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LEVY INSTITUTE

The Jerome Levy Economics Institute of Bard College

*The Jerome Levy Economics Institute*
*of Bard College*

# The Employment Act of 1946: 50 Years Later

## Conference Proceedings

**Including speeches by**

**S Jay Levy,** Chairman, Board of Governors, The Jerome Levy Economics Institute

**George Becker,** President, United Steelworkers of America

**The Honorable Katharine G. Abraham,** Commissioner, Bureau of Labor Statistics, U.S. Department of Labor

**Richard E. Cavanagh,** President and Chief Executive Officer, The Conference Board, Inc.

**The Honorable Alicia H. Munnell,** Member, Council of Economic Advisers, Executive Office of the President

*April 25–26, 1996*

*Bard College*
*Blithewood*
*Annandale-on-Hudson, New York*

# CONTENTS


## Foreword

**Dimitri B. Papadimitriou,** Executive Director, The Jerome Levy Economics Institute . . . . . . . . . . 3

## Speakers

[In order of presentation]

**S Jay Levy,** Chairman, Board of Governors, The Jerome Levy Economics Institute . . . . . . . . . . 4

**George Becker,** President, United Steelworkers of America . . . . . . . . . . 8

**The Honorable Katharine G. Abraham,** Commissioner, Bureau of Labor Statistics, U.S. Department of Labor . . . . . . . . . . 12

**Richard E. Cavanagh,** President and Chief Executive Officer, The Conference Board, Inc. . . . . . . . . . . 18

**The Honorable Alicia H. Munnell,** Member, Council of Economic Advisers, Executive Office of the President . . . . . . . . . . 21

## Sessions

**I.** The Links among Technological Change, Corporate Restructuring, and Stable Employment . . . . . . . . . . 27
**Jeffrey Brown** (moderator), Senior Producer, *The NewsHour with Jim Lehrer*

**II.** The Economic and Labor Market Effects of Immigration . . . . . . . . . . 31
**Joel Perlmann** (moderator), Senior Scholar, The Jerome Levy Economics Institute

**III.** Options for Low Inflation and Long-Term Employment . . . . . . . . . . 35
**Howard Rosen** (moderator), Executive Director, Competitiveness Policy Council

**IV.** Marketplace Dynamics and Less-Skilled/Low-Wage Workers . . . . . . . . . . 39
**Fred R. Bleakley** (moderator), Economics Senior Special Writer, *The Wall Street Journal*

**V.** The Employment Act of 1946: A Perspective from the Council of Economic Advisers . . . . . . . . . . 44
**Steve Pearlstein** (moderator), *The Washington Post*

**VI.** Employment Policy in a Changing Marketplace . . . . . . . . . . 49
**Dimitri B. Papadimitriou** (moderator), Executive Director, The Jerome Levy Economics Institute


The Jerome Levy Economics Institute of Bard College, founded in 1986, is a nonprofit, nonpartisan, independently funded research organization devoted to public service. Through scholarship and economic forecasting it generates viable, effective public policy responses to important economic problems that profoundly affect the quality of life in the United States and abroad.


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# Foreword

*By most accounts the U.S. economy has performed well recently. The unemployment rate has declined to 5.2 percent, family income has risen, and the poverty rate has fallen to 13.8 percent—all while inflation has been kept in check, hovering around an annual rate of 3 percent. Nevertheless, 7 million Americans remain unemployed, many workers have joined the ranks of the underemployed and the contingent workforce, and Americans in all occupations and income groups are expressing anxiety about their economic security. Rapid technological change, globalization of production, and the wave of corporate downsizings have forever altered the economic landscape, and many Americans risk being left behind as the American economy moves toward the next millennium.*

*Accordingly, the country is engaged in a debate over the appropriate course for public policy to assure equality of opportunity for all Americans and to improve the American standard of living. This conference, commemorating the fiftieth anniversary of the Employment Act of 1946, addressed the federal government's role in promoting prosperity. For example, the unemployment rate has fallen below most estimates of a minimum threshold for accelerating inflation according to the "natural rate" or NAIRU thesis. Although unemployment has fallen and wages have slightly risen, inflation remains subdued. Does this evidence challenge the use of the natural rate as a theoretical tool for monetary policy?*

*The Employment Act stated that it is the responsibility of the federal government "in a manner calculated to foster and promote free competitive enterprise . . . to promote maximum employment, production, and purchasing power." These proceedings are, I believe, a valuable guide in the search for the means to fulfill those obligations.*

*Dimitri B. Papadimitriou*
*Executive Director*

## Speaker

### Labor Force Angst and the Devil in "Deep Blue"

**S Jay Levy**
Chairman, Board of Governors, The Jerome Levy Economics Institute

The conference on employment is an annual event at Blithewood. Indeed, this institute traces its origins to Jerome Levy's concern about unemployment 88 years ago and to his belief that anyone who was willing and able to work should have the opportunity to find a job that well utilized his or her human capital. Last year I concentrated on the problem of unemployment and means of overcoming it. No one need doubt my belief that policy should aim at full employment and that this goal is achievable.

This morning I am going to discuss a new concern that I have about the general welfare. I fear that job insecurity as distinct from unemployment is rapidly spreading and intensifying. A chess match focused my attention on a trend in the economy that may be eroding the spirits and serenity of a great many individuals. Many people viewed the recent match between world champion Garry Kasparov and the upstart challenger Deep Blue, a computer, as a sports contest. I see it as a seminal event in the economic life of the nation.

Technology has wrought enormous changes in the last two centuries: Longevity has doubled, leisure time has been created, a flick of a switch brings light, people can be warm in winter and cool in summer, and indoor plumbing has erased a whole category of jokes. But change, even change that brings a better life in the long run, can be unsettling. Most of us believe that the changes I have mentioned were good for Americans. But I am beginning to worry about the changes now being foisted upon us by machines and those yet to come.

Until now people have used machines as servants to improve the quality of their lives. This morning I am asking: Are we becoming the servants of machines? Are we losing control of our lives as machines take over? If a computer can play championship chess, a highly intellectual activity, it can perform many other mental tasks. Deep Blue reminds us that widespread technological unemployment of a kind never before seen is occurring and more is in the offing.

Polls show that Americans are uneasy. They worry about the loss of their job and fear that they will not be able to afford retirement. At least one pollster avers that American anxiety is far greater now than at any time since polling was inaugurated some sixty years ago. Political pundits seem puzzled by the public's failure to give President Clinton credit for the improvements in the economy that have occurred since his inauguration.

Newspapers regularly report "downsizings"—firms terminating the jobs of tens of thousands of their employees. Paternalistic corporations, usually firms at the leading edge of applied technology, such as IBM, NCR, and Eastman Kodak, have turned their backs to the people on their payrolls. Some of the paternalistic—maternalistic may be the better word—corporations that were notable for providing medical services, facilities for recreation, even personal counseling, and, most important of all, security during both working and retirement years, have said to their employees, "You are on your own."

This change has not improved the general morale. Many people are suffering from severe losses of purchasing power and even more are uneasy about their future. What has happened? One observer, whose recent book received wide attention, attributes the change to a loss of ability to increase productivity; somehow America's problems with productivity are related to the improved competitiveness of other industrial nations. Another author says we expected too much. He implies that the system cannot provide security and a standard of living that increases apace with our technological prowess. The idea that expectations have been too high has some validity, but it does not explain the now endemic downsizings nor does it point the way toward greater employment and income security.

The political rise of conservatives represents the belief that our high expectations can be fulfilled if only government would stand aside. Bureaucratic wastefulness and restrictions on enterprise have significantly impaired businesses' ability to provide the good things of life and, in the process, jobs. To return to better times, all we need to do, according to this reasoning, is trust business. But such headlines as "AT&T Fires 40,000" have engendered a growing distrust of business. Shareholders, some commentators argue, are being coddled and other stakeholders, consumers, and especially employees are being slighted.

The rapid development and exploitation of new technologies are increasing the national product, but not the American peace of mind. Although I maintain that the present rate of unemployment (about 5.5 percent) is too high, many, including most policy-making officials, believe that it is optimum. Even if I agreed with them, I would still assert that job insecurity is a major problem.

People with almost any skill and experience are finding that their abilities and talents, prized yesterday, may not be wanted at all today or tomorrow. That situation of course disturbs them. Edward Wolff and William Baumol, authors of a Levy Institute study, find that people who lose jobs are spending a longer time without work than people did in the past and that often able and diligent men and women cannot replace lost jobs with jobs that pay as well.

As I stated at the outset, I have little doubt that the United States can create virtually full employment. I do not mean a concept of truncated full employment. Policy need not be guided by the nonaccelerating inflation rate of unemployment, by NAIRU. During 1994, when monetary and fiscal policies were overall expansive, employment increased 3.9 million. In 1995, when policies were restraining growth, employment rose only a third of a million. These figures are from the Bureau of Labor Statistics (BLS) household series. The trends in the BLS establishment series are similar, although not so dramatic. Had employment increased as much in 1995 as in 1994, the unemployment rate would be about 3.5 percent instead of 5.5 percent—and the Federal Reserve would be having convulsions.

Were the nation to maintain policies that stress growth and ignore the NAIRU, our economy would have full employment by almost any definition. But I am concerned that the present national uneasiness arising from technologically stirred turmoil in the labor market would barely be alleviated by a boost in the rate of employment.

The advance of technology, which historically has been at an accelerating rate, will almost certainly continue exponentially. Productivity in many industries will increase. Usually, when new machines are used, labor costs come down. The trend to greater use of computers and related machines will tend to limit price increases. Trying to fight inflation by maintaining a NAIRU or a "natural rate of unemployment" will increasingly be beside the point.

At various times I have heard people inveigh against technological unemployment. They did this during periods of widespread joblessness. However, when new machines displaced tens of thousands of workers during periods of low unemployment, few if any complaints were heard about technological unemployment.

Perhaps the greatest and most celebrated revolution of the twentieth century involved the advances in technology that devastated agricultural employment. A hundred years ago half of the American labor force worked on farms. During recent decades the figure has been less than 3 percent. The technology that brought this change is lauded for good reason. The essential, if simplified, story is that poor sharecroppers and farmhands lost their jobs when tractors, harvesters, mechanical cotton pickers, and other machines took over their work. For the farmworkers, most of whom lived in hovels with no plumbing and no electricity, the job losses were undoubtedly traumatic. But they migrated to industrial centers and often went to work assembling automobiles, milling steel or aluminum, and building skyscrapers. Their pay was higher than it had ever been before and they lived happily ever after in houses with plumbing, central heating, air conditioning, television, and garages occupied by automobiles.

But today something different is happening as a result of technological unemployment. Some joblessness results from policy arising from fears of inflation; that policy wants to limit the use of the labor force. Yet, technology is causing insecurity that would occur regardless of policy.

I sometimes think about Linotype operators, workers whose collars were somewhere between white and blue. If you are a member of the baby boom generation, you may not know about these skilled typesetters. They operated keyboard machines that quickly produced and justified lead type a whole line at a time. These machines represented a huge gain in efficiency over previous typesetting, which was done by hand, one character at a time. But then photo-offset printing began to reduce the need for Linotype. New operators were not needed. Twenty years ago desktop publishing and similar technologies finished the need for Linotype operators.

A typical Linotype operator who lost his job to the newest technology might have been over 50 years old. He conceivably could have been educated to perform a new task that required considerable skill—one that would bring him as high an income as operating a Linotype machine. I suspect, and I have some idea from where I speak, that it would not be easy for this over-50 individual to absorb the new training. And if he did, I question whether an employer would want to hire him when younger people with equal skills were available. I suspect that surviving Linotype operators, unlike the displaced farmworkers, are experiencing a reduced standard of living.

In the past the new machines that represented gains in productivity usually required operators with new skills. Today some machines—computers and word processors, for example—still do. But other devices are "dumbing down" jobs. In the era before supermarkets my mother sometimes took me along when she went to the grocery store. She might ask for a pound of butter, a pint of heavy cream, a dozen eggs, and other items. As the clerk placed each item on the counter, he wrote its price on a brown paper bag. When my mother finished her order, the clerk added the twenty or more numbers with a rapidity that awed me. At the time I was just learning arithmetic. Today the clerk does not need to add or even write numbers. The scanner at the checkout counter performs those operations.

Some decades ago F. W. Woolworth adopted a new procedure to control inventories. When a box of a dozen screwdrivers was delivered to a store, the box included an order form for the clerk at the hardware counter. The clerk was instructed to order new screwdrivers when two were left in the box. But, alas, Woolworth found that its clerks were averse to taking a chance of being without screwdrivers, so they sent in the order for new ones as soon as they opened a box.

Nowadays, at Walmart and other chains scanners at the checkout instantaneously tell the manufacturer that an item, for example, a red sweater, size large, was sold. The manufacturer knows when to ship more red sweaters. Assistant buyers, who formerly were needed to order merchandise, are likely to have been fired. In the old days these assistants were on a career path to buyer and even merchandise manager. Today, maybe, they are running sophisticated software on a computer, but maybe they are doing nonskilled labor somewhere.

The executive vice president of a leading bank recently told an audience here that his institution, responding to competitive pressures, had cut employment by 1,000 during the past year. When I asked him if this reduction in personnel was made possible by computers, he replied that it certainly was. A recent newspaper story described the plight of a former bank loan officer who was now working for the minimum wage. Computers can memorize a bank's criteria for granting or denying loans, certainly automobile loans, and make the decisions. A person who has been a loan officer for thirty years can suddenly find that his or her three decades of experience is worthless.

The computer that was trying to win the chess championship should have no trouble making loan decisions, managing an indexed mutual or pension fund, or perhaps serving as a college admissions officer. One accomplishment of Deep Blue and its relatives will be to separate the truly creative occupations from the analytic ones, no matter how complex the analysis.

Because relatively few people who perform mental tasks can truly claim that their work is creative, one of Deep Blue's relatives is likely to take their job away at any time. What will they do then? The bank vice president who makes loans to small businesses, the Wall Street broker who finds investments for customers who want to risk a fifth of their funds in communications industry stocks, the physician who is attempting to use the results of various tests to make a diagnosis and a prognosis, and the media buyer at an advertising agency are all likely to find some day that a computer can do their jobs faster, better, and cheaper than they can. My colleague here at the Levy Institute, Oren Levin-Waldman, notes in a new study on unemployment and unemployment insurance that compared to earlier periods, "a higher percentage of managerial and professional specialty occupations have been suffering long-term unemployment." The likelihood is that computers are taking their jobs.

Most of the managers and persons in professional specialty occupations who lose their jobs are without skills that will enable them to find new positions with remunerations comparable to what they were accustomed to. I believe that the economy can at almost any time create a great many jobs, just as it did in 1994. But I fear that driven by technology, the economy will be discarding many types of jobs at an increasing rate. I am speaking of jobs that are well paying and require skills and experience. Many of the people holding such jobs will be in unenviable situations. New skills are often difficult to acquire and experience cannot be picked up in a cram course.

Has technology ceased serving human beings? Is technology taking over and making us its servants? Nowadays these questions are worth asking. Should the answers be affirmative, what ought we do? If, as I fear, technological advances are a major contributor to the present American angst, to the widespread sense of economic insecurity, a question of ethics is raised. Is embracing a system that makes masses of people uncomfortable, if not unhappy, supportable?

We cannot prevent technology from marching on at an ever-faster pace. Monetary policy might slow this march a little, but at great economic and psychological cost and with no chance of ultimate success. If one country prohibits a firm from using a machine that reduces its payroll, that nation's economy will succumb to competition from countries that have no such inhibitions.

National dissatisfaction arising from a sense of personal economic insecurity is upon us. Much of this insecurity is a realistic reaction to a real development, to machines that can analyze situations faster and more accurately than human beings. It is a paradox that this problem arises from one of the gifts of the twentieth century. The trouble is that neither economic theory nor the wisdom developed by other disciplines has experience with this problem. I do not know how or if we can prevent people from falling victims to machines. But we must try. If we have the ingenuity to create and program Deep Blue, we may have the ability to control his evil side, Deep Blue's Mr. Hyde.

# Speaker

## The Future of Labor Unions

**George Becker**
President, United Steelworkers of America

Let me begin my remarks by saying that I am not an economist and am proud of it. I would, however, like to tell you a little bit about myself and maybe add a little to that very generous introduction. I went into a steel mill in 1944 when I was 15 years old. I went in on one of the dirtiest, rottenest, most dangerous jobs that existed at that time. I was frightened to death and was convinced that I would never get out of the place alive. That feeling persisted day after day.

I can't recall what I made in the way of wages at that time—it wasn't very much, and it sure wasn't enough for what I was doing. I was put underneath a steam-driven blooming mill dating back to the 1800s. The oil and water ran down on top of you. I had a fire hose that would have beaten me to death if I had ever turned it loose. They put you down there at the beginning of the shift. When the mill shut down for a break at lunch you could come out for a while, and then you went back down. It was just a horrible experience.

My initiation into work and economics was a very real thing for me. As I said, I am not an economist. I must admit that I don't fully understand all of the economic models that people present to me, but I know enough to know that I am not a fan of trickle-down or supply-side economics. I do know what doesn't work; I know instinctively what isn't good for workers and what isn't good for America.

We went through a period during the 1980s when we tried supply-side economics, starting with President Reagan's election in 1980. During that time the steelworkers' union lost over 500,000 members—half a million people. The steel industry was virtually dismantled. We had a government that sat idly by and watched, encouraged imports, and controlled inflation by literally giving our jobs away. That didn't happen only to steelworkers. It happened to the autoworkers; it happened to the electronics industry, textiles, shoes, and others. The government just devastated a major portion of life in the United States.

Those lost jobs were what I call family-supportive jobs—the kind of a job where you could go to work and make enough money to participate in the American dream. You could raise a family, you could buy a house, you could buy a car, you could educate your children. The people who worked in the mill that I did came to this country to work, make a living, and live in a democracy. They had nothing to offer but their work and a work ethic that was very good and very strong. They saved, they learned, they educated their children, they participated in the American dream. This was the type of job that we lost during this period.

We lost a half a million jobs in the steelworkers' union, 250,000 in western Pennsylvania alone. I have heard many estimates about the number of jobs that we lost throughout the United States in other industries—anywhere from 9 million to 11 million jobs. The jobs that we lost were, as I said, family-supportive jobs.

