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Scorecard on the Economy: A Guide for Policymakers

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SCORECARD ON THE ECONOMY: A GUIDE FOR POLICYMAKERS

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The U.S. economy has displayed a remarkable resilience following the 2001 recession. The economic slowdown of late 2000 that turned into a fully developed recession in early 2001 worsened with the terrorist attacks and corporate scandals late in the year.

This economic "perfect storm" produced a sluggish economy that many experts, including Federal Reserve Chairman Alan Greenspan, expected to remain sluggish or to worsen in 2002 and 2003. Instead, the economy burst out of its post-recession doldrums to record some of the best economic numbers of recent memory. Indeed, so robust has the economy been since the middle of 2003 that Chairman Greenspan, in his own understated fashion, paid the economy high praise by calling it "resilient."

The effectiveness of U.S. policies since 2001 is behind some of this resilience and led to the shallowest recession in modern American history. Today, business investment continues on an unprecedented expansion, and more Americans are working than ever before. Still, myths of economic weakness are rampant, driven by political hype about outsourcing, deficits, and oil prices.

Challenges remain for the next President, but the fundamental strength of the economy has kept America prosperous and offers the best promise for continuing growth in the years ahead. This paper presents a basic statistical overview of the American economy and prosperity that Americans enjoy today.

JOBS, EMPLOYMENT, AND INCOME

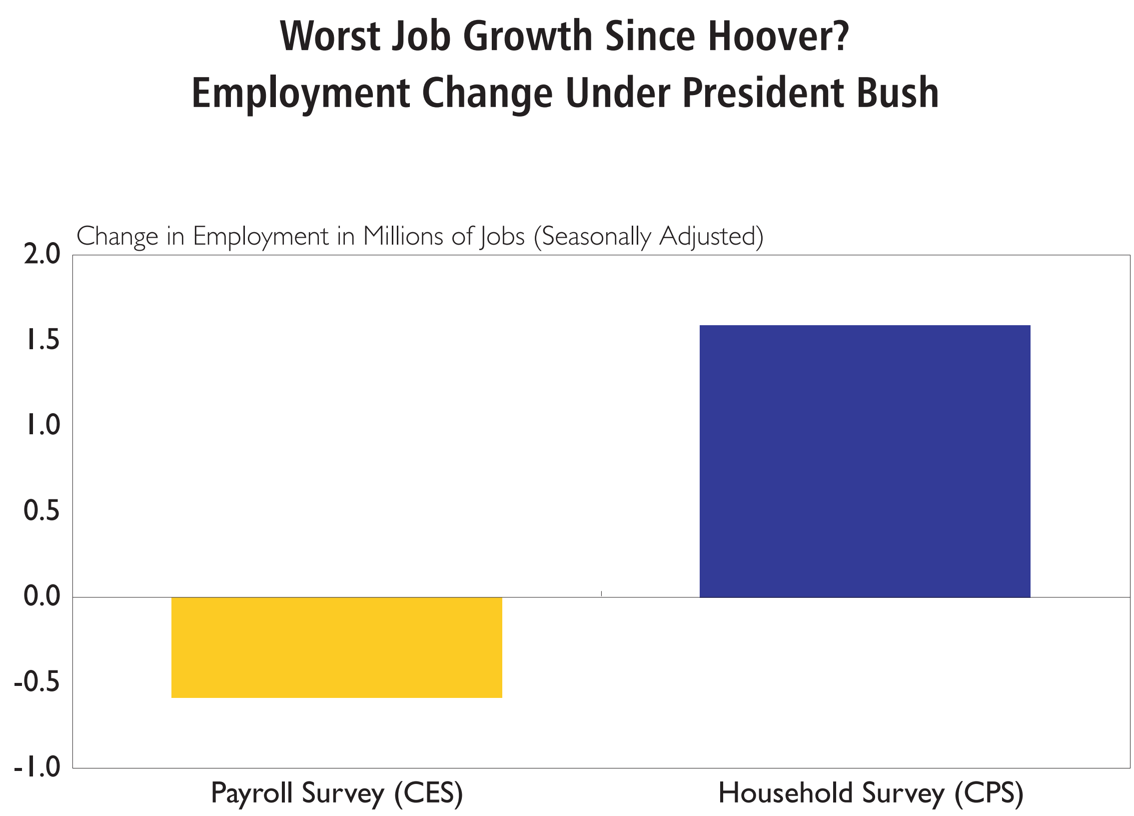
Three main indicators inform the issue of employment in America: the overall growth in the number of people employed, the unemployment rate, and labor compensation. Naturally, a net increase in employment is seen as progress, but this statistic is sensitive to population and uninformative about willingness to work. Instead, economists have long believed that the key measure of employment is the percentage of people who are employed out of the entire population of potential workers. However, many people simply do not want to work in the formal labor force, either because they are studying for advanced degrees, are retired, or are caring for other matters in the home.

Thus, the unemployment rate is the best way to assess economic health. Another useful indicator is labor compensation, which for many observers represents the quality of jobs.

Jobs: Payroll or Household? The government provides many measures of job creation, but the two best known are the payroll survey from the Bureau of Labor Statistics (BLS) and the household survey from the Bureau of the Census. As widely reported, the two surveys are telling different stories:

- Since January 2001, when President George W. Bush was sworn in, payroll jobs have declined by millions and recovered by millions, but still remain 700,000 below their peak, even after factoring in a recent benchmark revision.[1]

Chart 1 CDA 04-10



Source: U.S. Department of Labor.

- On the other hand, the household survey reports a record high level of working Americans in 2004, with 1.8 million more jobs since January 2001.[2]

Yet both surveys may be correct because they count jobs differently. Their counts are different in part because the household survey counts all jobs—not just payroll jobs—including a growing but hard-to-define class of new economy workers who are not on payrolls, such as part-time consultants, eBay entrepreneurs, and real estate agents.

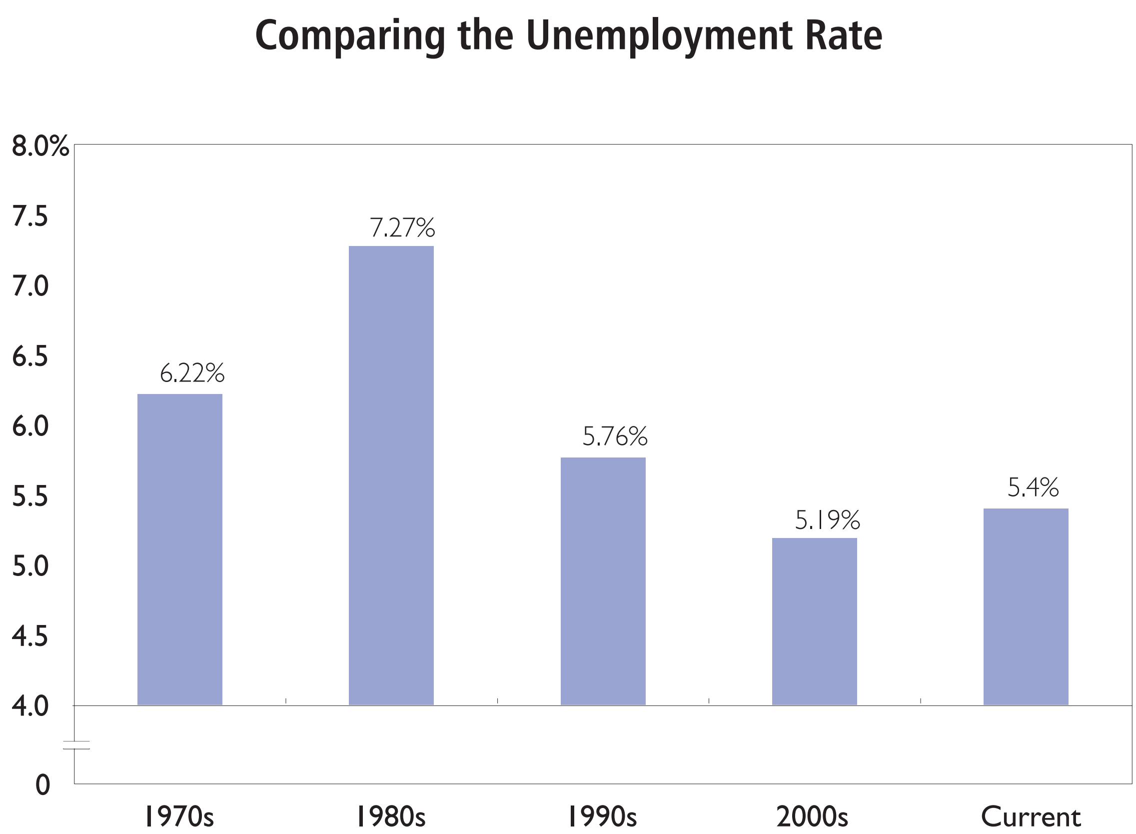
In contrast, the payroll survey's name says it all. While payrolls provide a much larger sample size, this does not guarantee accuracy. In August, the BLS acknowledged that the survey has sample problems: It counts workers twice when they change jobs, which the BLS estimates accounts for about 250,000 of the difference that has opened up between the two surveys since 2001.[3]

