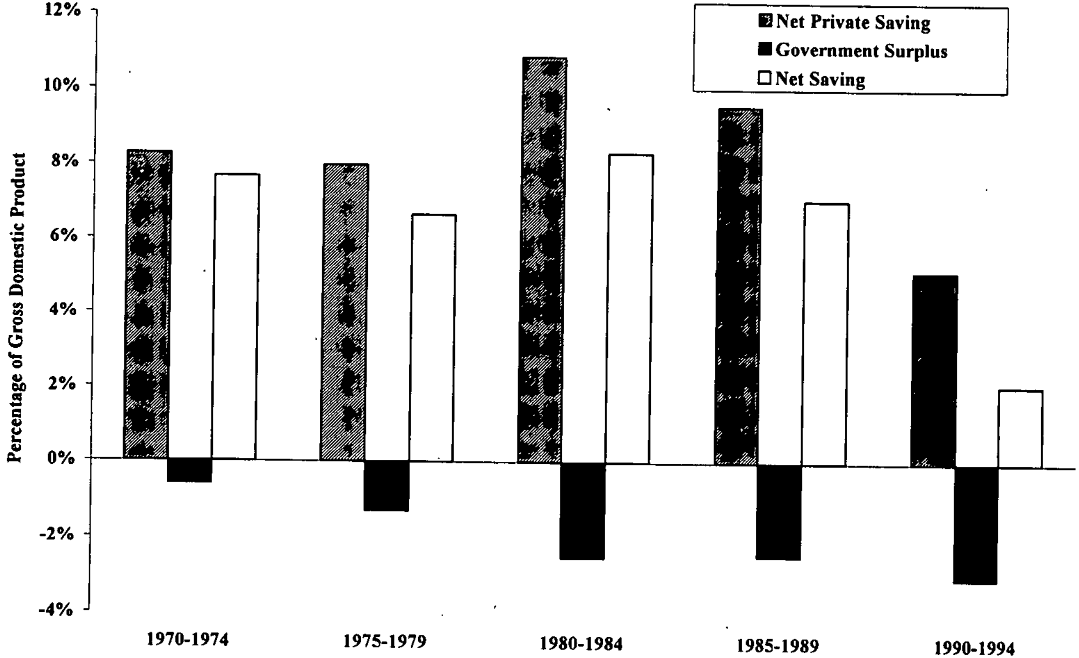
Source: OASDI and HI Board of Trustees 1995 Annual Reports

Chart 2
Social Security Tax Collections Exceed Current Benefits, But Are Not Enough to Fund Future Promises



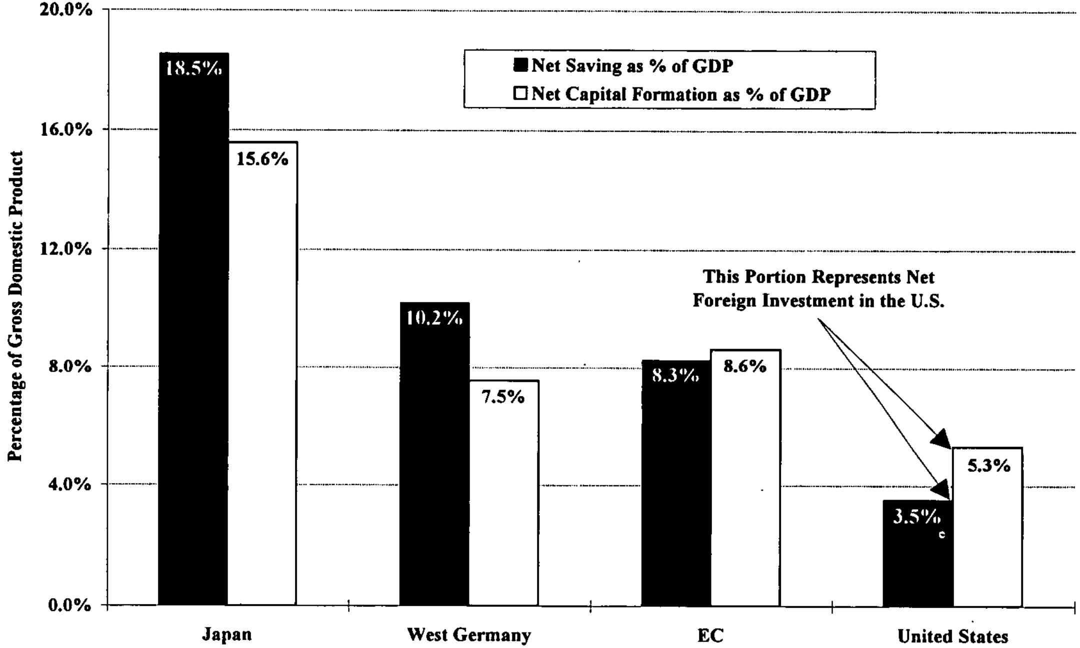
Source: OASDI Board of Trustees 1995 Annual Report