The communities in which these plants and facilities were located have still not recovered. I can take you to mill towns up and down this valley or the steel valleys in Pennsylvania, to Lackawanna, Johnstown, Youngstown, and many other places—these communities were virtually wiped out. Vital services were curtailed. In many cases water systems were shut down, schools and hospitals were closed, police and fire services were curtailed, and these services had to be supplied from neighboring communities. The devastation in these communities—broken dreams, lost homes, separated families, suicides—is just unbelievable. Our union stayed close to these communities; there was no way to escape it—these were our members. But many people turned their backs on these communities. So I am not an economist, but I sure know what is wrong and what was wrong with America during this time.

But through everything, life goes on. We went through this period and found that no matter how bad it became, the sun came up the next day and somehow you had to pull things together and keep going. We worked with the survivors as well as we could. We literally had to force some companies to survive. We became experts in words that we had never known before: concession bargaining, ESOPs, LMPTs, unique plans that we would try to devise to work with companies to keep them afloat. We took part in concession bargaining and then insisted that the companies reinvest in the plant at the first opportunity. We made appearances before all different kinds of bankruptcy judges and commissions in order to keep the plants going and, by and large, we were successful. In many cases we virtually took over the mills ourselves, forcing the company, in the course of negotiations, to turn large portions of the operations over to the union and workers and then installing new work practices. Today we have partnership agreements in many of the steel mills and in all of the integrated mills. The surviving steel industry in America is the most competitive steel industry in the world. This same thing has been duplicated in other unions in varying degrees throughout the United States.

But the world of work for people changed forever during this period, and it will never be the same. There is no way to turn the clock back. As far as workers and their families are concerned, family-supportive jobs in America are gone. Some still exist—in the dinosaur industries, like steel and auto—but family-supportive jobs are no longer being created within new industries.

Today both spouses work and the pay received by both of them doesn't equal what one family-supportive job paid back in the mid 1970s. Day care is a way of life in young families. There's been a loss of the family values that people talk about as a result of this new kind of living. It is the exception today that a youngster seeking a job will find one that pays health care benefits. Job security is not even a dream to most of them. Everyone in authority in this country, from the highest levels down to the bottom, says that this is the day of the contingent worker, that we no longer expect anyone to have a secure job, that industry can't provide security, and that you should plan on being a contigent worker. This despite the fact that productivity levels in this country are soaring.

The 1980s, then, turned our whole world upside down. Both spouses are now working, and with none of the protections that working people used to have. When I was growing up, people believed that all it took was to work hard, stay sober, show up to the job, and be industrious. That is no longer the case today. What happened to the so-called American dream?

A broader issue, apart from family and local issues, is the merger mania currently taking place. Corporate America seems to believe that no matter how many people are working in a given workplace, it is too many. That somehow or other we have to eliminate other people's jobs or we are not doing our job. That in order to meet the shareholders' requirement of quick, rapid runup in the value of the stock, we have to reduce the number of people working. Downsizing has become a way of life, and it cuts across all lines of workers, not only union workers, but salaried technical workers and supervisory workers. We are being told that this is what the future holds for all of us.

Corporate executives, left to their own devices, strip companies, while their remuneration has nothing to do with their performance as a CEO; it is just how much they can bleed out of the company. In some cases the more they lose, the more they get. This is becoming a standard way of life in America. There seems to be no loyalty, either to the employees who helped build a company or to the community in which the company exists. Why is all of this happening, and what is happening to the middle class? If I can believe what I read in the papers, the middle class is practically being driven out of business.

In a recent article by Charles Krauthammer, a columnist for the *Washington Post*, he said, "Let's start by being honest. Let's admit that no one has any idea what causes the problem of stagnant wages. Let's admit that we don't know how to raise wages in America." Well, that's bull. We do know what's wrong in America. We do know what's happening to working people. We do understand what is necessary to turn things around, and there is no mystery in it. There was never a more horrible time in America than the Great Depression. It was worse than today in that there was no safety net to help workers when they were laid off and needed relief. From that experience, Franklin Roosevelt, the Democratic Party, and the leaders at that time decided that somehow we needed to enfranchise workers, to permit them to organize, to bargain collectively with their employers, and to share in the wealth that they were creating. This was all embodied in the Wagner Act, which permitted workers to develop, protect, and fight for themselves. To do that you needed an entity that could challenge the corporate structure; you needed a union. This was the purpose of the Wagner Act, and it worked. Millions of workers were organized and, through collective bargaining with their employers, were able to share in the wealth that they created. Coming out of that experience was the creation of a middle class in America.

This was, in effect, a contract with America and its working people, and it existed and worked well for 30 years. It saw us through World War II, in which every available resource was applied to fighting fascism. But during the last 15 to 20 years this contract has been rejected. For the last 15 to 20 years business has made every effort to effectively declare war on working people, on the middle class, and on our system.

Global competition is the reason given for this attack against labor. In the United States we have virtually been stripped of our right to organize and to represent workers. We think it is shortsighted on the part of business to do this. I'm certain that, eventually, everyone will realize that this is a mistake, that the path that we are on is the wrong one. But in the meantime we are being devastated and the labor movement is not able to represent people in an effective way. We are not able to bargain effectively. We are not able to organize. Workers can't go on strike today without being permanently replaced, and the threat of being permanently replaced stifles bargaining from the outset and makes a sham and a mockery of collective bargaining.

The AFL-CIO has adopted the saying "America needs a raise." America does need a raise, and the only way working people are going to get that raise is by being able to represent themselves effectively. They are not going to get it through the government, they are not going to get it through minimum wage, they are not going to get it through an employers' code of ethics. The only way they are going to get it is through the right to organize and the right of the unions to bargain collectively on behalf of their members—that will produce the raise that America needs.

I would like to make a couple of other points. Obviously, I am not a fan of the Federal Reserve and its low-growth policy. I believe that the future of working people depends on a full employment policy in the United States. We need a policy that is going to encourage and assist in the creation of family-supportive jobs. The Federal Reserve and its policies are part of the problem, not part of the solution.

One of the indicators that the Fed uses in determining interest rates is the unemployment level, and, for whatever reason, Alan Greenspan has fixated on a rate of 6 percent; that means that if the unemployment level drops below 6 percent, the Fed raises interest rates. Two things happen when it raises interest rates. One, there is a tremendous transfer of wealth from working people to Wall Street—which is in and of itself criminal. Second, companies' ability to invest is curtailed, projects are canceled, and housing starts slow. The whole purpose is to stagnate the economy and to have people laid off.

I want to focus on that a bit. What such a policy says is that the bottom 6 percent of workers that want to work—not deadbeats, not homeless people, not people incapable of getting a job, but the bottom 6 percent of employable people—are not going to get a job, are not going to participate in the American dream, are not going to be able to do the things that everyone should be able to do: buy the house, buy the car, educate the children. Any system that requires a large reservoir of unemployed people to keep wage rates and the economy depressed in order to be successful is fundamentally flawed. Everybody who wants to work should be able to work, and any artificial means that would deny a person the right to work is wrong from the outset. We should fight such a system in every way possible.

The other point I want to raise is on the trade agreements. I am not an isolationist or a protectionist by nature. On the other hand, I am not willing to hand over the keys to my car or my house or any of my property.

I grew up when there were a lot of protections in the United States and we had one of the healthiest economies that we ever had. The entire middle class was built during this period, a period in which the United States had controls and a managed import-export policy. We talk about improving [the middle class] with our trade agreements and find that the agreements don't work in quite the way we want them to.

For people who want to make a living and work in this country, the trade agreements rub hard against the grain in two areas: trade union rights and environmental accords. The United States has to compete for jobs on a global basis, but who exactly are we competing against? I understand that everybody needs to make a living and everybody needs to work. But how can our workers compete against child labor?

How can they compete against situations in which workers are being forced to work under oppressive conditions? How can they compete against prison labor? How can they compete against workers who can't organize or bargain on their own behalf? Nobody wants to address this issue; nobody wants to face it straight up.

The other area is environmental accords. We could say that we don't care what the environment is like in other countries, but we really do care. We in America pay a social price to have clean water, clean air, safe workplaces for our workers, unemployment and workmen's compensation, and protections like the 40-hour work week that are built into the law. Citizens know that American goods cost more because of these costs, and we are willing to pay the costs. But if citizens in other countries don't have to pay such costs, how can we compete against them? How can we give our workers a fair break?

I haven't gotten a straight answer out of anybody about this issue. I have talked to government officials, but they just turn their heads. They say we can't interfere with how another country wants to deal with its citizens or workers. I talked to [Commerce Secretary] Mickey Kantor within the last two or three weeks about the language on free trade being drafted for the Accords for the Americas. The language says that we are going to harmonize standards and regulations among countries, but what does that mean? Does that mean we are going to lower our standards down to theirs or that they are going to raise their standards up to ours? Does that mean that we are going to tell our employers that they can take the scrubbers off, that they don't need environmental equipment for clean air, and that we are going to roll back our safety and health protection for workers?

I grew up across the street from a steel plant and I played in it as a kid—there were no fences. Today, the whole town is redlined by the insurance companies because of carcinogens. We had a lead smelter in the town, and now the EPA wants to dig up 18 inches of ground over the whole city because it is another Love Canal. It used to be that workers were the only ones who lived under those conditions; now everybody does. Are we now going to compete with nations that don't require any environmental protection? The real beneficiary from these agreements is Wall Street, not workers. I don't see any great benefit to society and work in America from NAFTA, GATT, and all these other accords that are being put into place.

Let me close by saying that I believe in a free, democratic trade union movement. I believe that you can't have a democracy without a free, strong, democratic trade union movement. I don't believe that you can develop a middle class without a free, strong, democratic trade union movement, and I don't believe that we are going to be able to develop a society that is going to create a brighter future for our children without a free, strong, democratic trade union movement.

I think our leaders recognize this. Labor works closely with governments of emerging nations in Africa and other third world countries, and those governments always encourage us to work with them. They help us get over there, and they want us to work with them because they know that to have a democracy requires a free trade union movement. We are close to losing that movement in the United States, and I think we had better think about that.

We used to have the right to organize—that is what brought us out of the Great Depression, that is what created a strong society, that is what created a middle class, and that is what created the purchasing power that allowed this country to grow and thrive and become a great market. If we want to give America a raise, if we want to figure out how to stop wage disparity and put some purchasing power back in the hands of the people, then we had better give them the freedom of association, the right to form a union, and the right to bargain collectively. If we do that, we can answer Krauthammer very clearly and we can reclaim the American dream.

## The State of Our Economic Intelligence: Where We've Been and Where We're Going

**The Honorable Katharine G. Abraham**
Commissioner, Bureau of Labor Statistics, U.S. Department of Labor

I thought that I would draw on the theme of this conference and talk about what has happened to the state of our economic intelligence since the passage of the Employment Act of 1946. Although the Employment Act of 1946 makes no mention of the statistical agencies of the federal government, it is clear that the availability of sound economic data is critical to the role that the act envisions for those who are charged with the development and execution of macroeconomic policy.

### Development of Economic Data

By 1946 a surprising amount of information about the economy was regularly available. The Bureau of Labor Statistics (BLS) began collecting information on employers' payrolls and employment in 1915. The BLS was led into the business of collecting employment data by concern about what was happening to the availability of jobs during the recession of 1913 to 1914. In 1932 the bureau added survey information on average weekly hours and average weekly earnings, the motivation for which, I suspect, is fairly obvious.

The industrial coverage of the survey was, to start with, fairly narrowly focused on manufacturing. Over the course of the 1930s and 1940s, however, the industrial coverage was expanded, especially during World War II, as a consequence of interest in having better data for the purpose of administering wartime programs.

During the 1930s the lack of regular data on unemployment became a big issue because people wanted to know more about what was going on. It also was a big issue because Harry Hopkins, the administrator of the Works Progress Administration (WPA), needed, but didn't have, good information for assessing the likely demands on the programs he was responsible for. It was Hopkins who pushed for the establishment of a regular survey that would collect information from individuals on their labor force participation and produce data on unemployment. However, it was not until 1940 that the WPA actually got the monthly household survey off the ground and the federal government started producing unemployment statistics. That survey was taken over by the Census Bureau in 1942 and by the Bureau of Labor Statistics in 1959. By 1946 there was a monthly survey producing data on unemployment.

The history of price data collection goes back even further than the history of employment and unemployment data collection. The first data on wholesale prices were collected by the Bureau of Labor Statistics in 1902, motivated by congressional interest in knowing something about the cost of different kinds of items for the purpose of administering tariff programs. Consumer price data collection got started a bit later. The BLS began issuing a cost of living index in 1919 as a result of the concern that had developed during World War I about what inflation was doing to the cost of living for the average working person.

Work on developing the national income and product accounts (NIPA) began during the 1930s. Private researchers had already done some of the work, but the project was ultimately taken over by the federal government. In 1942 the predecessor to the Bureau of Economic Analysis (BEA) published the first annual estimates of gross national product; in 1947 it made the first formal presentation of the whole system of national income and product accounts.

Thus, federal agencies had begun to produce a large amount of information on a fairly regular basis by about the time that the 1946 Employment Act was passed.

I would like to note that we didn't start out with a model for how data would be collected or reports made. There were some states, such as Massachusetts, that early on had bureaus of statistics that collected information. The initial experience in Massachusetts, as I understand it, was not terribly good in the sense that the first commissioner of labor statistics in the state was someone who was quite political, and the early reports of the Massachusetts Bureau of Labor Statistics were perceived as advocacy pieces rather than objective analysis. The next commissioner was much more professional. He ultimately became commissioner of the U.S. Bureau of Labor Statistics, bringing to it his professional orientation. There has, then, for a long time been a separation between policy and advocacy on the one hand and provision of objective information on the other. I am happy to be able to say that the tradition in the federal statistical agencies has been professional, without an axe to grind, and I think that precedent has served us well.

By 1946 the elements that are at the heart of our current system of economic intelligence were in place. Since then there have been substantial improvements in the production of those core measures. The concepts employed have been sharpened, the scope of the coverage of the data has been expanded (we now publish more detailed information than we used to), and the data come out somewhat more quickly.

## Evolution of Economic Data

Without going through the whole history of each program, I want to give you an idea of some of the ways in which the economic data available to us have changed. Because I know more about them, I will focus on improvements in the products of the Bureau of Labor Statistics. The Bureau of Economic Analysis has done a lot of work to improve its products as well.

With respect to our payroll employment data, we now have more detail in terms of industry and geographical coverage. The *Current Population Survey* has, in its history, been through two major overhauls—one in 1967 and a second in 1994—that sharpened its concepts. There is a tension, of course, between wanting to have the best possible survey and wanting to have data that allow you to look at what goes on over time. This tension has made the statistical agencies cautious about changing concepts. You don't want to be changing the data every year; if you do, the data can't be used for many of the purposes for which you might want to use them. As a result of a big push during the 1960s, we have a lot more detailed information on unemployment by demographic groups.

With respect to our price statistics, there have been efforts to improve them by ensuring that we are measuring transaction prices, not list prices, in the producer price arena. We also have seen some expansion in the producer price arena in service sector coverage. The consumer price index (CPI) has been broadened in its coverage. It initially was designed as a measure of the cost of living for clerical workers, and we still produce the so-called CPI-W based on the market basket of wage and clerical workers. We also now produce a CPI for all urban consumers. It is interesting that, for historical reasons, Social Security is still indexed to the CPI-W.

In price statistics for both producer prices and consumer prices, we have made improvements in the indexes. We have shifted them to probability sampling, which means that we make a real effort to ensure that we are pricing items that are representative of what people are actually transacting or purchasing. We also have made some progress in incorporating explicit adjustments for changes in the quality of the goods and services that we are pricing.

Many of the improvements in core economic statistics have been the outgrowth of expert panels that have been brought in to review the statistics. With respect to employment data, the Gordon Committee issued a report in 1962 and the Levitan Commission in 1979. With respect to price data, many groups have been brought in to study the CPI in response to claims that the CPI data were biased in one way or another. The most comprehensive review was conducted by the Stigler Committee, which issued its report in 1961. Many of the issues discussed in that report continue to appear in press accounts about issues pertaining to the CPI. We are still working through the agenda laid out by the Stigler Committee.

These reviews don't come out of the blue. It is not the case that people say, "It's been a long time since we looked systematically at our employment statistics or our price statistics. Let's convene an expert commission and have a comprehensive look at this." These reviews usually grow out of the perception that there is some serious problem with the data that are being produced.

The Gordon Committee, for example, was set up after a 1961 *Reader's Digest* article alleged that the Kennedy administration was slanting the interpretation of the unemployment numbers, trying to make unemployment seem higher than it really was in order to promote Labor Department programs, and that the numbers themselves were wrong in that they overstated the amount of unemployment. This was an attack on the competence and even the integrity of the Bureau of Labor Statistics. In response, President Kennedy appointed the Committee to Appraise Employment and Unemployment Statistics, a group of distinguished people who carried out a comprehensive review of the statistics, vindicated the methods used by the Bureau of Labor Statistics, but also came up with some valuable suggestions for improving the data, many of which were later implemented.

The events that led to some of the reviews of the consumer price index have been of interest. Perhaps the most interesting are those that led to the 1944 review that was carried out by a group headed by Wesley Mitchell. We were in the midst of World War II and wage and price controls had been in place since about the beginning of 1942. Many of the unions believed that wages were being controlled, but prices were not, but the data produced by the Bureau of Labor Statistics—called the cost of living index—didn't show much increase in prices. Some union researchers studied the bureau's methods and produced an alternative index. Their work showed that between January 1941 and December 1943 prices had risen by more than 40 percent, whereas the bureau's data showed an increase of about 20 percent. One of the reasons advanced as to why the bureau's measure might significantly understate the rate of growth of the cost of living was that deterioration in the quality of items and shortages of items weren't adequately being taken into account.

The review by the Mitchell group largely vindicated the bureau's methods, concluding that although there may have been an understatement in the rate of growth of prices, it was small and not the 20 percent figure that the union study suggested. The group also came up with some suggestions for improving the bureau's work.

There was an interesting bit of fallout from this whole incident. As I mentioned, the price measure used at that time was called the cost of living index. After all this played out, the secretary of labor at the time decided that it would be better to change the name of this measure. It was not, in fact, a cost of living index; a more accurate name would be the consumer price index. It has been the consumer price index since that time. This distinction between the cost of living index and the consumer price index has, I think, been somewhat lost over the succeeding 50-plus years.