Moreover, this BLS analysis may be conservative: A Heritage Foundation analysis estimates that

1. Payroll employment, as measured by the Current Employment Statistics survey from the BLS, peaked in March 2001 at 132,507,000 and reached its recent low in August 2003 at 129,789,000. Since then, the payroll survey has rebounded, hitting 131,567,000 in September 2004 after 13 straight months of gains. Additionally, the BLS announced that payroll numbers from March 2004 and on will be revised upward by an estimated 236,000 along with January 2005 data. Factoring in this change, payrolls are only 704,000 off their peak. See U.S. Department of Labor, Bureau of Labor Statistics, "The Employment Situation: September 2004," October 8, 2004.

2. According to the Current Population Survey, also known as the household survey, 139,480,000 Americans were employed in September 2004—not far from the survey's high of 139,681,000 in August 2004.

Chart 2 CDA 04-10



Source: U.S. Department of Labor.

this flaw may result in an undercount of as many as 1 million jobs.[4]

Unemployment and the Recession.

- Unemployment, a lagging indicator, remained mild throughout and after the 2001 recession, peaking at 6.3 percent. In contrast, unemployment peaked at 7.8 percent after the 1990 recession, and unemployment peaked at 10.8 percent after the 1980 recession.
- After the 1990 recession, unemployment exceeded 6.3 percent (the peak rate after the 2001 recession) for 40 consecutive months.
- The peak unemployment rate after the 2001 recession (6.3 percent) is lower than the average unemployment rate for the 1980s and less than one point higher than the average unemployment rate for the 1990s.

Unemployment and Discouraged Workers. The unemployment rate is the preeminent measure of the intensity of labor demand. When the rate dips below what economists consider the "full-employment" rate of 5 percent to 5.5 percent, the labor market is likely overheating, driving up inflation.

Over the past year, the unemployment rate has dropped in every region of the country and in 45 states. Moreover, non-farm payroll employment has increased in 47 states over the past year.

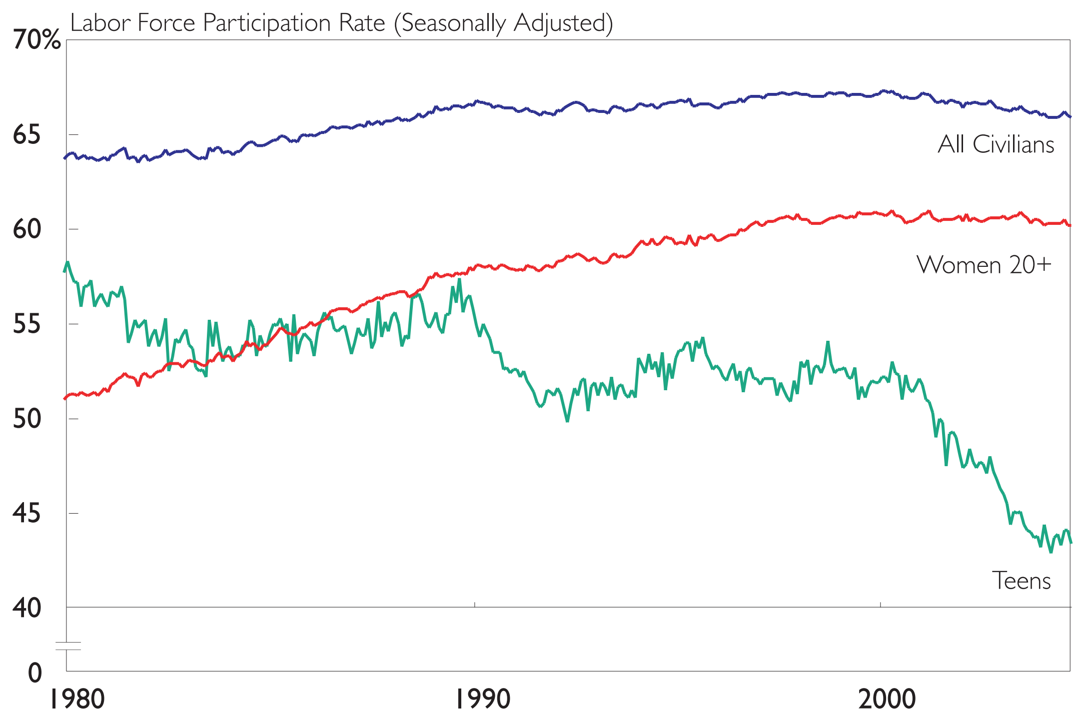
Still, some critics contend that the current low rate of 5.4 percent is a mirage because it neglects to include all the discouraged workers. The problem

3. U.S. Department of Labor, Bureau of Labor Statistics, "Effects of Job Changing on Payroll Survey Employment Trends," August 6, 2004, at *www.bls.gov/ces/cesjobch.pdf* (October 13, 2004).

4. Tim Kane, Ph.D., "Diverging Employment Data: A Critical View of the Payroll Survey," Heritage Foundation *Center for Data Analysis Report* No. 04–03, March 4, 2004, at *www.heritage.org/Research/Labor/CDA04-03.cfm*.

Chart 3 CDA 04-10

Teen Dropoff, Not Discouraged Workers



Source: U.S. Department of Labor.

with this argument is that the BLS counts discouraged workers and even publishes an alternative "underemployment rate" called U-4, which is barely higher than the official rate. There are no more discouraged workers today than there were in the mid-1990s.

Labor Force Participation. The fallback critique is that labor force participation has declined from a peak of 67.2 percent in January 2001. That is true, but most of the decline was due to 9/11, not the recession. Labor force participation was 66.8 percent in October 2001, then 66.0 percent in August 2004. Analysts need to consider the reality that labor supply has changed, not just labor demand.

Two other points shed light on participation:

- First, the participation rate of women age 20 and above is the same today as it was in 1997 and higher than every year before 1997.
- Second, the decline in total participation rates since 2001 is driven largely by the unprecedented drop-off in teenagers ages 16–19 who are willing to work, from 52 percent in 2000 to 43 percent in 2004.