Chart 3
The Decline in Net National Saving



Source: Bureau of Economic Analysis

Chart 4
Our Competitors Save and Invest More Than We Do
1983-1993 International Comparison



Source: OECD *National Accounts: Main Aggregates,* 1995 Edition

Table E-4.
Revenues by Major Source, Fiscal Years 1962-1994 (In billions of dollars)

	Individual Income Taxes	Corporate Income Taxes	Social Insurance Taxes	Excise Taxes	Estate and Gift Taxes	Customs Duties	Miscellaneous Receipts	Total Revenues
1962	45.6	20.5	17.0	12.5	2.0	1.1	0.8	99.7
1963	47.6	21.6	19.8	13.2	2.2	1.2	1.0	106.6
1964	48.7	23.5	22.0	13.7	2.4	1.3	1.1	112.6
1965	48.8	25.5	22.2	14.6	2.7	1.4	1.6	116.8
1966	55.4	30.1	25.5	13.1	3.1	1.8	1.9	130.8
1967	61.5	34.0	32.6	13.7	3.0	1.9	2.1	148.8
1968	68.7	28.7	33.9	14.1	3.1	2.0	2.5	153.0
1969	87.2	36.7	39.0	15.2	3.5	2.3	2.9	186.9
1970	90.4	32.8	44.4	15.7	3.6	2.4	3.4	192.8
1971	86.2	26.8	47.3	16.6	3.7	2.6	3.9	187.1
1972	94.7	32.2	52.6	15.5	5.4	3.3	3.6	207.3
1973	103.2	36.2	63.1	16.3	4.9	3.2	3.9	230.8
1974	119.0	38.6	75.1	16.8	5.0	3.3	5.4	263.2
1975	122.4	40.6	84.5	16.6	4.6	3.7	6.7	279.1
1976	131.6	41.4	90.8	17.0	5.2	4.1	8.0	298.1
1977	157.6	54.9	106.5	17.5	7.3	5.2	6.5	355.6
1978	181.0	60.0	121.0	18.4	5.3	6.6	7.4	399.6
1979	217.8	65.7	138.9	18.7	5.4	7.4	9.3	463.3
1980	244.1	64.6	157.8	24.3	6.4	7.2	12.7	517.1
1981	285.9	61.1	182.7	40.8	6.8	8.1	13.8	599.3
1982	297.7	49.2	201.5	36.3	8.0	8.9	16.2	617.8
1983	288.9	37.0	209.0	35.3	6.1	8.7	15.6	600.6
1984	298.4	56.9	239.4	37.4	6.0	11.4	17.0	666.5
1985	334.5	61.3	265.2	36.0	6.4	12.1	18.5	734.1
1986	349.0	63.1	283.9	32.9	7.0	13.3	19.9	769.1
1987	392.6	83.9	303.3	32.5	7.5	15.1	19.3	854.1
1988	401.2	94.5	334.3	35.2	7.6	16.2	19.9	909.0
1989	445.7	103.3	359.4	34.4	8.7	16.3	22.8	990.7
1990	466.9	93.5	380.0	35.3	11.5	16.7	27.3	1,031.3
1991	467.8	98.1	396.0	42.4	11.1	15.9	22.8	1,054.3
1992	476.0	100.3	413.7	45.6	11.1	17.4	26.5	1,090.5
1993	509.7	117.5	428.3	48.1	12.6	18.8	18.5	1,153.5
1994	542.7	140.4	461.5	55.2	15.2	20.1	22.1	1,257.2

SOURCE: Congressional Budget Office.