There have been some recent reviews of the work of the statistical agencies, again growing out of controversy. I will mention just a couple of them. The first one is the 1993 review carried out by the American Statistical Association (ASA) of the bureau's payroll employment data. Just to resurrect recent history, 1992, of course, was an election year. The payroll employment data for 1992 were first reported showing some job declines during the recessionary period from mid 1990 to early 1991. But, as is the bureau's normal practice, once a year the data are rebenchmarked to reconcile the data from the monthly survey with the data from the unemployment insurance records, which are available only with a lag. The benchmark revision, as announced, was a large negative revision, making the job losses even greater. (There was a preliminary announcement in November 1991, but the final numbers were not announced until some time later.) This revision, coupled with "unexpected" movements in some of our other data series, led to charges that the data were being manipulated.

Bill Barron, who, in his role as deputy commissioner, led the bureau between Janet Norwood's departure and my arrival, asked the ASA to look into this and do a more thorough review of our payroll employment statistics. Again, the integrity of the bureau's methods was vindicated, but the panel also made a whole set of recommendations for improving the payroll numbers, the most important of which was to convert them to a probability sample basis.

How many of you realize that the payroll survey numbers don't come from a probability sample? I can tell you, it was news to me; perhaps it shouldn't have been. I think the fact that they do not come from a probability sample accounts for why the sample has not tracked well with the data for the full universe of establishments and why our annual benchmark revisions have been bigger than is desirable. I hope that what we are doing now addresses these problems.

The group that has gotten the most recent press attention is the advisory commission appointed to study the consumer price index. The impetus for the so-called Boskin

Commission was clear. In testimony before Congress concerning the consumer price index based on some work by researchers at the Fed, Alan Greenspan stated that he believed that there was a significant upward bias in the consumer price index (on the order of 1.0 to 1.5 percent per year) as a measure of the change in the cost of living. This isn't something that is just of academic interest. If the consumer price index were to go up less rapidly, federal expenditures would go up less rapidly, federal tax revenues would go up more rapidly, and the size of the federal deficit would be substantially reduced. Given the current climate, it is not surprising that his remarks got a lot of attention and led to the establishment of the Boskin group. We are, at this point, waiting for its final report, which is due to be issued later this year. I hope that it, following the precedent of these other panels, will have reviewed various aspects of the bureau's work and come up with some implementable recommendations that will allow us to improve our methods and produce better data.

### New Economic Data Series

In addition to these improvements in the heart of our economic intelligence system, we have, over time, added data; we collect information on more things than we did in 1946. We started producing aggregate productivity data in 1955. In the early 1970s we began producing import and export price data. In 1976 we began producing the employment cost index, which was of great interest as a measure to track compensation rates and in the inflationary climate of that time was an important addition to the battery of economic data.

The monthly *Current Population Survey* goes far beyond producing an official unemployment rate. Following the recommendations of the Gordon Committee, in 1967 we began producing data on discouraged workers. There are many people who argue that the official unemployment rate isn't the right measure to be looking at. In part for just that reason the bureau produces a whole range of measures, some of which build on the discouraged worker data.

We have added income and earnings data to the *Current Population Survey*. The current debate about what is happening to better-educated versus less-educated workers builds on the fact that we actually have information on the earnings of both types of workers. In 1984 we conducted what has come to be the first in a series of supplements to the *Current Population Survey* on displaced workers, which has, again, proved to be an extremely valuable source of information. In 1995 we conducted what I hope will be the first of a biennial series of supplements on so-called contingent work.

We also have lost some things. We used to have data on labor turnover. You could argue about how good those data were, but whether they were high or low quality, we don't have them any more. There was a period from 1969 to 1973 when we collected data on job vacancies in manufacturing. There are many people, and I'm one of them, who think that data on job vacancies would be helpful in understanding what is going on in the labor market, but we don't have them.

### Improvements in Procedures for Release of Economic Data

On balance, in terms of the richness of the information that we have to work with, we are considerably ahead of where we were in 1946. We have also made some improvements in the way that the data are released, which I think should add to the public's confidence in the information. A source of controversy in the past was that the bureau didn't announce in advance when data were going to be released. That was, in fact, a big issue in 1960, an election year. The unemployment data were scheduled for release on Thursday, November 7, 1960, two days after the election. That date wasn't announced well in advance, and control over the data was not as tight then as it is now. Somehow, some inkling of what the data were showing leaked out. George Meany heard that the data were less favorable than had been anticipated, and he charged that they were being held back until after the election. It is clearly a bad thing to have people think that political manipulation is involved in the release of important economic data. Following that incident, the secretary of labor asked that the bureau announce a year in advance when the unemployment data were going to be released and that practice has been followed since then. As you might imagine, we are looking carefully at our plans for the next six months or so to ensure that we have informed people well in advance of everything we are intending to release so that there will be no surprises.

There also has been considerable tightening with respect to who sees economic statistics prior to their release. The data that we produce are sent by encrypted fax to the Council of Economic Advisers late in the afternoon of the day before they are released so that the council can advise the president. The secretary of labor doesn't see the numbers until 8:00 a.m. on the day they are released, and I meet with him from 8:00 to 8:30 (when the data become public) to talk to him about them. There are people who have trouble believing that the secretary of labor does not see the data until they are ready for release, but that in fact is the situation.

### Misperceptions about the Current State of Economic Data

My assessment is that we now are substantially better off with respect to our system of economic intelligence than we were in 1946. I would go further to say that our statistical system is second to none in the world and that we have quite good information about what is going on in the economy. I state that in part because that is not the impression that I think you would get from reading news accounts of the quality of current data. If I am right that our data really are quite good, why is there such widespread perception that they are bad? I think that a number of factors come into play.

One factor is that over the last 50 years demands have been placed on the information we produce that were not envisioned at the time that the surveys and data series were designed, and the demands are increasing. Part of what is going on is that more information leads people to ask more questions; that is a good thing, only natural. I hope that we will be able to make continuing improvements in the statistics being produced.

Some of these demands result from the pocketbook implications of the data. Market traders are paying increasing attention to these numbers, and statistics that are released can have enormous effects on prices in the stock market. Since traders can be affected, positively or negatively, in a big way by the data, they have a real interest in understanding every nuance of the data. That is all good, but it does mean that the data are getting a lot more scrutiny than in the past.

Similarly, a lot of federal programs have been tied to the statistics that are produced. This is especially true about the consumer price index. I can list a number of programs that use the consumer price index, and federal tax brackets are also tied to the index. This, too, has led to increased scrutiny of the data. Again, this is not necessarily a bad thing, but it is worth bearing in mind that these are not uses for which these data were designed. The data were designed as economic indicators; they were designed for descriptive and analytic purposes. They were not necessarily designed to be accurate to the very last decimal point for purposes of determining escalation in federal outlays.

A second factor that may contribute to perception of the data as inadequate is that there have been substantial changes in the economy that the existing data do not substantially address. With respect to employment, there is greater diversity in work arrangements today than there was in 1946, and it would be nice to have a lot more information about what is going on in the labor market. The fact that the statistics were designed at a time when most people worked full-time and at the site of the employer paying them and when these other arrangements didn't exist or were not so common means that the statistics aren't designed to answer some questions that are important to people today.

With respect to price and productivity statistics, measurement has become more difficult. An increasing share of output is in high-tech products and in the service sector, and it is more difficult to measure output and prices in those sectors. My colleague Ev Ehrlich uses a wonderful metaphor that sums up the nature of this difficulty rather nicely; he says it is like trying to measure someone for a suit of clothes as that person is sprinting as fast as he can down the street. This difficulty in measurement has been a factor in why people perceive our statistics as not being good enough, and on this they are right. We do need to improve what we are doing.

While I do not wish to use this conference as a forum in which to plead for additional resources, I feel that a third factor is that the budgets of the federal statistical agencies have been fairly stagnant. In real terms the budget of the Bureau of Labor Statistics is no larger today than it was in 1978. Despite the facts that the economy has gotten larger and more complex and that the bureau is doing more than it used to, it has no more resources than it had in 1978. I think this has had some long-term consequences. For example, we now have six Ph.D. economists doing research on issues related to the consumer price index and people would probably agree that it would have been good if we had had more people working on these issues, but before the CPI became such a big issue, it was hard to persuade people that we needed a research staff at all. I think that in some sense the government hasn't made the investments it should have. Moreover, significant cuts in the bureau's budget could do real harm. Currently, the bureau spends about two-thirds of its money on its core economic indicators. Most of the rest of what we spend is on legally required projects and the National Longitudinal Survey program, which I suspect many of you in this room think is worth preserving. We don't have a lot left to cut, and the situation is similar at the other statistical agencies.

Where does the bureau go from here? In general terms, our agenda is pretty clear. Our payroll survey is a high priority. I hope we are going to have some suggestions, from inside and outside the bureau, for improving the consumer price index. After those two things, improving our data on the service sector is priority one, and making progress on that is going to require not just the efforts of the statistical agencies, but also help from the academic community.

Let me conclude by saying that I hope academic folks will get more interested than they have been in the recent past in some of these measurement issues. The bureau has a lot of interesting data to look at and a lot of projects that could be carried out if you or graduate students were to come and spend some time with us; I encourage you to do that. These problems are important. The quality of our economic data has enormous consequences and I think there are some exciting things to work on that could help us improve our economic statistics.

# Speaker

## A Business Perspective

**Richard E. Cavanagh**
President and Chief Executive Officer,
The Conference Board, Inc.

I thought I might explore the relationship between big business and employment in the United States. I think this is a topic in which you might share my interest because if you read the popular press and the academic press, you could easily come away with the impression that (1) large-scale enterprise is a sharply declining factor in employment in the United States; (2) downsizing is the principal management activity of big business in America; and (3) downsizing is being done, in essence, to satisfy the interests of Wall Street and the interests of the senior executives, who in turn also have the incentive to satisfy Wall Street.

It is not difficult to understand how these perceptions have become so popular. If we look, for example, at the ten largest companies that announced downsizing since 1993, we find that they have eliminated 279,000 jobs. That is greater than the federal government's elimination of 200,000 jobs since the beginning of the Clinton administration, an action that is almost universally applauded. We witness interest in these activities in the major news magazines, such as in the "Corporate Killers" cover story of *Newsweek* or the "Anxiety" issue of *Business Week*. (Indeed, corporate leaders who once might have sought to be on the cover of *Time* or *Newsweek* now are happy with anonymity.) But, as is often the case, it appears that the conventional wisdom is wrong—in this matter on all three counts.

I would like to tell you about some quick research that we conducted. (Even though we do $10 million worth of research a year at The Conference Board, I helped to do this myself.) I've brought my source with me—the Fortune 500 listing in the current edition of *Fortune*. The Fortune 500 consists of the 500 largest industrial and service corporations headquartered in the United States. For purposes of this discussion, let's call this listing "big business."

We looked at the job and profit data for the 390 companies that are in the Fortune 500 today and were also in the Fortune 500 in 1991 (the beginning of the expansion). You might say, "Well, hold it. What happened to the other 110?" Some of them have changed their name, which meant that I was unable to get the data to correspond between the two years. Some of them have merged. In fact, last year there were 11 mergers among Fortune 500 companies. I'm sure someone is thinking, "Ah, with all this merger activity, whatever he tells us is going to be suspect because merging will increase employment of the remaining bigger firm." But some of these firms have "demerged" as well.

For example, we all know that ABC and Disney merged this year. We all know that Westinghouse and CBS merged. Those of us who live on the Eastern seaboard know that NYNEX and Bell Atlantic are about to merge. But we also had significant demergers this year. GM announced the spin-off of EDS, which, had it been a merger, would have been a gigantic one. AT&T announced that it is splitting itself into three enterprises. Again, a major demerger. Sears, Roebuck last year demerged and created three Fortune 500 companies—Sears, Allstate, and Discover—two of them in the Fortune 100 by virtue of demerging. So there's an awful lot of activity that goes on among these 500 companies, which is why there are only 390 firms that we can compare.

### Jobs and Big Business

Let me tell you what we found out about jobs and big business. First, the Fortune 500 employ about 20 million workers, which is about 17 percent of U.S. employment. Fortune 500 employment as a proportion of total employment was 17.0 percent in 1960, 17.6 percent in 1980, 17.4 percent in 1990, and 17.0 percent in 1995. Indeed, a consistent pattern of employment—about 17 percent of the nation's workforce. Quite different from what the research of David Birch implies, and very different from the 1960s writings of John Kenneth Galbraith in which he predicted the rise of the industrial state.

Employment by big business has been consistent over time. Moreover, between 1991 and 1995 these 390 Fortune 500 companies created 500,000 net new jobs, which, given the 10 million total new jobs created during the period, accounts for 5 percent of the national increase in employment. I think we can therefore say that these firms are neither the principle creators nor the principle eliminators of new jobs, which is quite different from the impression that I've gathered from reading the economic press.

Big business, like all business, is not monolithic. Some of the Fortune 500 companies have experienced rapid employment growth. Sixty-one firms posted employment growth of more than 10 percent over the period, while 26 experienced employment declines of more than 10 percent, which implies that we're getting close to a bell curve distribution in terms of employment change.

If we go beyond the Fortune 500 companies to all public companies—and presently in the United States 13,000 are traded on some public stock exchange—we find, first, that they account for about 45 million jobs (including the Fortune 500's 20 million). Second, we discover that there was far more change among these 13,000 corporations. During the past three years the number of publicly held companies has increased by 8,000 from a base of 5,000 in 1993; and among the 4,600 for which we have common data for 1991 and 1995, 1.2 million new jobs were created, which represented about 12 percent of the job growth in the United States. Again, not a decline, but modest, stable growth.

### Causes of Employment

So what drives employment and unemployment? First is revenue growth. Not surprising, as you don't expect organizations with declining sales to be increasing employment (unless, of course, you're Eastern Airlines, which always tried the impossible). Of the top 25 big companies in terms of employment growth, 16 are in the top 25 companies in terms of revenue growth.

We also find that 30 of the 53 industry groups grew in employment. Some of these 30 groups were a little surprising, at least to me; they included textiles, apparel, and food and experienced above-average employment growth. Declining industries were the ones you'd expect, such as airlines, aerospace, chemicals, and telecommunications.

What drives employment in addition to revenue growth? It is something in which the person for whom this institute is named would find solace: profitability and return to shareholders is almost perfectly correlated with employment growth. That is, among the 390 Fortune 500 firms, the companies with high returns to shareholders over the past 10 years had very high employment growth. Those that had an over 20 percent return to shareholders had employment growth of about 7 percent, and those that had a 10 percent decline in returns to shareholders experienced a 9 percent decline in employment. It's a little bit like what Bernstein was told, "Follow the money." It turns out that employment follows the money; the better off the company, the better off the employment situation and vice versa.

These findings are contrary to the conventional wisdom that firms are "downsizing themselves to excellence" or "shrinking themselves to great profitability," because it is the firms that are losing investment returns that are cutting their employment. The firms with high returns on investment are increasing employment.

Looking at data for individual companies, we find that for those that seem to be doing well, individual performance is a lot more important than the industry or service sector they are in. For example, among the companies with the largest employment growth during the five-year period were Microsoft, Dell, Compaq, and Quantum; all are high-technology, information-technology companies. Among the companies with the largest declines in employment were DEC, Wang, and IBM, which are in the same sector. Therefore, employment growth is not necessarily a function of the sector the company is in, but of the company's performance.

Similarly, among the so-called mature industries, the old business of America, are some that have had large increases in revenue and, coincidentally, in profits and in employment. State Farm Insurance had employment up 38 percent during the period. Nike had employment up 27 percent. Fluor, the construction company, had employment up 20 percent. Mattel, the toy company, had employment up 19 percent. It doesn't seem to matter whether the sector is a growth sector or a declining sector.

People often ask, "What happened to AT&T?" because AT&T, even though it is not the largest company in terms of announced downsizing, has attracted great attention. Some months ago AT&T announced as part of its demerger the elimination of 40,000 jobs (which was later cut to 30,000 jobs). I asked some people to help me look at telephone employment in the United States, and it turns out that despite all that we've heard of phone companies' laying off people, if we look at total employment in phone services today versus total telephone employment in 1984 (when Judge Green decided that AT&T was no longer a natural monopoly), there are more people working in phone service today. In 1984 AT&T, the largest company on earth, employed 997,000 people. In 1996(before the 30,000 jobs were cut), it employed 317,000 people. However, AT&T plus its spin-off companies (the so-called Baby Bells) employ 932,000 people. When you add employment among the companies that didn't exist in 1984 or didn't exist as large-scale enterprises, companies such as MCI and Sprint, employment in the phone business is higher now than in 1984.

I'm told by my Harvard Business School friends that had there not been the technological improvements in telephone switching and had telephone operators remained largely a female-dominated occupation (as was the case in the 1970s and before), every woman over the age of 18 in the United States today would have to be employed as a telephone operator to handle just the current volume of phone service, excluding faxes and data.

## Tomorrow's Trends

What do we conclude from this quick research as we look forward? One of the things we do at The Conference Board is sponsor lots of conferences, which typically are attended by business leaders and the occasional economist. At these conferences we often ask people, "What do you think is happening? What do you see as the future?" First, we've found that American big business is increasingly focused on the top line (of revenue growth) rather than the middle line (of reducing costs), which represents a big change from three years ago.

Second, we've found that most people believe that downsizing and restructuring, while they will continue to be an important part of the landscape of American business, have more or less reached their limits.

Third, we've learned that the chief human resource officers of the 100 largest corporations in the United States predict that within 12 to 18 months many companies will be facing labor scarcity, particularly for high-quality, high-skilled jobs. Already, about one-third of our members are reporting shortages in entry-level and senior-level technical personnel. So the past may not be prologue when it comes to jobs and business.

To wrap up, what do I think we've learned from this week's *Fortune*? First, big business's employment share has remained remarkably stable over the past 35 years. Second, big business is not monolithic. Some companies are creating jobs at extraordinary rates and others are eliminating jobs at high rates, but overall there's a near–bell curve distribution. And that distribution of employment levels is related to two things: revenue growth and shareholder wealth. The higher the growth of revenues or return to shareholders, the higher the employment growth, and vice versa. Maybe Charlie Wilson wasn't so far off when four decades ago he declared, "What's good for business [GM] is good for America," and vice versa.