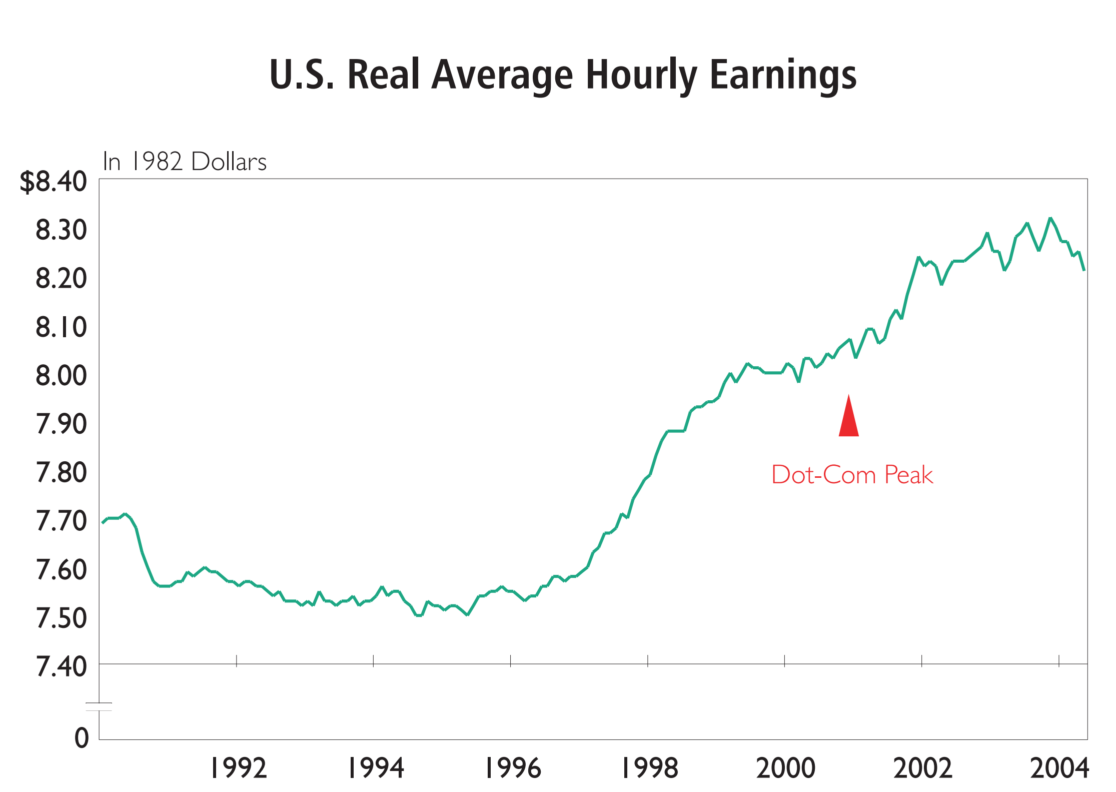
Unemployment Claims.

- Initial unemployment insurance claims for October 14, 2004, were at 354,000, and the four-week moving average was 348,500.
- The 25-year average of initial claims is 380,520.
- The Wall Street rule of thumb is that any level of claims below 400,000 signifies labor market strength.[5]

Real Earnings and Income. Worker pay is a sign of job quality. The Labor Department's measure of real hourly earnings is one of many pay statistics and includes all monetary compensation. However, it excludes benefits and, unlike other

5. Jon E. Hilsenrath, "Latest Data Suggests the Job-Market Is Improving," *CareerJournal.com*, November 21, 2003, at *www.careerjournal.com/salaryhiring/hotissues/20031121-hilsenrath.html* (October 13, 2004).

Chart 4 CDA 04-10



Source: Bureau of Labor Statistics.

measures, only counts earnings for non-executive workers.

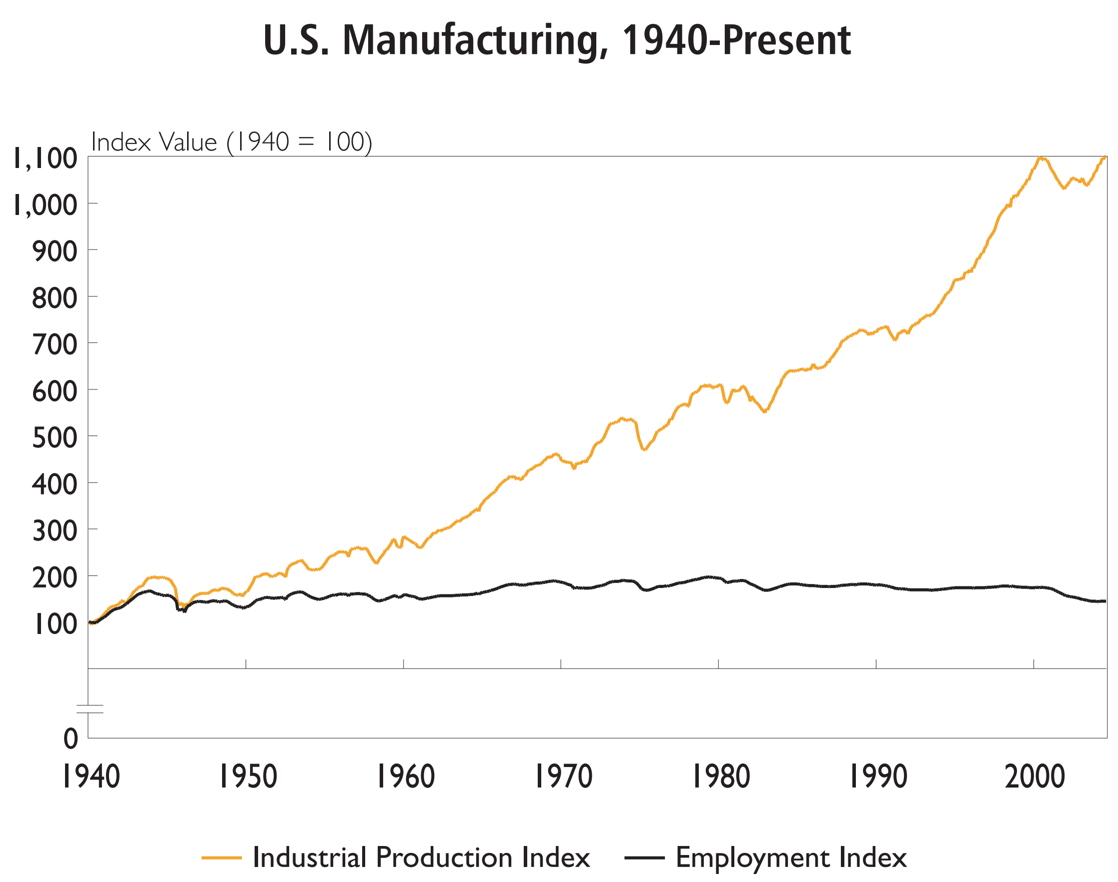
- During the 1980 and 1990 recessions, real hourly earnings declined.
- However, during and after the 2001 recession, real earnings increased—by 2 percent since the recession began in March 2001.
- Real earnings are higher now than they were at the height of the dot-com boom in 2000.
- Personal income is also growing. In the second quarter of 2004, personal income increased more quickly than during any other quarter of the past three years.

Manufacturing. Jobs in manufacturing are on the decline worldwide as a result of new technology, increasing productivity, and strong competition.