# Speaker

## The Employment Act of 1946: 50 Years Later

**The Honorable Alicia H. Munnell**
Member, Council of Economic Advisers, Executive Office of the President

I am delighted to be here today both as a current member of the CEA (Council of Economic Advisers)—one of the notable products of the Employment Act of 1946—and as a member of an administration dedicated to the employment and employability of today's and tomorrow's workers. I would like to begin with a few comments about the council, touch briefly on the state of the macro economy, and then look at some specifics about the nature of recent job growth and trends in the characteristics of displaced workers.

### The Contribution of the CEA

My CEA experience is unusual in two ways. First, according to Herb Stein, one of the profession's major historians of the CEA, 44 of the 50 members since Arthur Burns have come from primarily academic backgrounds; the six exceptions are Alan Greenspan, Herb Stein, Lyle Gramley, Charlie Schultze, Beryl Sprinkel, and me. Not bad company! While I support the notion of an academic-based team of economic advisers, experience from other institutional environments also can be useful. I hope that a few of us nontraditional types continue to be let into the club.

The second unusual feature of my tenure is that I came to the CEA after having spent almost three years in the administration, which means that I had the opportunity to see the CEA's contribution firsthand before I joined it. Let me assure you that it plays a unique role; it is not embedded in any agency and therefore does not have to defend any particular program. The staff of the CEA is very special. It consists of topflight economists who come to government for a year or two, loaded with energy, new analytical techniques, and fresh ideas. In my Treasury role, on many occasions I was delighted to look across the table and see someone from the CEA on whom I could count as an ally.

When the CEA's funding was threatened last year, former council members and supporters from both parties came forward to argue that the council provides good value per dollar of expenditure, that in administration after administration the council has brought a market perspective to policy debates and has consistently advocated policies that foster incentives, efficiency, and productivity. The bipartisan enthusiasm for the council is truly extraordinary. The shared framework and tools of analysis far outstrip any policy differences. Nowhere is this more evident than during a changing of the guard. Since the staff serves from June to June, a new administration—entering in January—inevitably inherits the staff from the former administration. The transition in 1993 was typical in that the staff continued to carry on the highest quality work for their new employers.

So as we examine the Employment Act of 1946 after 50 years, I would like to add my voice to the many who aver that the creation of the CEA is one of the statute's greatest successes.

### Commitment to Maximum Employment

Let me now turn to the broader issue of the 1946 legislation, namely, the commitment to maximum employment. My understanding from the experts—Charlie Schultze and Herb Stein—is that this legislation did little more than articulate an already established sentiment. According to Herb Stein, "given the experience of the 1930s, it is inconceivable that the government would fail to commit itself to maintaining full employment." Although early drafts of the 1946 legislation mandated activist policies to maintain full employment at all times, the final version contained very mild language and no enhanced authority to control the economy. While I have no reason to doubt these experts about the impact of the 1946 legislation, I have always taken heart from the fact that the act instructs "the Federal Government to use all practicable means . . . to promote maximum employment, production, and purchasing power." The legislation is a symbol of a fundamental change in thinking about the magnitude of economic fluctuations that society is willing to tolerate. A commitment to maximum employment is a good thing and writing it down was probably a good idea.

This audience is not one that needs to be lectured about the costs of allowing the economy to operate at less than maximum employment, but it is important to say that those costs are significant in both human and economic terms. Being able to work and support oneself and one's family is an absolute prerequisite for economic security and self-respect. The situation has improved a lot since the Great Depression with the introduction of unemployment insurance and other social welfare programs. Nevertheless, most families still suffer a painful loss of income when the breadwinner loses his or her job.

Even those whose income loss is cushioned by savings and unemployment insurance suffer when unemployment strikes. A man's place in our work-oriented society is often defined by his job, and the same can be said increasingly for a woman. Being forced into idleness has devastating psychological impacts. High unemployment has been linked to increased incidence of crime, psychological disorders, divorce, and suicide.

Unemployment also has a very real impact on an individual's future earnings. Accumulated work experience is a valuable asset. Not only do unemployed workers cease to accumulate experience, but their skills begin to rust. With less human capital, workers are less productive when they are reemployed. Even short periods of unemployment can be damaging. Employers value a steady employment record when considering applicants, and a worker who has been laid off frequently lacks this record of reliability.

For the nation as a whole, the economic costs of unemployment are high. When the economy does not generate enough jobs to employ all those who are willing to work, potential goods and services are gone forever. The losses can be enormous. A conservative estimate of total output forgone since 1974 because of high unemployment is roughly $1.8 trillion, or about the amount of output produced in the first quarter of 1996.

High levels of unemployment are particularly painful for the most disadvantaged members of society and aggravate existing trends toward greater earnings inequality. The situation of the poor and low skilled, which improved so much during the strong growth of the 1960s (the poverty rate dropped 10 percentage points and real income among even high school dropouts rose 3.5 percent per year), stagnated in the 1970s and worsened significantly during the recession in the 1980s. Unfortunately, the robust recovery between 1983 and 1989 did little to improve the lot of the nation's disadvantaged; the percent of people in poverty remained high and income of those without a high school degree fell. The macroeconomics were simply not powerful enough to overcome the shift in demand for high-skilled labor and the structural problems increasingly associated with poverty. Nevertheless, maximum employment remains a necessary, although clearly not sufficient, condition for improving the well-being of the disadvantaged.

One final note before discussing the employment performance during the last three years. Controlling inflation was not mentioned in the Employment Act of 1946. Indeed, it was not mentioned in the original 1913 Federal Reserve Act, which focused on facilitating commerce and business. Nor was inflation mentioned in the Banking Acts of 1933 and 1935, which expanded the powers of the Fed in the wake of widespread bank failures during the Great Depression.

The first time that controlling inflation was identified as a goal of government policy—most specifically of Federal Reserve policy—was in the 1978 Humphrey-Hawkins legislation (the Full Employment and Balanced Growth Act of 1978). This legislation instructs the Fed to conduct monetary policy so as "to promote effectively the goals of maximum employment, stable prices, and moderate long-term interest rates." Thus, the discussion about maximizing employment should be couched in the context of not igniting inflationary pressures. Anyone who lived through the late 1970s and early 1980s and saw the costs of bringing inflation back in bounds wants to avoid any repetition of that painful episode.

## Job Growth in the Current Expansion

Let's turn to the current performance of the economy and speculate about what the authors of the Employment Act of 1946 would have thought. To appreciate the economic performance of the last three years, it is useful to go back and review the state of the economy when President Clinton took office. At that time we inherited an economy that was adrift. Technically, the 1990–1991 recession ended in the spring of 1991, but the first year of recovery was weak. The economy grew, but it produced almost no increase in jobs. We correctly called it the "jobless recovery." Our first priority, therefore, was to get the economy moving and to get people back to work.

Underlying the jobless recovery, however, was a major structural problem—a huge budget deficit. This deficit was growing not only in dollars, but also as a percent of national output. Moreover, the ratio of the deficit to output was increasing even as the economy was recovering—a particularly alarming trend.

Outsized and rapidly growing budget deficits have two harmful effects. First, they drain the nation's savings and thereby keep interest rates high, which discourages businesses from investing and expanding. Second, and in my view equally important, they give the sense that the country is not being well managed and the public sector is out of control. This creates uncertainty, which also dampens business confidence and economic activity.

The Omnibus Budget Reconciliation Act (OBRA) of 1993 fundamentally changed the fiscal landscape. We moved from a situation that was out of control to one in which deficits both as a percent of GDP (gross domestic product) and in nominal terms were slated to decline. And the projections have come true; deficit reduction did what it was supposed to do. In dollar terms the deficit has been cut in half, from $290 billion in 1992 to an OMB (Office of Management and Budget) and CBO (Congressional Budget Office) estimate of about $145 billion in 1996 (subsequently reduced to $117 billion for FY 1996). The deficit as a share of GDP has been reduced by much more than half; it has been cut from 4.9 percent in 1992 to an OMB and CBO estimate of about 2.0 percent in 1996.

One final note on the deficit before we look at the employment picture. The federal government is now running a primary budget surplus. That means that revenues exceed all government expenditures except interest. In other words, if it were not for interest payments on the debt we inherited, the federal government would not have a deficit. Finally, I should note that the general government deficit in the United States is a smaller percentage of GDP than in any of the other major industrialized countries.

Bringing the deficit under control had positive and immediate effects on the economy. As soon as the details of the plan were announced in early 1993, interest rates began to fall and confidence increased. As a result, business investment in equipment started to take off and other interest-sensitive sectors followed.

The economy is now in the twentieth quarter of a broad-based investment-led expansion. As a result of that expansion, the economy has moved from one with high levels of unemployment and unused capacity to full employment. According to the Bureau of Labor Statistics (BLS) survey of establishments, the economy created 8.5 million net new nonfarm jobs between January 1993 and March 1996. Almost all of these (93 percent) were in the private sector; federal employment has actually declined by over 200,000 during the last three years. Because of such robust employment growth, the unemployment rate fell from 7.3 percent in January 1993 to 5.6 percent in March 1996.

This is terrific job growth, not only in a historical context, but also compared to other countries. Of the G-7 countries, only Canada experienced a similar pace of job growth; the others had negligible gains or outright declines. Looking at it another way, with a labor force only two-thirds the size, the U.S. economy created at least six times more jobs than the other G-7 countries combined.

The job growth is remarkable for two other reasons. First, all of this economic growth and job creation occurred during a period of low and stable inflation. Both the CPI (consumer price index) and the PPI (producer price index) have been running at 3.0 percent or less for the last three years. Inflation is at its lowest average level since the Kennedy administration and is really no longer a factor in economic decision making.

Second, as I was discussing, all this has occurred in a period of deficit reduction. Deficit reduction is real; it means a decline in the number of federal jobs and negative numbers for purchases of federal goods and services. Yet despite the fact that federal purchases have been declining at a rate of about 5 percent a year since 1993, GDP has grown, and grown enough to create 8.5 million jobs.

## Quality of New Jobs

While the number of new jobs created is indisputable, critics have questioned the quality of those jobs. Some worry that because much of the job growth has been in the service sector, the new jobs are low-skill, low-wage jobs. Others claim that all of the new jobs are part-time slots. A quip has worked its way into the conventional wisdom: a young woman is reported to have dismissed the news of 8.5 million new jobs by replying, "Yeah, and I have three of them."

In an attempt to sort out the information and misinformation on job quality, the CEA just released a study that looks at the full-time/part-time issue, the extent of multiple-job holding, and the earnings associated with the new jobs. Let me summarize what we found, starting with the easiest area.

We did not have to do any work in the case of multiple-job holders; the BLS has produced sporadic annual data on the percentage of the workforce with more than one job since 1970 and monthly data since 1994. The multiple-job-holding rate in 1970 was 5.2 percent. Since then, it has fluctuated in a relatively narrow band between 4.5 percent and 6.2 percent. In 1994 the rate was 5.9 percent; in 1995 it was 6.2 percent. In short, the percentage of people holding more than one job has been remarkably stable. The United States has not suddenly become a country where everyone has a second job.

Getting a handle on the full-time/part-time issue was also relatively straightforward. The first piece of evidence comes directly from the BLS household survey. This survey asks respondents whether they are working full-time or part-time. If they respond "less than 35 hours," the survey asks whether part-time work was the only job they could find or whether they chose to work part-time. The results of the survey show no dramatic change in the percentage of the workforce employed part-time; if anything, the percentage has declined slightly. The redesign of the *Current Population Survey* (CPS) in January 1994 reallocated some part-timers from the involuntary to the voluntary category, but since January 1994 voluntary part-timers have hovered around 14 percent of the workforce and involuntary around 3.5 percent. The household survey indicates no increase in the number of part-time positions.

The second piece of evidence comes from the BLS establishment survey. The notion is that if the new jobs were disproportionately part-time, the percent increase in hours worked would be much less than the percent increase in jobs. The BLS data do not show any significant disparity. Between January 1993 and March 1996, the number of nonfarm payroll positions increased 7.8 percent and the total number of hours worked increased 7.7 percent. This evidence lends some indirect support for the conclusion from the household survey that the bulk of the new jobs are full-time.

That leaves the question of whether the new jobs are well paying or are low-wage, entry positions. Until recently, we did not have a complete answer to that question. Observers were concerned because a high percentage of the new jobs were in traditionally low-wage industries, such as services and retail trade.

From the beginning we knew that, regardless of the industry, the new jobs tended to be in high-wage occupations. The BLS household survey shows that between January 1993 and the present more than 60 percent of job growth occurred in "managerial and professional specialty"—an occupation group that pays well-above-average wages.

With regard to industry, we have also seen some encouraging signs. Whereas initially most of the jobs were indeed in the low-wage industries, the pattern has improved to the point where between February 1995 and February 1996 more than half of all new jobs were in industries that pay above-median wages. In other words, the new jobs now appear to be both in higher-paying occupations and in higher-paying industries.

Still we thought it would be nice to get a somewhat better fix on this issue, so we did the following exercise. We took full-time workers in the February 1994 CPS survey and distributed them among 45 detailed occupations in 22 industries. We ranked the cells by the median weekly earnings of these full-time workers and found that half of all these workers fell into cells with median earnings above $480 (in February 1996 dollars). We then placed workers from the February 1996 survey in these same cells to determine the employment growth in these high-wage job categories.

Our results show that two-thirds (68 percent) of the job growth between February 1994 and February 1996 fell into categories paying above-median wages.

So what does this all mean? It means that the bulk of the 8.5 million jobs created over the last three years have not been low-skill, low-wage jobs—sometimes referred to disparagingly as "hamburger-flipping" jobs. In fact, detailed annual survey data show that employment in *real* hamburger-flipping jobs—food counter, food preparation, and kitchen workers—actually fell in 1994 and 1995 and that 68 percent of new full-time jobs, at least in the last two years, have paid above-average wages. This could overstate the good news if full-time jobs were a declining share of the total. But as we just saw, the data show no increase in the proportion of part-time positions. Finally, the data also show no significant increase in multiple-job holders.

If the new jobs have been so good, you might ask, why haven't we seen any improvement in wage growth? The answer is that the number of net new jobs, 8.5 million, is relatively small compared to total employment, 118 million. With average annual job growth equal to roughly 2 percent of the labor market, the average wage depends much more on the pay of current workers than on the wages of new entrants.

## Displacement, Unemployment, and Reemployment

Despite a steady economic recovery, substantial job growth, growth of good jobs, a low unemployment rate, a deficit under control, and inflation at levels not seen since the 1960s, people are worried about their jobs. We took a look at the data to see whether this concern reflects a real increase in the probability of getting laid off.

We found that this is a difficult question to answer for two reasons. First, the best information on layoffs comes from the BLS's *Survey of Displaced Workers*, which it conducts every two years. The most recent available survey was carried out in 1994 and covered the period 1991 to 1993. The 1996 survey, covering the period 1993 to 1995, was completed in February, but will not be available until late summer 1996.

The second problem rests with interpreting the displacement rates. Essentially, the number of workers displaced was roughly the same proportion of the workforce during the 1990–1991 recession as during the previous recession in 1981–1982: 3.9 percent in the 1980s and 3.8 percent in the 1990s (among workers with three or more years of job tenure). Of course, the 1981–1982 recession saw greater loss of employment and output than the 1990–1991 recession, but the question is how to correct for the business cycle. To crystallize the puzzle for you, let me tell you how Tom Kane, a very good economist on the CEA staff, puts it. On the one hand, you can look at the displacement rate conditional on the unemployment rate and conclude that displacement has gotten worse. Alternatively, you can look at the unemployment rate conditional on the displacement rate and conclude that something has improved in the sense that a given displacement rate produces a much lower unemployment rate.

Regardless of how one interprets the pattern of displacement rates since the early 1980s, our best guess is that layoffs have declined since 1991 to 1992. We will not know for sure until the release of the 1996 *Survey of Displaced Workers*. But two pieces of evidence are suggestive. First, the fluctuations in the ratio of recently unemployed job losers (those who are jobless, looking for work, unemployed less than five weeks, and not on temporary layoff) to total employment in the household series tended to mirror the displacement rate through 1992. Since 1992 the number of new job losers has had a downward trend. If the relationship between job losers and the displacement rate holds, we would expect the displacement rate also to show a downward trend.

Second, a private sector firm (Challenger, Gray, and Christmas, Inc.) that monitors layoffs reports that announced layoffs fell from a peak of 615,186 in 1993 to 439,882 in 1995. Although these announcements are probably not representative, their decline is consistent with the evidence provided by the new job losers. In short, increased anxiety probably has not come from a massive increase in layoffs.

Then where does it come from? Part of the problem may be the great attention given to announced layoffs by large corporations. For a while it seemed as if CEOs were taking great pride in reducing their workforce, perhaps hoping that big layoffs would raise their stock prices. Just for the record, the CEA took a look at several studies of the relationship between layoffs and stock prices and found little support for this hypothesis. A layoff notice does not appear to convey unequivocally good or bad news to the market, although the announcement does appear to increase stock price volatility at the time of the announcement. Even in the oft-cited AT&T case, although the stock price went up in the wake of the announcement, it did not go up substantially more than the S&P (Standard and Poor's) 500, which it had been tracking for several years. Moreover, in the months since the announcement AT&T's stock price has dropped steadily. The evidence for a positive relationship between layoffs and stock price increases is just not there.

Back to the source of anxiety. Heightened anxiety may also stem from the changing nature of those who have been laid off. Older, white-collar, and more-educated workers were considerably more at risk during the 1990–1991 recession than during the previous recession. Although younger, blue-collar, and less-educated workers are still more likely to be displaced, displacement rates have clearly risen for previously protected groups. My guess is that it is this development that has caught the attention of the reporters and editorial writers.

The costs of being laid off from one's job remain high. Roughly 25 percent of those displaced during 1991 and 1992 had either stopped searching for work or had not yet found work by the time they were surveyed in February 1994. The remaining 75 percent had found employment, but only about half of this group had found jobs that paid as well as or better than their previous employment. Among displaced workers who found new full-time jobs, the average real wage loss was large, roughly 10 percent. These costs show that whether layoffs have increased or not, they are a terrible problem for those affected by them. It is little comfort to workers who lose their jobs that job creation and job destruction are natural processes in a dynamic economy, especially one faced with rapid technological change and increased globalization.