- From 1995 to 2002, worldwide manufacturing employment declined 11 percent, which matches the decline of manufacturing employment in the United States over that period.[6]
- Even in China, employment in the manufacturing sector has fallen—by 15 percent from 1995 to 2002.[7]
- Nevertheless, manufacturing in the United States has rebounded strongly of late. Production is rising quickly. As measured by the Department of Commerce, manufacturing sales grew at a 6.1 percent annual rate in the second quarter of 2004, which followed a 6.6 percent annual rate of growth in the first quarter.
- Manufacturing employment reversed its decline in February 2004 and has since added 70,000 payroll jobs.
- Overall, the manufacturing sector has expanded for 16 consecutive months, through September 2004.[8]

6. Joseph Carson, "Manufacturing Payrolls Declining Globally: The Untold Story," AXA Advisors, LLC, October 10, 2003, at *axaonline.com/rs/axa/public_articles/10202003Maufacturing_Payrolls_Declining.html* (October 13, 2004).
7. *Ibid.*

Chart 5 CDA 04-10



Source: Board of Governors of the Federal Reserve System and U.S. Department of Labor.

ECONOMIC GROWTH

- Real gross domestic product (GDP) grew at a 3.3 percent annual rate in the second quarter of 2004, following a high 4.5 percent growth rate in the first quarter.
- In 2003, GDP grew by 4.4 percent.
- The average growth rate during the 1990s was 3.26 percent, just under the last quarter's rate of growth and well below the growth rate for 2004 so far.

Tax Cuts and Business Investment. The 2003 tax cuts reduced taxes on business investment. When businesses invest in facilities, equipment, computers, software, and other inputs, they both demonstrate their belief that future growth will be strong and create the preconditions for economic expansion and job creation.

- Business investment contracted at a 1.14 percent annualized rate over the 14 quarters prior to the 2003 tax cuts.
- Business investment grew at a 13.03 percent annualized rate over the three quarters following the 2003 tax cuts.

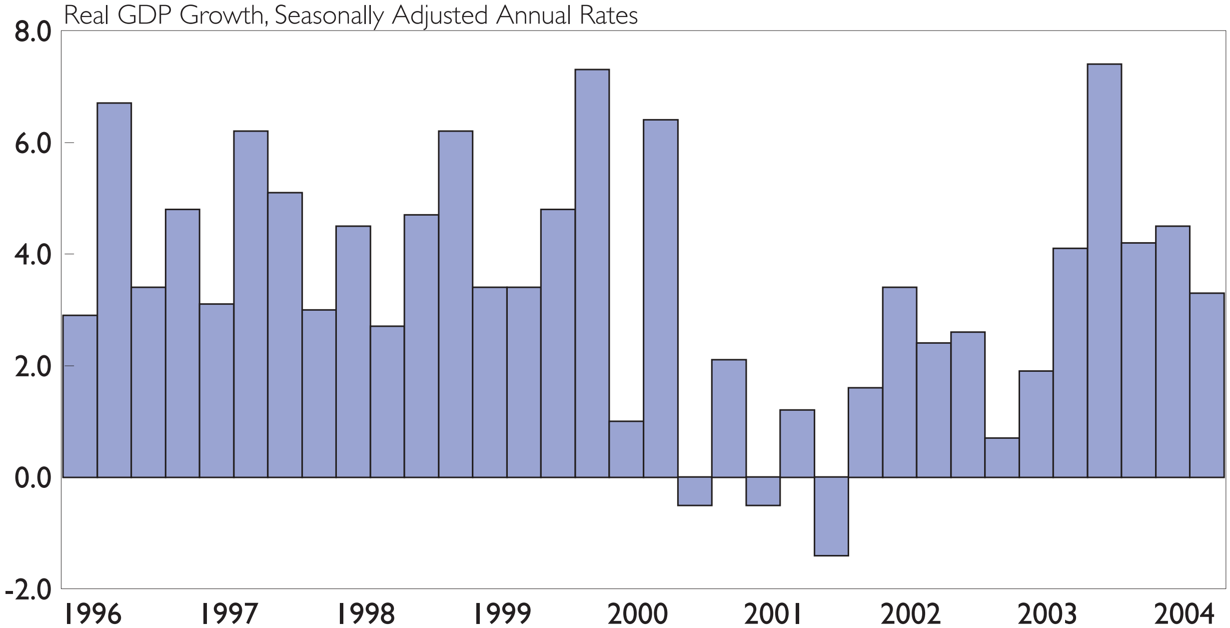
OUTSOURCING AND INSOURCING

- Today, more than 5.4 million jobs in America are the result of insourcing; i.e., they have been outsourced from other countries into the United States.[9]

8. Institute for Supply Management, "September Manufacturing ISM *Report on Business*," October 1, 2004, at *www.ism.ws/ISMReport/ROB102004.cfm* (October 13, 2004).
9. Organization for International Investment, "The *Facts* About *Insourcing*," at *www.ofii.org/insourcing* (October 13, 2004).

Chart 6 CDA 04-10

Strong 2003-2004 Expansion in GDP



Source: Bureau of Economic Analysis.

- Annually, these insourced jobs account for \$307 billion in wages and salaries.[10]
- Insourced jobs pay an average of 19.1 percent more than the average job in the United States.[11]
- Forrester Research estimates that 3.5 million jobs will be outsourced between 2000 and 2015.[12]
- Over the past decade, on average, 7.71 million jobs were lost every quarter as part of the normal flux of the economy.[13] Forrester's estimate would account for less than an average of 1 percent of the jobs lost each quarter.
- In the first quarter of 2004, just 4,633 workers were laid off as a result of outsourcing—about 2 percent of total mass job layoffs.[14]
- In terms of the industries affected and positions potentially at risk, the use of outsourcing has changed little over the past five years. In other words, this is no rapidly accelerating trend of outsourcing.[15]

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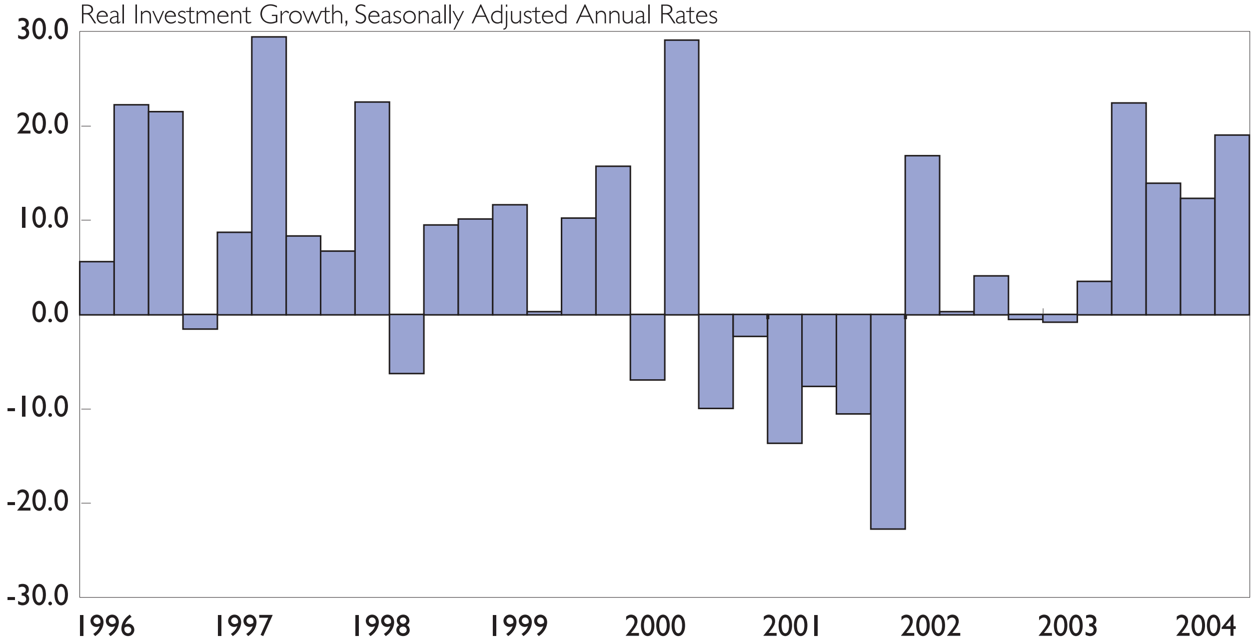
10. *Ibid.*
11. *Ibid.*
12. "U.S. Outsourcing Is 'Accelerating,'" BBC News, May 17, 2004, at *news.bbc.co.uk/1/hi/business/3722739.stm* (October 13, 2004).
13. U.S. Department of Labor, Bureau of Labor Statistics, "Business Employment Dynamics: Fourth Quarter 2003," August 3, 2004.
14. U.S. Department of Labor, Bureau of Labor Statistics, "Extended Mass Layoffs Associated with Domestic and Overseas Relocations, First Quarter 2004 Summary," June 10, 2004, at *www.bls.gov/news.release/reloc.nr0.htm* (October 13, 2004).