The question is how institutions like the government should respond. Three types of policies seem important. First, encourage education, training, and retraining so that workers laid off by one company will be attractive to another company. Second, foster the portability of benefits so that workers do not lose health and pension protection when they lose their jobs. Finally, use the unemployment system as a reemployment system; one-stop career centers can provide useful, timely information about training and job opportunities so that workers can move as rapidly as possible to the next stage in their careers. These are the policies that President Clinton has advocated since the beginning of his administration.

## Conclusion

Let me conclude by returning to the Employment Act of 1946. In my view a good macroeconomic environment is the key component of any labor market policy. In that regard we are in good shape. In fact, we are in remarkable shape; unemployment at 5.6 percent and inflation somewhere between 2.5 and 3.0 percent would have been unimaginable a few years ago. Moreover, these gains have been made during a period in which the dollar value of the deficit has been cut in half. With inflation and the deficit under control, we have the sound macroeconomic environment we need for a continuation of the current expansion and further job growth. While we still face challenges on several fronts—namely, slow productivity and wage growth, particularly for low-skilled workers—I think the framers of the Employment Act of 1946 would be pleased.

# Session I

## The Links among Technological Change, Corporate Restructuring, and Stable Employment

**Jeffrey Brown** (moderator)
Senior Producer, *The NewsHour with Jim Lehrer*

**Robert Cohen**
Adjunct Scholar, Economic Strategy Institute

**Lawrence Mishel**
Research Director, Economic Policy Institute

**Edward N. Wolff**
Research Associate, The Jerome Levy Economics Institute; Professor of Economics, New York University

**Jeffrey Brown** posed several sets of questions for consideration by the panelists. First, how much technological change has taken place? What is its effect on the workplace? How is that change different from technological change in the past? Brown noted two different views on this set of questions, one that new technologies will result in fewer and fewer jobs and the other that new technologies will change the composition, but not the level, of employment. In *The End of Work* (New York: Putnam, 1995) Jeremy Rifkin argues that the effect of new technologies—the permanent disappearance of jobs—is only now being felt in the workplace. According to Rifkin, "In the years ahead, new, more sophisticated software technologies are going to bring civilization ever closer to a mere workerless world." Brown noted that lest such a view be considered extreme, Alan Greenspan has been quoted in *The Wall Street Journal* as saying that "human skills are subject to obsolescence at a rate perhaps unprecedented in American history."

In contrast, in *1939: The Lost World of the Fair* (New York: Avon, 1995), David H. Gelertner wrote

> In 1939, technology . . . was not remote and esoteric. It was down to earth, and its achievements were heroic. In the factories of the pre-electrified age, lighting was dim and layout was dictated by the web of overhead shafts and leather belting that connected each machine to the central steam engine or water turbine. . . . Computers are powerful and wonderful machines, and they do have the potential to change life radically, but for my money, they haven't yet, and imagination deficit among software builders, complacency and low standards on the users' parts have killed any chance of a real computer revolution so far. That conclusion is controversial. For now, I am content to leave it at this. In the [1930s] technology accomplished breathtaking things. That was the age of technology par excellence.

Second, is corporate restructuring more prevalent and causing more turbulence in the labor force today than in the past? To what degree do technology, global competition, and new pressures from pension and mutual funds looking for short-term results cause this turbulence?

Third, what is the possibility that a new social contract will be written between employee and employer? What would the specifics of such a contract be?

Fourth, have we always had the job insecurity that exists today, and, if so, how does today's insecurity differ from insecurity in the past? Is there a qualitative or quantitative difference in employment today? Is the duration of unemployment longer? Are people employed (and unemployed) more or less often? Are different members of the labor force affected differently?

### Technology and Employment

**Robert Cohen** considered the effects of technology and corporate restructuring on today's labor force. He expressed doubt that the stagnation in real wages has been entirely the result of technology. Rather, technological advances could be expected to be accompanied by productivity gains that would lead to some increases in the real wage. It is likely that we are in the early stages of a revolution in the technology of communications and computing. Costs could continue to drop as drastically as they have over the past 20 to 30 years, during which firms experienced up to tenfold reductions in the costs of high-end corporate communications every four or five years. A revolution is occurring in computing as well. Instead of using machines as machines, we are starting to use machines as thinking, teaching, and informational devices.

Such advances might instill the fear in some people that these devices will throw people out of work, that only those with at least a college degree (or those very knowledgeable about computing or communications) will survive, and that all others will be relegated to a constant cycle of short-term jobs and unemployment. Such a view is one possible side of the coin. The other possibility is that the new technology will create new jobs in new fields and bring with it new ways for workers to retrain for those jobs. Instead of going back to school, workers could acquire new skills via new technologies (such as on computers over the Internet) at convenient times.

Cohen predicted that this period of changing technology will be coupled with increasing industrial globalization. There is likely to be a merger between either a European or Japanese communications company and a large U.S. firm. Industries that previously had no global connection will begin to link, resulting in domination of the industry by four or five global communications companies by the year 2005 or 2010.

This trend toward market concentration has already occurred to some extent in computing. When a firm such as AT&T announces plans to lay off 40,000 people, it is not just a matter of cutting back on jobs for the sake of cutting back on jobs, but a reflection that AT&T is in crisis. Not knowing how to respond to this crisis, it lays off employees because that is the easiest thing for it to do in order to cut costs. If, however, AT&T does not establish a longer-term strategy, it will, according to Cohen, "be lost . . . [with] another 200,000 employees on the street." AT&T is under pressure to find new responses that are different from what it is used to doing. There are some indications that AT&T is beginning to do this.

Using BLS data for 1977 through 1989, Cohen examined the relationship between productivity and the percentage of spending on equipment devoted to computer and communications equipment (his study was based on similar work by Stephen Roach). Cohen found that productivity effects were largest for firms with high spending levels; those with 40 to 50 percent rates of spending experienced 2 percent and higher rates of productivity growth. (Cohen did note that other factors could affect productivity and that the effect of communications alone was difficult to separate from such effects.) In the period between 1985 and 1989, however, it appeared that productivity returns were better for firms that had rates of spending on this type of equipment that were less than 50 percent (compared to firms that had rates that were more than 50 percent). Cohen indicated that his recent work suggests that such returns will increase again during the period from 1990 to 1995 for smaller firms and for high-spending firms. He stated that the most successful technology firms that he had observed were those that invested much of their profits back into new technology and training.

### Duration of Unemployment

**Edward N. Wolff** stated that the rising duration of unemployment is a fundamental change in the nature of today's labor force. Cyclical fluctuations in the economy cannot alone explain changes that have occurred during the past 50 years.

- The average duration of unemployment (the average number of weeks an unemployed person remains unemployed) has nearly doubled.
- The percentage of unemployed persons who have remained unemployed for 27 weeks or more has almost tripled.
- The average duration of unemployment has grown at a compounded rate of approximately 1 percent per year.
- The percentage of those unemployed for half a year or more has grown at a compounded rate of 1 percent per year.

These trends represent a dramatic change in this particular aspect of unemployment. Moreover, the phenomenon is not unique to the United States; it is, in fact, much stronger in other industrialized countries. For example, in 1993 almost 60 percent of those unemployed in Belgium and Italy had been unemployed for half a year or more.

In their research for the Levy Institute, Wolff and his colleague William Baumol posit that the changing duration of unemployment is a function of the pace of technological change. The basic idea behind their premise is that when leave some reason to question whether there is any payoff for all the pain. If so, what is the evidence that we are in a transition to a new wonderful information economy?

One possible gain is that the United States is in a better global competitive position than it was in, say, the 1970s. Advocates of this position cite rising U.S. exports as an example of the benefits of growth. However, according to Mishel, U.S. competitiveness has come at a price. The U.S. import share has increased dramatically, resulting in a high trade deficit. As a result, U.S. production and manufacturing workers have experienced a decline in real hourly compensation, while workers in the other advanced countries and the developing nations have experienced an increase. These changes, accompanied by the fall in the value of the dollar, were what drove U.S. competitiveness. Mishel acknowledged that the United States did manage to post some improvement in manufacturing productivity growth (relative to the world and relative to past U.S. gains), which would have lowered U.S. unit labor costs. However, the presence of a significant trade deficit (which could be argued to be the result of either structural factors or macroeconomic factors) and the fact that European and Japanese workers now make 25 percent more (in dollar terms) than U.S. workers while posting higher productivity rates make it appear that there is no payoff for the experienced pain, at least in the international sector.

Another possible economic gain is increased capital accumulation, which would raise productivity growth and, eventually, living standards. The growth of the capital stock per worker has been slower in the 1990s than in the 1980s and was down in the 1980s from the 1970s. But capital services per hour worked (which is a bit fairer measurement because it includes services provided during the year, whereas much new investment is in computers, which depreciate over the course of the year and therefore are not included in the economic accounts) grew during the 1990s, although much more slowly than during the 1980s.

We should be aware, however, that during the last 15 years, the growth of human capital has accelerated. The share of the workforce with a college degree has doubled and the percentage of high school dropouts has been vastly reduced. To Mishel, however, it seems that hourly compensation rates have been growing too slowly given the resources being devoted to human capital accumulation. He asserted that if hourly compensation is corrected for the growth of human capital, it becomes negative during the 1980s and 1990s. The typical male college graduate earns 12 percent less today than a male college graduate in 1973. Earnings among workers with a high school diploma are down, as are those of high school dropouts and some workers with college degrees. Any growth of average hourly compensation, then, must be the result of a rapidly increasing percentage of workers in the highest wage and education groups.

Mishel pointed out that one indicator that has performed well is profits. Return to capital per dollar of assets on an after-tax basis is at a high level. Some might attribute this profitability to changing tax laws rather than to wage restructuring, but Mishel pointed out that the average effect of the federal tax burden was about the same for all members of the income distribution in 1977, 1989, and 1996 (except for the upper 1 percent of the distribution, for which the burden has varied), so that "the idea that somehow the problem with people's paychecks is what the government is taking out, rather than what the employers are putting in, is quite incorrect." Although taxes increased during the 1950s, 1960s, and 1970s, during the period in which there was a "middle-class tax squeeze" and declining incomes, tax rates were not rising, except possibly at the state and local levels (for which there is not much data available). Mishel concluded that there has been "a significant expansion of the [economic] pie, but there could have been more pie for a lot more people."

What, then, is causing the pain? According to Mishel, the 1990s saw a new factor not present in the 1980s, namely, a higher profit rate at the expense of wage increases. Productivity grew steadily, creating profits that provided room for larger wage increases than actually occurred. Mishel noted his belief that high profits are not bad per se, but that profitability can be achieved with strategies that result in growing living standards for the many instead of the few.

Two groups of factors contributed to wage inequality. The first group is the shift to low-wage service industries, the globalization of trade, and immigration, which together account for about a third of the growth of wage inequality. The second group is weaker labor market institutions, such as the decline of labor unions, which can explain another third of the growth of wage inequality. All of these factors have resulted in too-high unemployment rates, the existence of which has systematically disempowered workers relative to their employers.

# Session II

## The Economic and Labor Market Effects of Immigration

**Joel Perlmann** (moderator)
Senior Scholar, The Jerome Levy Economics Institute

**Richard M. Estrada**
Associate Editor, *Dallas Morning News*; Member, U.S. Commission on Immigration Reform

**B. Lindsay Lowell**
Director of Research, U.S. Commission on Immigration Reform

**Julian Simon**
Professor of Business Administration, University of Maryland

**Joel Perlmann** began the session by observing that it is impossible to predict all the ways in which immigration might influence American life. When we attempt to analyze these influences, many factors and economic effects, such as the extent to which immigration has and is influencing employment in the United States, must be considered.

**B. Lindsay Lowell** summarized the recent economic literature on immigration and discussed the policy implications of those findings. Issues pertaining to illegal versus legal immigrants have been discussed, but other, less obvious categories are only beginning to be recognized. These categories include refugees and legal, temporary migrants (foreign students, multinational executives, computer programmers, and agricultural workers).

As the result of agreement that immigration policy as a whole should be viewed as a system, consensus appears to have been reached that in order to have a liberal and legal admission system, the door to illegal migration has to be closed. For a nation of law, illegal or unauthorized migration is undesirable regardless of any economic effects such immigration might have.

Major policy divisions have existed on issues such as enforcement, management, and integration (also referred to as Americanization or economic assimilation and usually measured in terms of wages). Integration has been the subject of a recent surge in research and policy considerations regarding immigration. The late Barbara Jordan, when chair of the U.S. Commission on Immigration Reform, argued that through policies focusing on Americanization, immigrants might be more fully integrated into the labor force and, therefore, more productive.

Other topics of debate are the composition of the immigrant population, especially with respect to educational distribution, and the immigration premium, the idea that immigrants work harder and after 10 or 15 years catch up to natives in terms of wages. Some people contend that the quality of immigrants has declined during the last 25 years, with a greater percentage coming from less-developed countries with a lower level of education. However, the percentage of immigrants with a college-level education has remained steady over time, indicating that rather than a declining average educational level, there is a more bimodal distribution of educational level.

A related debate is whether earnings growth among immigrants has declined and will continue to decline over time. According to Lowell, there is evidence that the earnings trajectory has declined over time, but without longitudinal data it is difficult to know why this is the case. Moreover, different types of immigrants (illegal, legal, refugee, and so forth) have different experiences; illegal immigrants with six years of education will not perform as well as legal immigrants with an educational level that exceeds the average of natives.

As a result of these debates, the commission has suggested increased documentation requirements (such as a trial run for Social Security data banks) and border enforcement to keep unauthorized immigrants out of the labor force. It is not clear exactly how or if policy should change with respect to refugees, although some argue that policy should try to preintegrate refugees. Another question is whether the system governing legal immigration should shift from its current family-based emphasis (under which over 80 percent of immigrants are admitted) to increased emphasis on employment and labor market needs (under which only 14 to 20 percent of immigrants are admitted).

Resolving issues regarding integration and welfare is particularly difficult because of problems in estimating the net cost of immigrants. For example, should second-generation children be included in the cost-benefit analysis? Should costs incurred when immigrants displace native workers be included? Are there adequate measures of displacement costs? Unauthorized immigrants appear to have used welfare moderately, but to have increased their usage over time. According to Lowell, illegal immigrants are a net cost to society because they have larger families and a lower associated tax base (due to lower earnings), while legal immigrants have a zero net cost, that is, in terms of transfer payments less tax payments they do not cost any more than natives.

According to Lowell, the rising cost of immigrants has contributed to a feeling that the federal government has a responsibility to compensate states and localities for services they provide (such as the incarceration of illegal immigrants) as a result of large concentrations of immigrants. Other policies stemming from the assumed cost of immigration are holding sponsors more responsible for new immigrants and barring immigrants from certain programs, such as AFDC, education, and health care. Barring immigrants from such programs, however, may pose larger problems than it solves because exclusion may breed an "underground population" whose flexibility and integration will be reduced over time.

Lowell then turned to the issue of the labor market effects of immigration. Based on the 1980 census data, labor market effects were estimated as being minimal. However, such a result could have been obtained because the data were cross-sectional and were averaged across U.S. metropolitan labor markets. There were also problems with case studies of labor market effects. For example, some research clearly demonstrated that black janitors in Los Angeles lost jobs during the 1980s to illegal immigrants, but other studies on all jobs citywide suggested that black workers were not affected at all. Again, this points to possible problems associated with using averaged data.

There are at least a handful of studies that seem to suggest that when researchers use time series data and data on average income for low-skilled and high-skilled natives to examine the effects of immigrants on the labor force, immigrants appear to have a measurable effect on the wages of low-skilled workers. Evidence of the increasing effects of immigrants on wages implies that future immigration policy might need to take levels of immigration into account. We may need to look at early indicators of possible problems, especially in terms of immigration and localities. The answer may not be to restrict immigration, but to reform the entire system.

**Richard M. Estrada** noted that not all of the issues he looked at in his study of immigration are related to economics; some are rooted in societal values and some have to do with the very controversial question of national sovereignty in an increasingly competitive global economy. He stated his disagreement with the view that life in the world and in the United States has gotten better over the long term and with those who emphasize trends based on long-term averages. According to Estrada, "long-term averages tend to mask real-world downturns for workers and others at different times in different labor sectors, different labor markets, and in different parts of the country."

Estrada remarked that the debate about completely open borders versus allowing no immigration whatsoever was a "rhetorical device." The real debate was, first, whether to maintain or even raise existing levels of legal immigration or to cut them back to the levels of a half-dozen years ago and, second, whether to leave intact current policy based on family reunification or to reform it.

Estrada noted that the U.S immigration experience has been one not of ever-increasing numbers of immigrants, but of an ebb and flow in numbers. Immigration policy in the nineteenth century was based on mass immigration, largely indifferent to total numbers of immigrants or characteristics of individuals, such as skill levels. Between the late 1920s and mid 1960s there was a relative hiatus in immigration. In 1965 a policy of mass immigration was reintroduced in the form of family reunification. The U.S. Commission on Immigration Reform concluded that family reunification should remain an important part of the immigration system, but also has recommended rethinking the advisability of keeping all of the existing family reunification categories. Estrada stated his own view that immediate family reunification should continue to be a linchpin of immigration policy, but that preferences should not extend beyond immediate family members.

Estrada remarked that policymakers considering the effects of immigration need to consider the many different circumstances in different immigration periods, each having different labor market repercussions. First, the earlier wave of immigration was marked by an economy undergoing mass industrialization, while the current wave of immigration is the first to occur during the postindustrial era.

Second, it requires a higher level of skills and education to earn a good salary today than in the past; that level is increasing; and the data indicate that the level is likely to continue to increase. Estrada noted that few issues are more important than the skills characteristics of immigrants, but the issue requires a more sophisticated analysis than merely stating that immigrants bring needed skills to America. For example, he argued that any attempt to base overall immigration policy on average skills levels is fundamentally flawed because no such average exists. Rather, skills are clustered around the extremes of high skills levels and low skills levels. Policymakers concerned with minimizing possible adverse effects of immigration must decide whether they wish to emphasize admission of high-skilled or low-skilled immigrants.

Third, today's wave of immigrants is the first to occur since the creation of the modern welfare state. The costs of not working today are less than during previous waves of immigration, during which a sink-or-swim situation prevailed.