Chart 7 CDA 04-10

Investment-Driven Expansion



Source: Bureau of Economic Analysis.

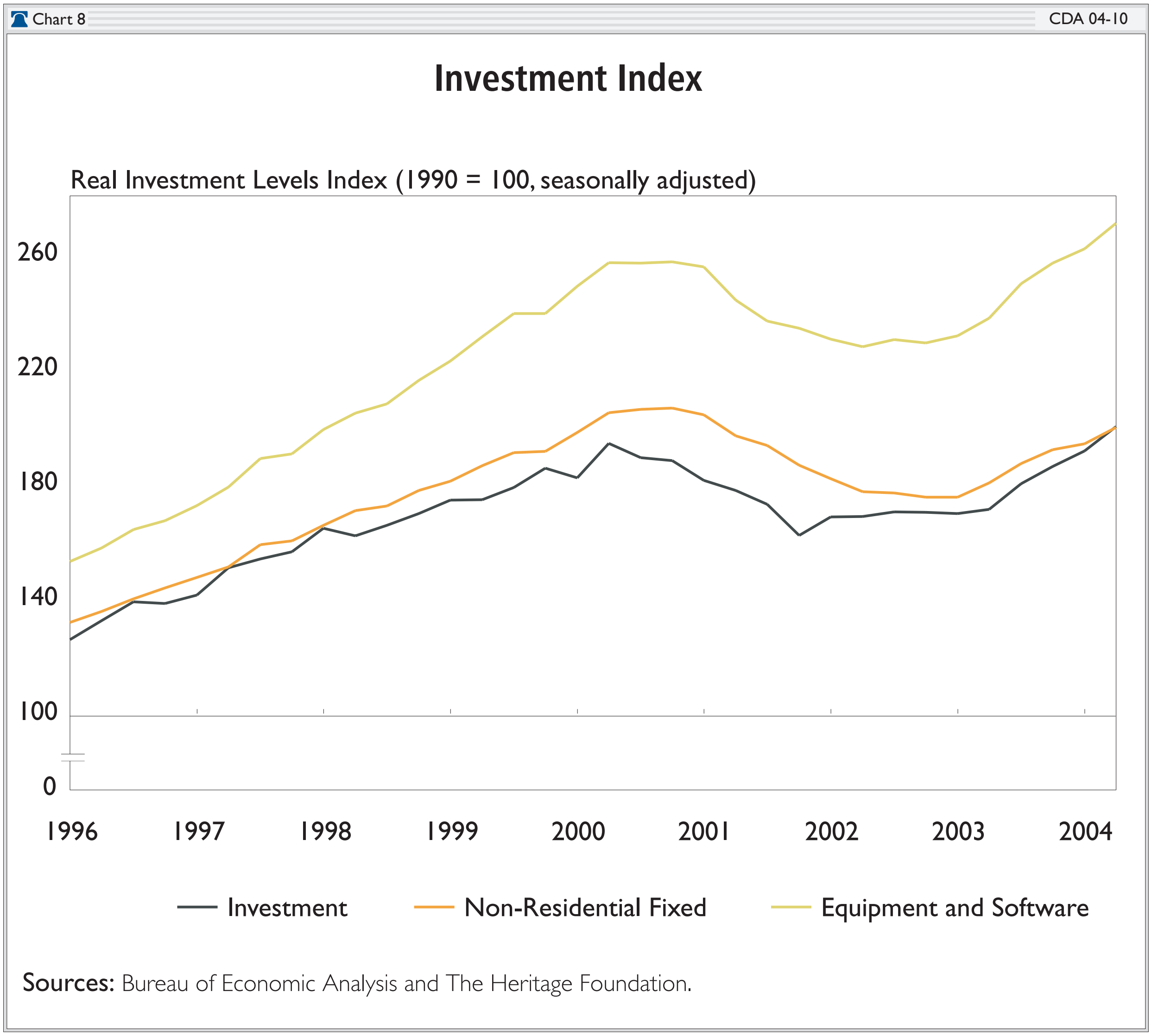
- The United States exports more business, technical, and professional services than it imports (offshore outsourcing of service work is synonymous with importing those services). In 2003, the trade surplus for these services was $27.0 billion.[16]
- Overall, the United States ran a $57.7 billion trade surplus in all services in 2003.

HEALTH CARE

The Uninsured. According to the U.S. Bureau of the Census, 44.9 million Americans went without health insurance for some part of 2003.[17]

- The typical family that loses coverage is uninsured for 5.6 months.[18]
- Only 3.3 percent of all Americans went without some kind of health insurance for four or more years.[19]

15. U.S. Government Accountability Office, "International Trade: Current Government Data Provide Limited Insight into Offshoring of Services," GAO–04–932, September 22, 2004, at *www.gao.gov/new.items/d04932.pdf* (October 13, 2004).
16. U.S. Department of Commerce, Bureau of Economic Analysis, "Foreign Direct Investment in the United States: Detail for Historical-Cost Position and Related Capital and Income Flows, 2003," and "U.S. Direct Investment Abroad: Detail for Historical-Cost Position and Related Capital and Income Flows, 2003," in *Survey of Current Business*, Vol. 84, No. 9 (September 2004), p. 66, Table 4, and p. 107, Table 4, at *www.bea.gov/bea/pub/0904cont.htm* (October 13, 2004).
17. Carmen DeNavas-Walt, Bernadette D. Proctor, and Robert J. Mills, "Income, Poverty, and Health Insurance Coverage in the United States: 2003," U.S. Department of Commerce, Bureau of the Census, P60–226, August 2004, at *www.census.gov/prod/2004pubs/p60-226.pdf* (October 13, 2004).



- In 1996, some 8.8 percent went without health insurance for the entire year. This figure dropped to 8.0 percent by 1999.[20]
- In 1996, 78.2 percent of all Americans had health insurance for the entire year. By 1999, the rate had risen to 80.4 percent.[21]
- Medicaid enrollment has grown in recent years, but the Census Bureau's survey of the uninsured undercounts Medicare enrollment by 18 million, compared to figures from the Centers for Medicare and Medicaid Services.[22]

Health Savings Accounts. Health Savings Accounts (HSAs) were enacted as part of the Medicare Modernization Act of 2003 and took effect on January 1, 2004.