Fourth, there is no huge manufacturing boom on the horizon such as during and after World War II. This boom was, of course, an important factor in catapulting the immigrants of the previous waves, their children, and their grandchildren into the socioeconomic mainstream.

Fifth, unlike previous waves of immigration, the current wave does not seem likely to ebb any time soon. Telephones, fax machines, e-mail, relatively low-cost jet transportation, and growing international trade are rendering immigration much easier today than in the past. Moreover, legal immigrants have the right, upon becoming citizens, to sponsor the entry of yet more immigrants, which in itself creates an immigrant-driven immigration system.

Policymakers concerned with effects of immigration need also consider disparate geographical impacts as approximately 75 percent of all immigrants tend to settle in six or seven states: California, Texas, Florida, New York, New Jersey, Illinois, and possibly Arizona. Anywhere from 40 to 50 percent of illegal immigrants (Estrada's intentionally sole reference to that phenomenon) reside in California alone. Moreover, the argument that the effects of 1 million immigrants annually in a nation of 260 million are minimal is unjustified and based on "averaging"; in fact, since the early 1990s immigration has accounted for about 40 percent of population growth and 40 percent of labor force growth.

Estrada concluded that immigration policy that serves the national interest must address three basic questions: Who shall come? How many shall come? How does the government enforce the law? The way in which society answers these questions will say much about its values today and about the legacy it leaves to future generations.

According to **Julian Simon**, those who deal in immigration policy should be concerned about the "unchanging nature" of the data regarding immigrants. Although immigration levels are higher today than at the turn of the century, they are lower in terms of total population. For example, based on 10-year moving averages, total immigration today is nearly equal to that at the turn of the century, but after standardizing the rate of immigration by the size of the population, immigration today is approximately one-third the rate at the turn of the century. In addition, the absolute number of foreign-born residents is higher today than at any time in U.S. history, but as a proportion of the total population, there are fewer foreign-born residents in the 1990s than in any decade from the beginning of the nineteenth century through the 1940s. Moreover, Simon noted that the United States has a lower ratio of immigrants to total population than Australia, New Zealand, Canada, and South Africa and a somewhat higher ratio than France, England, and Japan.

Simon argued against the contention that there has been a reduction in the quality of immigrants. He noted that there has been a reduction in the proportion of both native-born Americans and recent immigrants with eight years or less of education and a rise in the proportion of natives and immigrants with 16 or more years of education (with a greater proportion of immigrants than natives in the higher-education group). These data indicate that there has been no decline in the quality of immigrants over time. Simon also noted that the proportion of doctorates awarded to foreigners (many of whom later become immigrants) in science and engineering has risen steadily since 1958. In fact, the proportion of foreigners with such doctorates now exceeds the proportion awarded to native-born Americans. Simon conceded that many of those who received these degrees will not reside in the United States.

With respect to unemployment effects, Simon asserted that there is a consensus that, in the aggregate, immigrants do not adversely affect employment among natives. He acknowledged that there may be adverse employment effects in localized markets and some small effects on the wages of particular groups. For example, the incomes of physicians have suffered due to immigration, while the incomes of lawyers have benefited. Simon contended, however, that most research has shown that the most vulnerable groups—blacks, women, and low-income earners—have not suffered as the result of immigration.

Simon then turned to the issue of the costs of immigrants in terms of social programs. He presented data on average spending for various programs for native-born Americans as compared to immigrants. He noted that although annual spending for welfare (including food stamps, SSI, general assistance, and aid for families with dependent children) was higher for immigrant families ($400 per family on average) as compared to natives ($250 per family on average), overall public flows (such as for health care, Medicaid, Medicare, public schooling, and Social Security) to natives were much higher. (Simon's rough estimate of total flows per family was $2,590 for immigrants and $3,818 for natives.) According to Simon, the disparity is due to the fact that immigrants tend to be young and therefore do not use those services whose costs are high, namely, services for the aging (Social Security and Medicare). Moreover, Simon noted that data from the 1970s showed that on average immigrants paid more in taxes than did natives. (Although current data do not bear out this finding, Simon insinuated that the older data were of better quality than newer data).

# Session III

## Options for Low Inflation and Long-Term Employment

**Howard Rosen** (moderator)
Executive Director, Competitiveness Policy Council

**William Dickens**
Senior Fellow, Brookings Institution

**David R. Howell**
Research Associate, The Jerome Levy Economics Institute;
Professor of Economics, New School for Social Research

**Marvin Kosters**
Resident Scholar and Director of Economic Policy Studies,
American Enterprise Institute

**Andrew Weiss**
Professor of Economics, Boston University

**Howard Rosen** introduced the session by observing that a tension exists between economic theory and reality and asking what the role of theory is. He noted that the recent debate in Washington about the minimum wage focused on economics textbooks' rendering of price floors as distortionary, "as if that [were] the only issue related to the minimum wage." He commented that this narrowness of focus was part of the problem of the role of theory in policy and argued that theory should be viewed as a tool to assist in understanding issues.

Rosen charged the panelists to think about the following:

- What is really happening in labor markets? Are we trying to devise models to reflect reality or trying to fit reality into our models?
- Is productivity growing? If so, why are wages not growing with productivity?
- What are the consequences of the fact that the United States is not only one big economy, but many different economies?
- What is meant by long-term employment? Do we mean holding a job for the long term or do we mean the long-term prospects for employment?

Rosen noted the importance of his introductory question in the context of setting monetary policy, particularly in reference to the use of the nonaccelerating inflation rate of unemployment (NAIRU) and its effects on unemployment and inflation.

**Andrew Weiss** proposed a corporate tax policy that he asserted would have the effect of reducing cyclical unemployment rates. Firms would pay taxes on profits as they now do, but would also receive rebates on their losses. Offering rebates would "level the playing field between large and small firms." Weiss estimated that because of current asymmetries in the tax structure, the effective tax rates of small firms are about triple the tax rates of large firms. He also estimated that the corporate tax burden of small firms would be reduced from 35 percent to 22 percent under his plan.

He explained that firms should be thought of as collections of projects. A small firm has one project and a large firm has many. If a small firm loses money on its project, it must carry the entire loss. In contrast, if a large firm loses money on a project, that loss is written off against the profits of other projects. During economic downturns large firms, in effect, reduce their taxes by lowering overall profits with money-losing projects. The losses are therefore subsidized by government.

Under Weiss's plan small firms, which are most affected by cash-flow problems during economic downturns, would get cash infusions just when they most need them. During the recessions of the 1980s and 1990s, cash-flow problems were not met by external financing. With a tax-policy subsidy from the government when small firms had losses, such firms, particularly startups, would gain access to external capital markets because risk would be reduced.

Unemployment would be minimized because investment could be sustained at efficient levels.

The current tax system already has loss carryforwards and carrybacks; they allow a firm that loses money today to carry the loss forward for eight years or backward for three years. But these provisions do not constitute a stabilization policy for small firms. Most firms take carryforwards, which are, in effect, rebates by the government on losses, during years in which the firms are profitable and have the least need for rebates. During a recession or a business or sectoral slump, there is little access to previous liabilities for startup firms that do not have a history of profits or have successive years of losses. Weiss maintained that his scheme, in addition to its stabilizing effects, would allow a minimal opportunity for tax manipulation.

Weiss was asked why the government should become partners with entrepreneurs, who, by definition, take risks. He was also asked whether there were better countercyclical strategies than his proposed tax scheme. He responded that entrepreneurs do indeed take risk, but that it is not in the national interest to increase risk and discourage entrepreneurship. He defended his statement that the current system treats large and small corporations differently and discourages risk taking by entrepreneurs by arguing that the government shares on the upside, but not on the downturns. He added that the government should be "in the business of quickly putting money out to smooth the business cycle."

**Marvin Kosters** commented on the evolution of economic focus since the Employment Act of 1946. In the years immediately following the act, concern centered on avoiding unemployment rates like the ones posted just prior to the act, which were as high as 19 percent per year. In the 1970s concern focused on inflation. Today, there is quibbling over whether the NAIRU is 5.0 or 6.0 percent, but such rates are well below the rates in the 1930s. Moreover, U.S. unemployment rates are well below European rates, and U.S. inflation is less than it was in the 1970s. The current focus has therefore shifted to how people feel, which Kosters viewed as progress.

Kosters noted that critics of the NAIRU argue that a 5.0 or 6.0 percent rate of unemployment is too high because it suggests that output growth cannot be increased beyond about 2.5 percent without fueling inflation. However, a recent article in *International Economy* reported that when seven frequently quoted economists were asked if 2.5 percent growth is the limit, five answered no and the other two hedged. The five who said no qualified their answers by suggesting policies that they asserted would allow additional growth: reducing taxes, limiting monetary policy to the single goal of price stability, increasing saving and investment, improving workers' skills, increasing the pace of technological change, and increasing short-term growth above 2.5 percent while limiting long-term growth.

A frequent criticism of the NAIRU framework is that nobody knows exactly what the NAIRU rate is. Kosters claimed that this was not a disadvantage for setting aggregate monetary policy. More important, according to Kosters, is knowing what the real growth rate is and what kind of policies can contribute to more rapid growth. Kosters advocated policies that would discourage consumption, encourage national saving (especially with the baby boomers heading toward retirement age), and stimulate investment, primarily in plant and equipment, but also in human capital. However, he asserted that the marketplace provided adequate incentives (with high rates of return for college-level schooling) for people to make investments in human capital. He concluded that an investment strategy was a good one to raise growth rates, but noted that such a strategy would not produce miracles.

**David R. Howell** questioned the prevailing view that the decline in living standards for most people is due to shifts in demand for skills related primarily to globalization and technological change. Restating Rosen's introductory question, he asked, "Does this view reflect reality or are we fitting reality into theory? If the view is not correct, then what is the source of the decline?" In Howell's view, skills mismatch is an inadequate explanation of the decline.

Howell noted that it is frequently stated that U.S. unemployment rates fall far below European rates. However, if the United States added disguised unemployment—prisoners and involuntary, part-time, and discouraged workers—to the unemployment figures, then European rates would seem modest in comparison. Howell pointed out that the U.S. experience over the last 15 or 20 years is not one that Europeans want to emulate.

Proponents of the skills mismatch theory argue that technological change, which favors higher skills, is a critical factor in raising the demand for more-skilled workers relative to that for less-skilled workers. These demand shifts have accelerated within industries and have resulted in an increase in the ratio of skilled to unskilled workers within each industry. If this argument is true, Howell asked, why is the United States the only industrialized nation to report declining real earnings? Some argue that the decline is due to wage inflexibility; other industrialized nations are willing to pay the price of maintaining living standards with higher unemployment. But Howell pointed to research that argues that if wage inflexibility is the cause of higher unemployment in France, then patterns of employment growth in France should differ from those in the United States. However, a comparative study of France, the United States, and Canada found nearly identical employment growth patterns. These findings, according to Howell, dismiss the casual assertion of a trade-off in which the United States has accepted low wages and France has accepted high unemployment.

Howell also has found that the employment data do not support the skills mismatch argument. Although the wage collapse was felt primarily by blue-collar, male workers, there was no shift in the skill mix after 1983 for these workers. The employment change was experienced in the white-collar sector, where there was a rise in the share of managerial and professional workers and a fall in the share of administrative support workers. The only effect that technology has had in the labor market in terms of skills, then, has been in reducing the employment share of administrative support workers, who, Howell noted, are mostly women.

Howell thought it would be useful to investigate which types of jobs drove the wage collapse at the bottom of the earnings distribution. He found that for the most part they were not manufacturing jobs. Rather, the data showed the decline to be in the wages of 20- to 39-year-old, full-time, male workers with a high school diploma or less, despite the fact that such workers were employed in jobs that saw employment growth. Therefore, Howell noted, the cause of declining wages is more complicated than a shift in the demand for skills.

During the question and answer period Howell explained the political economy of wage collapse in terms of workers who have jobs with low and declining earnings and few benefits and jobs that do not require a college education. Human capital solutions will not provide answers to the real earnings problem of such workers; rather, solutions will have to relate to how the labor market works. For example, the institutionalist argument suggests that limiting wage competition is good not only for workers, but also for the economy; raising the minimum wage, requiring the portability of health insurance, and increasing the incentives of workers would therefore be viewed as positive developments.

Legislation under consideration by Congress would set a single goal for the Federal Reserve—price stability. Price stability is often interpreted to mean zero inflation. **William Dickens** noted that the notion behind the legislation is that price stability is the best way to achieve economic growth. However, he argued that "price stability is anathema to economic growth." Furthermore, it is impossible to have price stability and high employment. Both Canada and New Zealand have adopted zero-inflation policies and both have had relatively high unemployment.

Dickens set out to revive the notion of a long-run Phillips curve. He explained that in an economy in which nominal wages are rigid, real adjustments occur when nominal wage increases lag inflation. Accordingly, full employment cannot be achieved at a zero inflation rate. Recent research, which Dickens asserted contained large measurement errors and few good validation studies, has suggested that there is almost no nominal wage rigidity; most survey data and union contract data suggest otherwise. Except in periods of severe economic distress or in cases in which individual companies perform poorly, he found that wage cuts were extremely rare.

Having built substantial nominal wage rigidity into his economic model, Dickens found a long-run Phillips curve, that is, a long-run trade-off between inflation and unemployment. Assuming 1.0 percent productivity growth, he found a trade-off between unemployment and inflation of 1.0 percentage point of unemployment for moving from a 3.0 percent rate inflation to 0.0 percent inflation. He derived a particular kind of Phillips curve from his theoretical model based on how the economy behaves under a condition of nominal wage rigidity.

After estimating his nonlinear, multiparameter model on annual data from 1947 to 1994, Dickens applied his model to conditions during the Great Depression, a time during which nominal rigidity was an important economic factor. If this exercise is performed assuming a standard Phillips curve, the high unemployment rate posted during the later stage of the depression correlates with the deflations of the early 1930s, but also with continuing, accelerating deflation during the later 1930s, because the natural rate of unemployment is assumed to be about 5.0 or 6.0 percent. Since unemployment rates are actually higher than the natural rates, inflation would have to have been high and decelerating.

In Dickens's model the severe deflations of the early 1930s created a situation in which the sustainable rate of unemployment was actually much higher than the standard natural rate. His model predicts the actual inflation of the mid 1930s and the following fluctuations. According to Dickens's estimates, if the Federal Reserve's goal was to aim for zero inflation, then, with a starting point of 6.0 percent inflation, the consequence would be a long-run, steady-state result of 6.5 percent unemployment; if the goal were 3.0 percent inflation or 4.0 percent nominal output growth, the result would be slightly less than 5.5 percent unemployment. Dickens concluded that the Federal Reserve should not be limited to the monolithic goal of price stability and that Canada and New Zealand should discontinue their zero-inflation policies.

When asked whether there was less downward wage rigidity now because of the increase in outsourcing, temporary positions, and consultancies, Dickens responded that outsourcing is a one-time event; once a company outsources, it cannot do so again, and therefore outsourcing has no long-term effect. There will be more of a long-term effect, however, if the growth rate in temporary positions and consultancies continues. Although there has been huge growth in this type of employment, it has affected only a small fraction of the economy. The tenure distribution of workers in the United States has been the about the same for the last 15 years.

William Niskanen commented from the audience that unemployment is not the only measure of merit of monetary policy and noted that several studies have indicated that productivity growth is negatively related to inflation. Therefore, to the extent that inflation reduces productivity growth, there is a trade-off between the effects of inflation fighting on employment and productivity. Dickens responded that the empirical literature does suggest there is a correlation, but it is difficult to determine whether the correlation is the result of business cycles, institutional effects, or something else. A theoretical paper has suggested that the tax system could have distortionary effects in the presence of inflation. Dickens's solution to eliminate the distortions was to alter the tax code.

# Session IV

## Marketplace Dynamics and Less-Skilled/Low-Wage Workers

**Fred R. Bleakley** (moderator)
Economics Senior Special Writer, *The Wall Street Journal*

**James K. Galbraith**
Professor of Economics, Lyndon B. Johnson School of Public Affairs, University of Texas at Austin

**Teresa Ghilarducci**
Professor of Economics, University of Notre Dame

**Heidi Hartmann**
Executive Director, Institute for Women's Policy Research

**Kevin Lang**
Professor of Economics, Boston University

**Fred R. Bleakley** described the recent development of an activist, nontraditional approach to the training of low-skilled workers. For example, the Center for Employment Training in San Jose, California, provides job training first and then the remedial math and English tutoring necessary for the job. In most training programs the remedial study is given first, which drives away many trainees. The YWCA in Milwaukee, Wisconsin, trains women for nontraditional jobs, such as telephone line repairer, machinist, and plumber; it also advises the women on how to deal with sexual harassment. The Quest Program in San Antonio, Texas, goes to industry to ask what types of skills are needed; it also works with economic development officials, who inform potential employers outside the area about the existence of a local labor force that can be trained to fit their needs. There is also talk of creating a so-called R-corporation, the responsible corporation, which would receive tax breaks in return for working with its shareholders, community, and workers to provide workers with better benefits and pension plans.

Bleakley listed important questions to be discussed in this session:

- How do we bring less-skilled, lower-wage workers up the economic ladder?
- How do we speed up the creation of openings for these workers?
- What role should the public sector play—passive spectator or active participant?

**James K. Galbraith** addressed the apparent anomaly of the weak performance of average wages, particularly those at the bottom of the pay scale, and the generally good performance of the economy. According to Galbraith, however, closer scrutiny reveals that during the current expansion cumulative growth in real gross domestic product (GDP) and growth in employment have been lower than average for a postwar expansion period. In fact, two postwar expansions had higher rates of employment growth, one had a higher rate of productivity growth, most had higher rates of overall output growth, and all had higher average growth in real wages than the current expansion. Galbraith, then, suggested that the basic problem with wages reflects a relatively weak economy.

Galbraith identified two types of postwar business cycles: those with expansions that lasted about as long as the current expansion and those with expansions that lasted several years longer. Specific events encouraged the lengthier expansions. Tax cuts and the military buildup during the Reagan years and tax cuts and the Vietnam war during the 1960s brought on the second wind of those expansions. Therefore, policies to improve wage performance should consider raising the growth rate and ensuring that the current expansion does not peter out.