- The majority of HSA enrollees pay between $51 and $100 per month for coverage—far less than other types of individual insurance would cost.[23]

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18. Shailesh Bhandari and Robert Mills, "Dynamics of Economic Well-Being: Health Insurance 1996–1999," U.S. Department of Commerce, Census Bureau, P70–92, August 2003, p. 10, at *www.bls.census.gov/sipp/p70s/p70-92.pdf* (October 13, 2004).
19. *Ibid.*, p. 2.
20. *Ibid.*, p. 4.
21. *Ibid.*
22. See Derek Hunter, "Counting the Uninsured: Why Congress Should Look Beyond the Census Figures" Heritage Foundation *WebMemo* No. 555, August 26, 2004, at *www.heritage.org/Research/HealthCare/wm555.cfm*.

- Early experience shows major cost savings for small businesses. Some small businesses have been able to cut their health coverage expenditures by 20 percent using HSAs while holding employee out-of-pocket expenses steady and actually improving the level of care.[24]

POVERTY

The 2001 Recession.

- The poverty rate for 2003 was 12.5 percent, which is higher than for recent years but still better than the poverty rate for 1998 of 12.7 percent and the poverty rates of the previous 15 years.[25]
- Poverty always rises with recessions, but the increase in poverty stemming from the most recent recession was about half the increase of each of the previous two recessions.[26]
- In previous recessions, child poverty increased significantly, but during the most recent recession, it increased only slightly. The 1980 recession caused a 5.5 percentage point jump in child poverty, and the 1990 recession caused a 2.7 percentage point jump, but the 2001 recession caused only a 1.6 percentage point increase in child poverty.[27]

Poverty in America.

- More than half of all poverty "spells" (time spent in poverty) last less than four months, and about 80 percent last less than a year.[28]
- Very few people—only about 2 percent of the total population—are chronically poor in America, as defined by living in poverty for four years or more.[29]
- About 13 percent of poor families and 2.6 percent of poor children experience hunger at some point during the year. In most cases, their hunger is short-term; 89 percent of the poor report that their families have "enough" food to eat, while only 2 percent say they "often" do not have enough to eat.[30]
- About 38 percent of all households in the lowest income quintile (that is, the bottom 20 percent of earners) rose to a higher quintile within three years. An almost equal percentage (34 percent) of all households in the top quintile fell within three years.[31]

Income Inequality.

- According to the uncorrected Census numbers, the top 20 percent of earners (top quintile) earned $14.20 of income for every $1 of income earned by the bottom 20 percent.[32]
- However, the Census figures do not account for benefits provided by employers and the government, taxes, differing household sizes among the quintiles, and differing work habits among the quintiles.

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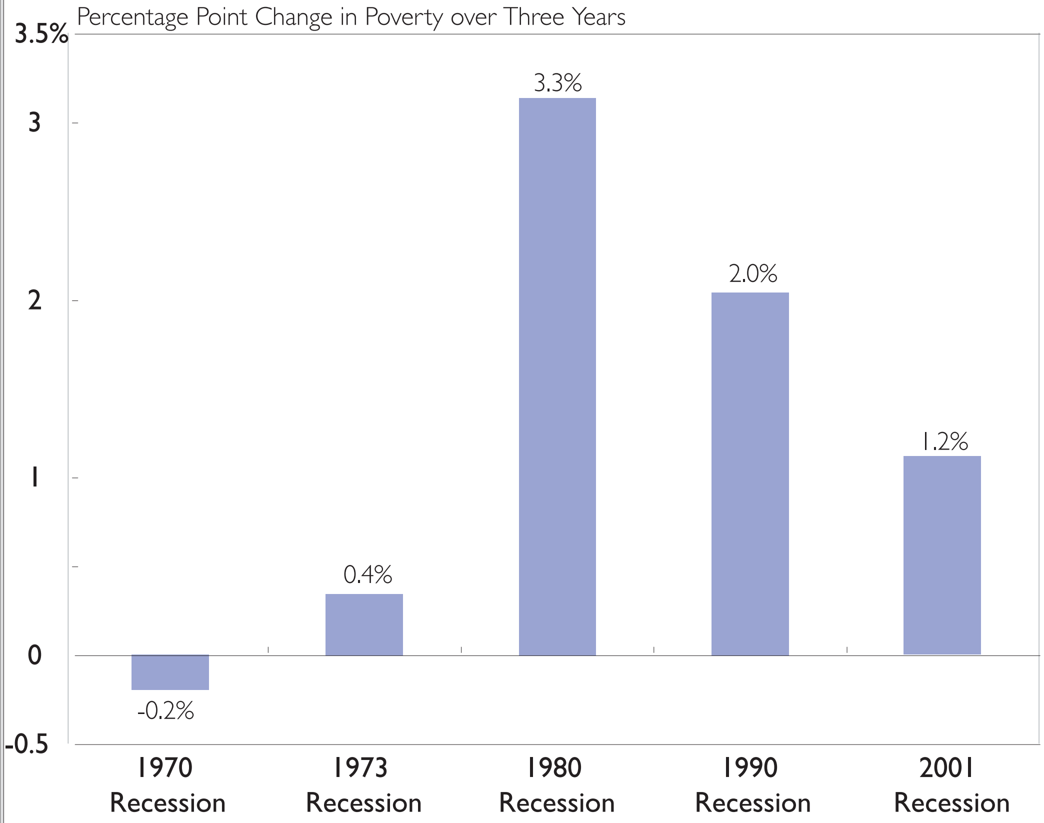
23. eHealthinsurance, "Health Savings Accounts Fact Sheet," April 2004, at *images.ehealthinsurance.com/ehealthinsurance/expertcenter/HSAFactSheet_Apr04.pdf* (October 13, 2004). See also Derek Hunter, "New Data on Health Insurance, the Working Poor, and the Benefits of Health Care Tax Changes," Heritage Foundation *WebMemo* No. 492, April 28, 2004, at *www.heritage.org/Research/HealthCare/wm492.cfm*.
24. Grace-Marie Turner, "New Studies Show Consumer-Directed Care Reduces Costs and Improves Access," Galen Institute, July 21, 2004, at *www.galen.org/fileuploads/New_Studies.pdf* (October 13, 2004).
25. U.S. Department of Commerce, Bureau of the Census, "Historical Poverty Tables," Table 2: Poverty Status of People by Family Relationship, Race, and Hispanic Origin: 1959 to 2003, revised August 26, 2004, at *www.census.gov/hhes/poverty/histpov/hstpov2.html* (October 13, 2004). See also Robert Rector, "Understanding Poverty and Economic Inequality in the United States" Heritage Foundation *Backgrounder* No. 1796, September 15, 2004, at *www.heritage.org/Research/Welfare/bg1796.cfm*.
26. Rector, "Understanding Poverty and Economic Inequality in the United States," p. 2.
27. *Ibid.*
28. Bhandari and Mills, "Dynamics of Economic Well-Being," p. 7, Figure 9.
29. *Ibid.*, p. 3, Figure 1.
30. Mark Nord, Margaret Andrews, and Steven Carlson, "Household Food Security in the United States 2002," U.S. Department of Agriculture, Economic Research Service *Food Assistance and Nutrition Research Report* No. 35, October 2003, at *www.ers.usda.gov/publications/fanrr35/fanrr35.pdf* (October 13, 2004).
31. Bhandari and Mills, "Dynamics of Economic Well-Being," p. 3, Figure 1.
32. Carmen DeNavas-Walt, Robert W. Cleveland, and Bruce H. Webster, Jr., "Income in the United States: 2002," U.S. Department of Commerce, Bureau of the Census, P60–221, September 2003, p. 25, at *www.census.gov/prod/2003pubs/p60-221.pdf* (October 13, 2004).

Chart 9 CDA 04-10

Three-Year Impact of Recessions on Poverty: Change in Poverty Rate of All Persons



Note: Figures represent the cumulative percentage point change in poverty in the first three years after the onset of a recession.

Source: U.S. Department of Commerce, Bureau of the Census, "Historical Poverty Tables," Table 2: Poverty Status of People by Family Relationship, Race, and Hispanic Origin: 1959 to 2003, revised August 26, 2004, at *www.census.gov/hhes/poverty/histpov/hstpov2.html* (October 13, 2004).

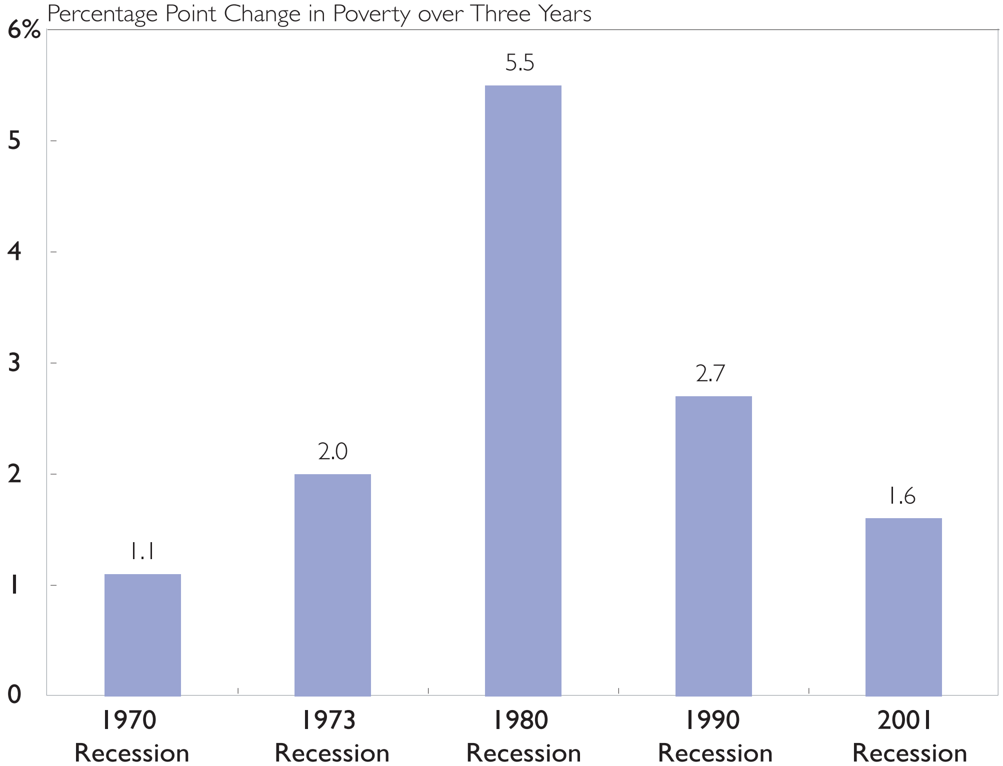
- After accounting for benefits and taxes, the income ratio between the top and bottom quintiles drops to $8.56 for every $1.[33]
- After also accounting for household sizes, the income ratio between the top and bottom quintiles drops to $4.21 for every $1.[34]
- Finally, accounting for hours worked (i.e., assuming that all non-elderly adults work equal amounts) reduces the income ratio between the top and bottom quintiles to $2.91 for every $1.[35]

33. Robert Rector and Rea S. Hederman, Jr., "Two Americas: One Rich, One Poor? Understanding Income Inequality in the United States," Heritage Foundation *Backgrounder* No. 1791, August 24, 2004, p. 5, Chart 2, at *www.heritage.org/Research/Taxes/bg1791.cfm*.

34. *Ibid.*, Table 1, p. 7.

Chart 10 CDA 04-10

Three-Year Impact of Recessions on Poverty: Change in Poverty Rate of All Children



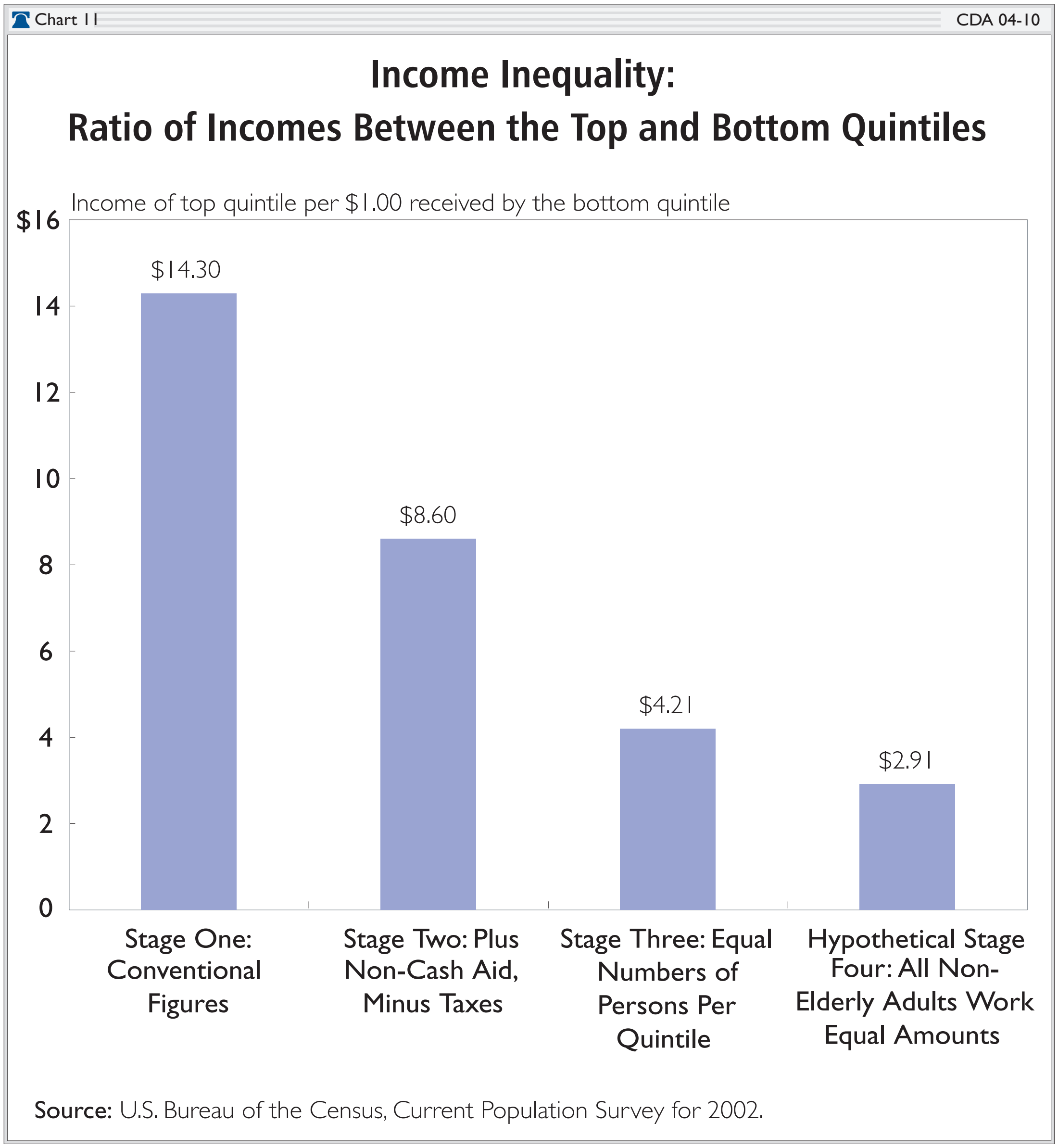
Note: Figures represent the cumulative percentage point change in poverty in the first three years after the onset of a recession.