Galbraith compared two sets of data on wages by industry, a set from the National Industrial Conference Board covering the period from 1920 to 1947 and a set from the Census Bureau covering the period from 1958 to 1992. He compared a measure of wage inequality over time with the unemployment rate and found that as the unemployment rate rose, inequality in industrial wages also rose. This finding is consistent with the substantial collapse in wages in the low-wage sector. Galbraith concluded that sustaining and even accelerating the current economic expansion "would be the single most sure and effective policy to raise the relative wage of the lower-paid worker in the industrial structure."

When asked by Bleakley whether allowing growth would stimulate inflation, thereby eroding the gains of higher employment and wage growth stimulated by growth, Galbraith said that if the cost of a modest increase in the growth rate was a high (12 to 13 percent) inflation rate, then inflation might erode the gains of growth and higher growth would not be preferable. However, by this stage in past recoveries inflation had risen a few points over what it was at the beginning of the recovery, whereas in the current recovery inflation has not risen at all. The argument that this is a great accomplishment is a misplaced one because the cost of that accomplishment has been a low rate of employment growth and a zero rate of wage growth. On balance, then, policy has preserved a climate of stagnation.

**Teresa Ghilarducci** spoke about the need for a simultaneous rise in the minimum wage and the earned income tax credit (EITC). Because so many workers in the United States are at risk for not having sufficient wage income to support them above the poverty line, the country has a system of social insurance. The minimum wage and the EITC are components of this system. The fact that the insured event—insufficient income—is increasing raises the question of whether the current insurance system encourages people who are working to live in poverty. Since 1975 the working poor population has risen during both economic recessions and expansions, making the problem not only cyclical, but also structural. Many jobs are being created, but they pay low wages; some jobs are increasing in number, yet declining in wages. Therefore, the labor market is a source of much of the risk.

The decline in the real minimum wage is at least part of the cause of low earnings, and the current policy solution is to raise the minimum wage. Ghilarducci predicted that Congress would pass Clinton's minimum wage bill, but stated that the increase was not large in real terms. Since 1960 a person working full-time at the minimum wage has not made enough to support a family of four above the poverty line. In the 1960s such earnings would support a family of three above the poverty line, but by the 1980s this was no longer the case.

However, according to Ghilarducci, the problem of poverty among the working poor would not be solved only by raising the minimum wage. Its biggest disadvantage, as opponents of the policy contend, is that raising the minimum wage has poor target efficiency. It is estimated that 40 percent of the enacted increase in the minimum wage will go to 20 percent of the poorest families; 60 percent of the increase will not go to poor families.

Ghilarducci also discussed the "Dostoyevsky problem" (after the moral question posed in *The Brothers Karamazov*), namely, "Is it right to torture a small, innocent child to its agonizing death if it would solve all the other problems of the world?" Ghilarducci asserted that the moral dilemma in raising the minimum wage is "Is it right to torture black teenagers in the inner city and cause their unemployment to raise the minimum wage?" However, she also noted that black teenagers might actually be helped by a rise in the minimum wage if the labor market worked differently from the classical demand curve.

Ghilarducci provided evidence that at least part of the social insurance system is not working. Steve Rose of the U.S. Department of Labor, for example, has estimated that, given current trends, during the next 10 years 39 percent of all families will be eligible for the EITC at least once; 16 percent of families will claim the EITC in any given year; and 30 percent of male-headed and 46 percent of female-headed families will collect the EITC at some point.

According to Ghilarducci, the EITC has better target efficiency than the minimum wage; 63 percent of the tax credit goes to the poorest families. Nevertheless, by subsidizing a low-wage employer, the EITC may increase poverty-creating jobs. A sound social insurance program should be characterized by target efficiency and minimal moral hazard. The EITC has better target efficiency, but the minimum wage reduces the incentive to create poverty jobs. Ghilarducci concluded that a simultaneous rise in the EITC and the minimum wage would mitigate the weaknesses of both proposals.

**Heidi Hartmann** focused on new developments related to contingent work and the problems of contingent workers. There is still disagreement on how to define contingent workers. The Bureau of Labor Statistics (BLS) has proposed defining contingent workers as those who were placed by temporary-help agencies, have a leased arrangement, are independent contractors, or are part-time workers. The BLS defines contingent jobs as those that are structured to exist for a limited amount of time. Hartmann noted that involuntary part-time workers make up 30 percent of all part-time workers. The Institute of Women's Policy Research (IWPR) found that about one-third of part-time workers are permanent part-time and one-third are clearly contingent. The 1995 BLS survey suggests that temporary contingent workers make up only 2.2 percent of the labor force. Richard Dulles from the National Planning Association asserts that contingent workers make up 30 percent of the labor force; IWPR research puts the figure at about 16 to 17 percent. In response to a question in the BLS survey 2.2 percent of the labor force said they thought their job would last less than a year.

The temporary-help services industry has 2.2 million workers on the payroll on an average day, yet 20 percent of those on that payroll claim they are not contingent. The duration of assignments in temporary-help services is lengthening because the industry is moving toward permanent staffing of jobs through temporary service agencies. The National Association of Temporary and Staffing Services (NATSS) emphasizes its long-term staffing capabilities. Not only are the assignments getting longer, but fully 40 percent of NATSS's revenues come from long-term contracts with a single-client firm. According to its annual report, NATSS receives 50 percent of its revenues from abroad, and temporary help is highly regulated all around the world except in the United States and Canada. Because NATSS has obviously learned how to generate revenues in a highly regulated environment overseas, Hartmann suggested there is ample room to regulate temporary work in this country.

Voluntary part-time work has leveled off, but involuntary part-time work has been on the rise and that rise is correlated with unemployment. Temporary-help services are still increasing. People who are tracking contingent work observe that it is not increasing as rapidly as it was, except for the small part of it that is the temporary-help services industry.

Hartmann listed some of the problems associated with contingent work: lack of security, lack of upward mobility and advancement, low wages, and low benefits. However, since these problems are not unique to contingent work, a policy response may be more broad-based and not necessarily targeted at contingent work.

Hartmann contended that policy responses should consider two issues. First, contingent work presents an obvious harm to workers and contingent workers are disproportionately women with children, that is, workers who have the most responsibilities and are the least likely to get health insurance and a decent wage. Second, contingent work poses an externality problem because employers who employ people in substandard jobs are passing on costs to other employers. For example, most contingent workers do not receive health benefits through their own employer, but do receive them through the insurance of another family member, thereby transferring the cost to another employer. Health care costs, in particular, are falling disproportionately on industries that tend to provide health care benefits.

In the last decade the rise in the duration of unemployment has resulted in many workers' becoming ineligible for unemployment insurance. Moreover, states are making their unemployment insurance policies increasingly restrictive. These changes correspond to a slight, long-term increase in part-time work and a tremendous increase in women's participation in the labor force. One policy solution would be to broaden eligibility for unemployment insurance to include at least some part-time workers.

Researchers at the IWPR examined the experiences of full-time and part-time male and female workers in getting unemployment insurance. Part-time men fared the worst; reasons for ineligibility were they were students, were not looking for work, were not in covered employment, or had not worked enough weeks to qualify. Part-time women fared second worse, often being ineligible because they had not worked enough weeks, did not receive enough in earnings during any one quarter, or did not have enough earnings in the base period. Hartmann asked why part-time workers should be excluded from unemployment insurance, especially for the reason that they have not earned enough, since part-time work is well established in the economy; for people over age 25 the average job tenure in part-time jobs is 3.9 years.

Hartmann asserted that the insurance system should be more responsive to the way work and workers have changed. Almost all of the difference between men and women in qualifying for unemployment insurance is accounted for by women's being more likely to work part-time. Full-time men and women are receiving about the same share of unemployment insurance benefits.

**Kevin Lang** considered several points related to labor market policy: (1) low-skilled workers are not homogeneous, and individuals have different productivity rates, (2) helping unskilled workers and reducing inequality are not necessarily equivalent, (3) the major policies currently under consideration to assist low-skilled workers will not have large effects, and (4) policies need to be based on realistic expectations and consideration of long-term effects.

Lang stressed the importance of recognizing the first point. Research has found a significant individual effect on productivity among workers in low-skilled jobs. Within one firm the range in productivity rates among those doing unskilled work was three to one. Policies will not affect the various individuals in low-skilled or unskilled jobs equally.

Regarding his second point Lang noted that some programs designed to help low-skilled workers may have the unintended consequence of increasing inequality, partly because of variations in productivity among low-skilled workers. For example, Card and Krueger's research on the effect of school quality on earnings found that reducing class size lowers the wage conditional on the level of education for those with a high school degree or less and increases the wage conditional on the level of education for people with more than a high school degree. A result of the increase in school quality, then, is a higher wage for low-skill workers, but a greater disparity of income between high- and low-skill workers.

Lang discussed his third point first in terms of raising the minimum wage and second in terms of education quality. He conceded that there is a fairly strong consensus that minimum wage laws do not have large disemployment effects. However, he contended that there is a much larger concern about what raising the minimum wage does to the distribution of jobs. He noted that there is weak evidence that the increases in the minimum wage in the early 1990s led to a redistribution of employment from adults to teenagers. However, unlike 20 years ago, teenagers who earn the minimum wage today are, on average, from families with less-than-median incomes. Higher employment and incomes (resulting from a rise in the minimum wage) among these teens, then, slightly close the distribution of income. But such payoffs are slight, according to Lang, given the targeting problems of the minimum wage. Programs of wage subsidies incur serious moral hazard problems. The EITC is well targeted, but the increases being discussed will not produce dramatic change.

Regarding policies to raise incomes of low-skill workers by increasing the quality of education, Lang noted that we do not know much about how to raise test scores. This does not mean that we should do nothing, but it is important to have realistic expectations about the outcomes of public policies. Some might view policies that increase the chance that an unemployed worker will get a good job by two percentage points as unsuccessful, but others might see such an increase as a major change. We must, then, keep realistic expectations in mind when evaluating programs. Moreover, because the effects of any labor program are likely to be small in the short run, we must make sure to think about its long-run effects, such as labor force attachment and how it can change the way in which people think about work. According to Lang, policies should be developed that encourage people to work by creating incentives to work and encouraging the development of skills. Lang noted that although the EITC will not dramatically improve the distribution of income, it is a part of a process of encouraging work and changing expectations over the long run by making work pay.

Lang mentioned other policy avenues based on social psychology. He noted his belief that there is a role for outside testing in schools, not to create national standards, but to reduce the tendency of students to discourage peers from doing well. In addition, improvements in mechanisms that allow information to travel from schools to the labor market might be an incentive for students to achieve.

Jeffrey Brown asked why the increasing sense of insecurity and a breakdown in the social contract as reported by the media do not show up in the data? Does the lack of hard evidence suggest that those doing empirical work are not asking the right questions? Or is it the journalists who are getting the story wrong?

Lang noted that some of the sense of insecurity might be the result of the changing structure of the household, and such changes would not be reflected in the data. For example, the data might suggest that for a worker the probability of getting laid off is 10 percent, but for a household with two full-time workers, the probability that one of those workers will be laid off is higher, thereby increasing economic insecurity.

William Dickens commented that although there has been a change in the social contract, we have been looking in the wrong place to identify economic insecurity and that the change in the contract cannot be the explanation for the change in people's feelings. If a worker lost a job in the 1960s, given the then 3 percent rate of productivity growth, no change in the distribution of earnings, and 2 percent normal growth in earnings on a new job, the worker could make up for his or her lost earnings in two years, and in three years the event would be forgettable in terms of earnings. Today, given the combination of low productivity growth and the drop in earnings at the bottom of the income distribution, a worker could lose 10 percent or more of his or her income and would "have to fight the head wind of the downward drift of low income." Losing a job today, then, is a much more major event than in the past in terms of lost earnings.

# Session V

## The Employment Act of 1946: A Perspective from the Council of Economic Advisers

**Steve Pearlstein** (moderator)
*The Washington Post*

**George C. Eads**
Vice President, Charles River Associates, Inc.; Member, Council of Economic Advisers, Carter Administration

**William A. Niskanen**
Chairman, Cato Institute; Member, Council of Economic Advisers, Reagan Administration

**James Tobin**
Sterling Professor of Economics Emeritus, Yale University; Member, Council of Economic Advisers, Kennedy Administration

**Murray Weidenbaum**
Mallinckrodt Distinguished University Professor and Chairman, Center for the Study of American Business, Washington University in St. Louis; Chairman, Council of Economic Advisers, Reagan Administration

> The Congress hereby declares that it is the continuing policy and responsibility of the federal government to use all practicable means consistent with its needs and obligations and other essential considerations of national policy, to coordinate and utilize all its plans, functions, and resources for the purpose of creating and maintaining in a manner calculated to foster and promote free, competitive enterprise and the general welfare, conditions under which there will be afforded useful employment opportunities, including self-employment for those able, willing, and seeking to work, and to promote maximum employment production and purchasing power.
>
> —Passage from the Employment Act of 1946

**Steve Pearlstein** opened the session by reading the above passage, stating his opinion that the 1946 act is "breathtaking" in its brevity (four pages), in its simplicity, in the confidence it exudes, and, perhaps, in its naivety. Pearlstein suggested, however, that the 1946 act seems anachronistic in that it assumed that the U.S. economy would remain a national economy (when in reality it has increasingly become borderless) with markets (not governments) dictating economic outcomes. Moreover, economic policy currently is highly partisan and polarized.

As Pearlstein reminded the audience, among the provisions of the Employment Act of 1946 was the establishment of the Council of Economic Advisers (CEA) and the Joint Economic Committee (JEC). The participants in this panel were all former members of the CEA: James Tobin, Sterling Professor of Economics Emeritus at Yale University, was a member during the Kennedy administration; George C. Eads, vice president of Charles River Associates, Inc., was a member during the Carter administration; and Murray Weidenbaum, Mallinckrodt Distinguished University Professor and chairman of the Center for the Study of American Business at Washington University in St. Louis, and William A. Niskanen, chairman of the Cato Institute, were members during the Reagan administration. Pearlstein asked the panelists for their ideas about if and how they would rewrite the act of 1946 or write a new employment act for 1996.

**Murray Weidenbaum** began with a broad assessment of the act, asserting that "the first half century of experience has neither been as bad as the opposition originally feared nor as substantial as the sponsors had hoped for." Looked at in the most fundamental way, the legislation has been successful, as the two institutions it created are still functioning and its "originally very controversial statement of policy" has become part of the government's bureaucratic fabric, with substantial government responsibility for the performance of the economy now widely assumed.

Weidenbaum recounted that the CEA's first chairman, Edwin Nourse, viewed the council as a nonpartisan group that was not to be an advocate for particular policies. Subsequent chairs and councils acted otherwise, but under Arthur Burns (appointed during the Eisenhower administration) the council avoided public controversy, and ensuing councils, while performing a more public role, have attempted to avoid being labeled as either advocate or oracle. (During his presentation James Tobin disputed this view, stating that Burns "wasn't that nonpartisan or nonpolicy oriented.") Weidenbaum identified Walter Heller's tenure as chair as the "golden age" of the council. According to Weidenbaum, however, by demonstrating the useful role of economists at the highest levels of government, the Heller council had the effect of bedeviling its successors. Thereafter, cabinet departments set up or upgraded their own economic staffs, thereby introducing competition among the staffs within the inner circles of government and "a cacophony of administration economists." As a result the public is often confused about where the administration stands on economic issues.

Overall, the council acts as "the economics profession's key window into Washington. Far more important, it is a source of professional advice to a president from a group that has no special interest baggage. It can serve as a proxy for the public interest." He noted that it is "a tribute to the power of mainstream economics that on so many issues the work of Democratic and Republican councils is interchangeable. I could have taken Charlie Schultze's memos and just updated them and you couldn't, I think, tell the difference between his memos and our own on issues such as subsidies."

Weidenbaum then discussed the other institution created by the act, the JEC, originally called the Joint Committee on the Economic Report. According to Weidenbaum, the committee has never had any authority to report out legislation and therefore does not have the power of a legislative committee. However, the JEC has gradually expanded its purview to hold hearings and to commission studies on a variety of issues. Some of its hearings, committee reports, and compendia have been influential in monetary and fiscal policy, international economics, defense procurement, taxation, and budget issues. In part because of its nonpartisan status and the establishment of separate budget committees in each house of Congress, the committee's influence has diminished. Nevertheless, the JEC remains the only institution in Congress that focuses on economics and one of the few in which members of both houses can interact regularly.

Finally, Weidenbaum turned to the policy declaration in the 1946 act, which offers a Keynesian, macroeconomic focus concentrating on fiscal policy. Accordingly, it is the continuing policy and responsibility of the federal government to promote maximum employment, production, and purchasing power. However, as a result of economic debates during the 1960s and 1970s, views on the effectiveness of fiscal versus monetary policy have changed. The Federal Reserve is now seen as the primary mechanism for achieving short-term stability, while tax and budget policies are seen as means to longer-term structural changes in investment, economic growth, and income distribution. "The reference in the Employment Act to purchasing power has been redefined to be the basis for the government's concerning itself with controlling inflation. . . . The original emphasis on maximum employment has taken a backseat," and current council reports contain chapters on micro issues, typically focusing on regulation.

In Weidenbaum's opinion, this change in focus provides a new opportunity to raise the subject of employment in the spirit of the act. He would accomplish this by having the council's annual report contain a section linking maximum employment and improvements to economic efficiency. Specifically, attention should be paid to "the discouraged employer," that is, aspects of regulation that discourage employers from adding to their payrolls. Weidenbaum noted that "some employers are on record that they will avoid hiring their 50th worker because of the onerous regulations that would be triggered. . . . That is a ceiling."

Weidenbaum concluded that the 1946 act should not be revised. It has made a lasting contribution to government policymaking and provides a signal that "national economic policy is a continuing federal function." He further stated that the experience of the Humphrey-Hawkins bill provides compelling evidence against revision because that legislative effort, which attempted to expand the 1946 act, resulted in a bill consisting of "a hodge-podge of wishful thinking without any teeth." However, Weidenbaum also criticized his "fellow conservatives" by stating that there is "no need to modify the statement of policy in the 1946 act with regard to the Fed. The Fed should focus its effort on controlling inflation. . . . However, the Fed does not ignore growth and employment nor should it."

**James Tobin** addressed the current debate about whether or not the economy could grow at a pace faster than its current rate. Those who suggest that it can grow faster sometimes accuse the Federal Reserve "as if the Federal Reserve were capable of making the economy grow faster." Others assert that the growth could be raised by undertaking a supply-side agenda or by balancing the budget.