Source: U.S. Department of Commerce, Bureau of the Census, "Historical Poverty Tables," Table 2: Poverty Status of People by Family Relationship, Race, and Hispanic Origin: 1959 to 2003, revised August 26, 2004, at *www.census.gov/hhes/poverty/histpov/hstpov2.html* (October 13, 2004).

Poverty and Taxation.

- Households in the top income quintile provide one-third of all labor in the economy.[36]
- Households in the top income quintile pay 82.5 percent of total federal income taxes and two-thirds of federal taxes overall.[37]
- Households in the bottom income quintile pay 1.1 percent of total federal taxes.[38]
- Nearly 40 million tax filers—about one-third of the total—pay no income taxes. Nearly all of these zero-tax filers are low-income individuals and families. Many of them actually receive

35. *Ibid.*, Chart 6, p. 11.
36. *Ibid.*, pp. 10–11.
37. Congressional Budget Office, "Effective Tax Rates Under Current Law 2001–2014," August 2004, pp. 10–11, Table 2, at *www.cbo.gov/ftpdocs/57xx/doc5746/Report.pdf* (October 13, 2004).
38. *Ibid.*



money for filing taxes through the child tax credit or the earned income tax credit.[39]

THE TAX CUTS

- The expanded child tax credit—recently extended by Congress and the President—benefits the parents of over 47 million children.[40]
- In 2001 and 2003, Congress and the President cut taxes on married couples to reduce the "marriage penalty"—the premium that a married couple paid in taxes above what the couple would have paid if they had filed separately.
- Congress and the President extended the marriage penalty fix in 2004, benefiting 33 million joint-filing couples—mostly couples in which both spouses work and the second earner contributes at least 30 percent of total income.[41]

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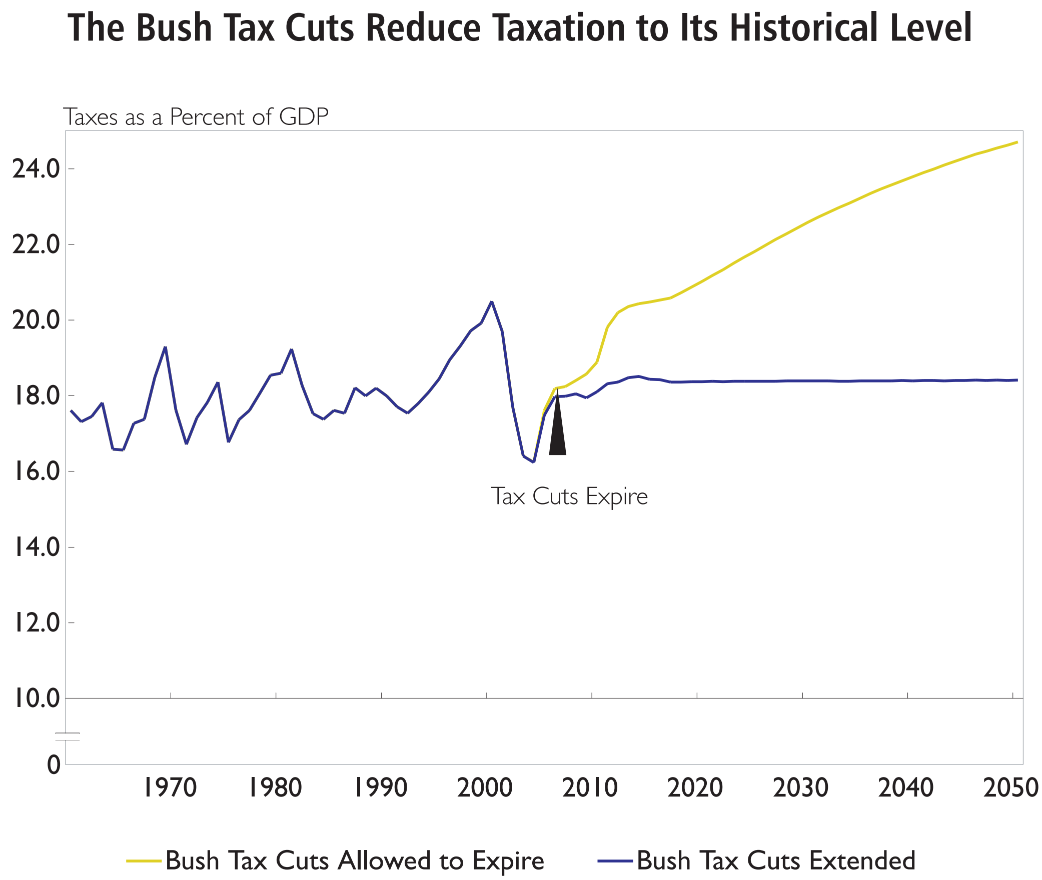
39. Scott Hodge, "40 Million Filers Pay No Income Taxes, Many Get Generous Refunds," Tax Foundation *Fiscal Facts: Putting a Face on America's Tax Returns*, June 5, 2003, at *www.taxfoundation.org/ff/childcredit.html* (October 13, 2004).

40. Rea S. Hederman, Jr., "One Cheer for the Tax Extender Package," Heritage Foundation *WebMemo* No. 572, September 23, 2004, at *www.heritage.org/Research/Taxes/wm572.cfm*.

41. *Ibid.*

Chart 12 CDA 04-10



Source: Congressional Budget Office.

- In 2001, Congress and the President created a new 10-percent tax bracket for low-income workers, reducing their marginal tax rate from 15 percent. In 2003, Congress and the President expanded the 10 percent bracket, and in 2004, Congress and the President extended the 2003 expansion, which was due to expire. That extension will benefit 80 million taxpayers.[42]
- The Bush tax cuts, even if made permanent and combined with indexing the Alternative Minimum Tax to inflation (essentially another tax cut), only return the tax burden to its historical level as a proportion of the economy (about 18.4 percent of GDP).[43]
- Conversely, allowing the Bush tax cuts expire would raise the tax burden to historically unprecedented levels (24.7 percent of GDP by 2045).[44]

CONCLUSION

The economy has added more than 1.5 million payroll jobs over the past year and nearly 2 million jobs on the household survey. Most indicators point toward continued growth. Output is booming, the manufacturing outlook is positive, business confidence is high, and productivity continues to set records.

Even such favorites among economic pessimists like data on long-term unemployment,

42. *Ibid.*

43. Congressional Budget Office, "The Long-Term Budget Outlook," December 2003, p. 56, at *www.cbo.gov/ftpdocs/49xx/doc4916/Report.pdf* (October 13, 2004).

44. *Ibid.*, pp. 45 and 57.

manufacturing employment, and worker discouragement are showing marked improvement—in addition to which the poverty rate is low by historical standards. Unfortunately for the pessimists, these are the facts that frame the debate on the economy today.

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