Tobin explained the ideas of potential gross domestic product (GDP) versus actual GDP in terms of supply and demand factors. Potential GDP, a supply-side idea, roughly corresponds to the peaks of the business cycle. Potential GDP, then, represents the gross rate of capacity and is related to growth of the labor force and productivity. Productivity growth, in turn, is a function of such factors as technology and capital deepening. Potential GDP defined in this manner also represents a full employment level of output, which represents an employment level compatible with "enough unemployment and all the associated symptoms of excess capacity" that there is no tendency for inflation to increase, a rate of unemployment sometimes referred to as the natural rate of unemployment and sometimes as the NAIRU, or nonaccelerating inflation rate of unemployment. Actual GDP represents actual aggregate demand in the economy.

During the course of the business cycle the GDP gap (the gap between potential and actual GDP) varies. Tobin argued against those who feel that the economy is limited in the rate at which it can safely grow. He noted that when the GDP gap is large, the economy can sustain a period of fast growth because the economy is "catching up" by using up excess capacity. However, some economists argue that if such growth continues long enough, excess capacity declines and GDP is confined to growing at its potential rate of growth.

Tobin disagreed with some of this analysis. For example, supply-siders today advocate tax cuts similar to those enacted during the 1980s; "We grew 4 percent and more in the 1980s, so why can't we do it now?" Tobin answered this question by noting that when the 1980 cuts were implemented, growth of actual GDP corresponded to a high rate of unemployment (10 percent or higher as compared to current rates around 5 percent), which allowed high growth for a relatively long period of time before reaching capacity. Moreover, such policies did not change the growth rate of potential output; rather the recovery that took place was due to a combination of demand-side policies and the pragmatic course of action taken by the Federal Reserve.

Tobin stated his belief that the Federal Reserve does not have the tools to increase the growth rate of *potential* output. However, a more relevant question is whether the way the Federal Reserve is acting implies that it believes the growth trend of potential GDP is greater than most other economists believe it might be. Since no one really knows the rate of the trend line, shouldn't the Federal Reserve follow a path of more balanced risk? A growth rate of 3.2 percent would add $75 billion per year to GDP. Moreover, if such a growth rate represented an unemployment rate that is beyond the barrier of growth with sustainable, low inflation, while there would be some costs (in terms of inflation), such costs are not irreversible; there would be an opportunity for policy correction.

Tobin then noted that when the economy is experiencing structural problems, the Beveridge curve, which shows the (generally negative) relationship between job vacancies and the unemployment rate, will shift to the right because of the simultaneous rise in vacancies and the number of unemployed people who, for one reason or another, are not connecting with the vacancies. During the 1950s and 1960s the desirable noninflationary unemployment target was thought to be 4 percent; the rate rose during the 1970s and 1980s and the curve shifted outward, signifying that for a given number of vacancies, the sustainable unemployment rate was higher than during the 1950s and 1960s. Since then, however, it appears that the curve is shifting back, indicating a reasonable possibility for a sustainable unemployment rate close to that of the 1950s and 1960s. Tobin did stipulate that if the standard 6 percent estimate of a NAIRU is still correct, taking a risk and increasing the growth rate of actual GDP might result in considerably more inflation for a time until the situation can be corrected. However, pretending that the rate is in the high 5 to 6 percent range, when it in fact is lower, means that we are losing some output and employment. Those who say, then, that there is no Phillips curve trade-off are not quite correct; there is a trade-off in terms of the uncertainty associated with balancing one risk against the other.

Tobin also commented on Senator Mack's legislative initiative to require the Federal Reserve to focus solely on price stability. Although he criticized the goals and employment targets expressed in the Humphrey-Hawkins Act as "inconsistent and unrealistic," Tobin stated that a fixation on price stability, as distinct from "inflation stability," would be misguided. Moreover, given the widely assumed measurement error in the CPI, it would be a mistake to aim at price stability relying on such an imperfect index.

He concluded by questioning the democratic legitimacy of the independent status of the Fed. The president is politically held responsible for the performance of the economy—although he has little to do with business cycle performance. Tobin found it odd that a group of unelected, unconfirmed people with unlimited tenure, namely, the presidents of the Federal Reserve district banks, are voting members of the Federal Open Market Committee (FOMC) and that these bank presidents vote on the nation's most important economic policy decisions, but the treasury secretary and the chair of the CEA cannot even attend the meetings. Therefore, he recommended that the FOMC be restructured to become more like a government institution with full accountability.

**William A. Niskanen** began by reading a passage from the 1996 *Economic Report of the President*, written by President Clinton's Council of Economic Advisers.

> The council's mission within the executive office of the president is unique. It serves as a tenacious advocate for policies that facilitate the workings of the market and emphasizes the importance of incentives, efficiency, productivity, and long-term growth. This perspective has been essential to formulating and advocating creative approaches for effectively addressing America's economic challenges. The council has also been important in helping to weed out proposals that are ill-advised or unworkable, proposals that cannot be supported by the existing economic data, and proposals that could have damaging consequences for the economy.

He made two observations about the passage. First, the statement would have been equally appropriate as the mission of the CEA under several past administrations. Second, the statement is dramatically different from the Employment Act and reflects a departure from the expected role of the CEA in 1946 and for some time thereafter. At the time the act was written, the major economic problem was inadequate demand, and fiscal policy was perceived as the primary tool to be used to avoid this problem. Starting in the late 1960s, and especially during the Reagan administration, the focus shifted to supply conditions. With an aggregate demand focus, the council was primarily concerned with changes in budget totals; with an aggregate supply focus, the council must address a range of policies, including spending, taxes, and regulation.

Niskanen gave two reasons for the change in focus. The first reason was a developing recognition that the institutions of the federal government made it difficult to use the budget on a discretionary basis. This was due to the difficulty of forecasting turning points in the economy and getting Congress to take action on aggregate fiscal policy as a problem develops. As a result, fiscal policy actions were almost always taken too late. The second of Niskanen's reasons for the change in focus was the breakdown in the mid 1960s (and the near-disappearance by the early 1980s) of consensus on the Keynesian perspective. Replacing this perspective was a developing consensus that after controlling monetary policy, budget totals have little effect on aggregate demand. The consequence of the change in focus is that the council now attempts to answer the question of how to increase potential output via supply-side changes to the tax code, budget, regulations, trade, and antitrust laws rather than via demand-side measures.

Niskanen argued that there was no need to change the Employment Act because "we haven't been bound by it in any meaningful way" for some time, although, conceptually, it might be helpful to add a concern about inflation and general productivity growth to reflect the shift away from an exclusive concern with aggregate demand. Niskanen did assert that the Humphrey-Hawkins Act should be abolished because it represents unrealistic expectations and offers inconsistent guidance and therefore has not had any effect.

He noted that "there is a case for clearer congressional guidance to the Fed." He proposed that congressional guidance take the form of an arrangement in which Congress and the Fed agree on a relevant nominal aggregate target (such as nominal domestic final sales) that would reflect a combination of output and price effects consistent with zero expected inflation. A demand target of this type would circumvent adverse behavior by the Fed in the case of a supply shock. This is not true of price level guidance, such as the arrangement proposed by Connie Mack. Price level guidance results in adverse monetary policy reactions to supply shocks. It would be preferable for the effects of supply shocks—either adverse, such as from an oil shock, or beneficial, such as from a rise in productivity—to be passed through as a one-time change in the price level and for the Fed to do nothing to change demand conditions.

Niskanen also expressed support for the independence of the Fed, citing that the "evidence across countries is very clear . . . inflation rates are a negative function of the independence of the central bank. The stronger the position of the central bank institutionally within the governmental structure, the lower the inflation rate." Although Congress has the authority to dictate its wishes to the Federal Reserve, the problem has been that Congress has given the Fed wholly inconsistent guidance. It is not clear, given the political world in which we live, that Congress would give the Fed the kind of guidance that would lead to better outcomes than the Fed has achieved without such guidance. Although the performance of the past two Fed chairmen has been superb, a law cannot be written based on an expectation that a certain person will be at the helm; rather, we should be writing laws or developing traditions based on the institutional biases of the institutions involved.

**George C. Eads** remarked that it was during his tenure at the CEA that the council first had to meet the obligations of the Humphrey-Hawkins Act. Indeed, the requirements and the numerical targets established by the act were "taken very seriously" by all parties, and there was intense pressure on CEA Chairman Charles Schultze to fulfill the obligations under the act.

Eads spoke about the importance of the council's microeconomic activities. One of the council's main microeconomic functions is to disentangle the effects of various proposed programs to assess whether markets are working or are failing to produce the results desired by program advocates. In areas where markets do not work, such as in the presence of significant externality effects, the council acts as an advocate for the use of marketlike mechanisms.

An area provoking much interest at the time Eads was on the council was policy aimed at protecting the auto industry. A task force examining the state of the auto industry and the effects of trade restrictions on Japanese entry into the U.S. market reached much the same findings as those reached by other economists. However, most economists did not sufficiently appreciate the nature of the change taking place in the world auto industry, especially with respect to the production process, the role of individuals in that process, and the role of the production systems and skills. Economists generally do not realize how much turmoil is created when an industry paradigm is erased, particularly when that industry appears, from all external observations, to be doing well. When an industry is conspicuously failing and nobody denies that change is needed, change can be implemented relatively easily; such was the case with Chrysler and Ford. General Motors, on the other hand, had a long-term alternative that allowed it to continue operating according to the old paradigm longer than it should.

Eads stated that a deeper understanding within the economics profession of how markets work would be a way to increase understanding about how government intervention and general periods of turmoil affect economic factors, such as productivity. Eads voiced concern about the degree to which many in the current debates seem to be looking backward, trying to recapture a "golden age of productivity" and the relationships that seem to have worked in the past. If we look forward, we can see mutually beneficial changes within the context of new kinds of relationships between labor and management with an enormous potential for productivity gains.

# Session VI

## Employment Policy in a Changing Marketplace

**Dimitri B. Papadimitriou** (moderator)
Executive Director, The Jerome Levy Economics Institute

**Robert L. Kuttner**
Founder and Co-editor, *The American Prospect*

**Brian S. Wesbury**
Chief Economist, Joint Economic Committee, U.S. Congress

**Brian S. Wesbury** noted that his background before coming to Washington, D.C., was in investment banking. He stated his belief that it is not possible to forecast financial markets without understanding what is going on in Washington because the political economy of fiscal policy is an important factor underlying the economy's potential growth rate and, therefore, in forecasting inflation. However, in current debates about economics no one who talks about potential growth speaks in a specific manner about the burdens of taxation or regulation on the economy. Rather, the potential growth rate seems to be spoken about as a given—a figure that we can do nothing to change; if the rate has changed in the past, that change had nothing to do with U.S. economic policy. Wesbury disagreed with this assessment and addressed how he felt changes in fiscal policy have affected potential growth over time.

Wesbury noted that the basis for economics as he understands it was laid out in Smith's *The Wealth of Nations* or, to give the work its full title, *An Inquiry into the Nature and Causes of the Wealth of Nations*. In referring to the book by its shorter title, we leave out the two words that should be most important in our discussion of the wealth of nations, namely, "nature" and "causes." As a result, we end up discussing the wealth of nations as though such wealth is a given—that countries that are rich have a lot of resources or are large. But this is not necessarily the case: Russia, a large country with a lot of resources, has little wealth; Japan and Britain, small islands without as many resources as the United States or other large countries, are wealthy nations.

What are the nature and causes of the wealth of nations? According to Wesbury, wealth is determined by the output of goods and services in a nation or economy. Where do those goods and services come from? They stem from a creative idea about a good or a service that other people need, want, or desire; that idea then must be translated into a product in the marketplace. What is it that makes people go through the pain of taking a good or a service from the idea stage into the marketplace and distributing it to people? In Wesbury's view, the answer is wealth. Factors that impede this process are taxation, regulation of producers, and competition by government services in the marketplace. The burden of government, then, has slowed economic growth. Wesbury asserted that worker anxiety and people's feelings about "being fed up" with government (as attested to in polls following the 1994 election) are a function of the increasing burden of government, which has acted to slow growth, decrease opportunities, and reduced the potential of the economy to raise incomes.

Wesbury supported his claim that government has slowed growth by presenting data showing actual versus trend rates of growth of real gross domestic product (GDP). During the 20 or so years following World War II actual growth stood at about 4 percent per year, and it was thought by many that this rate of growth could continue indefinitely. Unemployment averaged 4.9 percent. Since the late 1960s, however, growth has stood at only 2.5 percent per year, indicating that potential growth has declined, and unemployment has averaged 6.3 percent. According to Wesbury, it is more than coincidental that growth slowed at a time when the "Great Society" programs—programs that led to dramatic increases in government spending, taxes, and regulation—were enacted. We are experiencing higher unemployment as the result of policies put into place to reduce unemployment. The Full Employment Act and the Humphrey-Hawkins Act, which charge government with creating prosperity, do not in fact create prosperity, but reduce it. The GDP gap today is $2.9 trillion, or $12,000 per person in lost output.

Some observers mention the decline in the volatility of GDP after World War II and point to the passage of the Full Employment Act as a reason for the decline. However, Christina Romer has estimated a GDP series generated from commodity prices that shows that there was no significant difference in GDP volatility prior to and following the Great Depression. Government fine-tuning and management of the economy has not, then, rid the economy of volatility, but has slowed growth from an annual rate of 3.86 percent between 1870 and 1929 to 3.22 percent from 1946 until today. This decline in growth since 1946 has cost us $10,000 per person in lost output. Wesbury also noted that between 1983 and 1989 poverty rates declined (with over a million fewer families living in poverty in 1989 than in 1983), and median incomes in every quintile rose in each of those years.

As growth has slowed, we have increasingly turned to the Federal Reserve to pump money into the economy and to the government to spend more money on programs that add even more burdens to the economy. It appears that we are reaching an understanding about these things. The era of big government is over not only because it is politically correct to think so, but also because it is economically correct. Wesbury expressed his hope that we can continue to move in that direction; by lowering taxes and reducing regulation, we can decrease the burdens of government and raise potential growth.

Wesbury also commented on the Humphrey-Hawkins Act, asserting that it suggests that the Federal Reserve bail us out when the burdens of government dampen growth by limiting the unemployment to 4 percent. This is an impossible task because the rate is lower than anybody's calculation of the NAIRU (nonaccelerating inflation rate of unemployment) and will result only in inflation; "printing money cannot create prosperity." According to Wesbury, "the Federal Reserve cannot create economic prosperity except by keeping prices stable over time. Only in that way can the best environment be kept for businesses over time."

**Robert L. Kuttner** disagreed with Alicia Munnell's idea that we have to settle for a 2.2 or 2.3 percent rate of economic growth. He noted that although he and Wesbury probably have diametrically opposed strategies for achieving higher growth, they would agree that the rate should be higher than 2.3 percent. Moreover, the conventional methodology for raising the potential rate of growth—higher population and productivity growth—completely begs the question of causality.

Kuttner recalled articles written in the 1930s about a similar debate (about whether we have to settle for a prolonged period of slow growth and high unemployment) that reached much the same conclusions as today. At that time a theory of mature capitalism was popular. After examining the prevailing industries in the economy at that time, economists all-too-accurately calculated that the demand for these products—shipping, coal, basic industry steel, and so forth—was satiated. Economists from both sides of the spectrum concluded that a 1.0 or 1.5 percent growth rate was the best that could be expected from a mature market economy. The war followed, and the economy grew at 12 percent per year for four straight years. Although the analogy to today is imperfect (the degree of capacity utilization is different today), Kuttner contended that such thinking is illustrative of how easy it is to get tunnel vision when talking about the limits to the potential of an economy.

Kuttner stated his belief that there is an "iron consensus" among classical economists that markets are to be lionized and even worshipped, and since the 1970s classical economists of both parties have advocated essentially the same policies. As a result, the Keynesian origins of the Employment Act of 1946 have been turned almost on their heads. This 20-year period has been marked by increasing marketization, deregulation, privatization, liberalization, and liberation of market forces. Kuttner disagreed with Wesbury's interpretation of history, contending that it is easier to make the case that growth would not have been as slow as it was over the past 20 years had there not been so much emphasis on market liberalization.

In any case, the past 20-year period of rising inequality and slow growth has resulted in a consensus that such conditions are the best we can hope for. "At some point, you have to wonder for how many decades this view has to be ascendant before somebody starts seriously questioning whether the most marketized economy is consistent with optimal rates of growth."

From the end of World War II through the early 1970s the structural characteristics of the economy broke almost all of the rules: it was a more managed, regulated, oligopolistic economy fairly unexposed to trade and less so to price discipline. Despite these circumstances, which laissez-faire advocates claim should impede economic growth, the economy grew at a rate of approximately 3.8 percent per year for about 25 years. Those favoring laissez-faire conditions need to answer questions about how a managed and interventionist economy could do so well if it was breaking so many rules, while an economy that follows the laissez-faire recipe has turned in such a mediocre performance.

Kuttner then turned to policies that might stimulate economic performance. One fairly familiar version assesses the problem in terms of a skills mismatch combined with price equalization in a world of more liberal trade. These two factors depress the wages of workers who are either adding less value to production than other workers or who have skills that are valued less in a globalized economy. As a result, the same job can be done elsewhere with comparable production technology by workers paid a lower wage. Although Kuttner found some merit in the skills mismatch theory, he echoed David Howell's view that if the skills mismatch theory was a major component of today's economic story, there would be a higher return to skills.

Kuttner recalled George Eads's remark that during the postwar era workers in many industries were benefiting from labor rents. Labor markets in the 1980s and 1990s, however, operate more like textbook labor markets, so that workers cannot command the same pay rates as during earlier periods, especially in an era of free trade. However, Kuttner questioned whether so-called labor rents are necessarily a bad thing, given that the period during which workers received such payments also was marked by rising rates of real growth and a slight improvement in income distribution. Kuttner also noted that productivity was high in the electric power industry during the period in which the industry was regulated and that real prices fell faster in telecommunications and the airline industries prior to the deregulation of those sectors.

It is difficult to conclude, then, that greater degrees of laissez-faire optimize outcomes. It is also illogical to view productivity growth as being limited to 1.1 percent per year. The real debate, then, is not about whether there is an artificially low ceiling on growth, but how higher growth is achieved.

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