Remarks on the 2004 Economic Report of the President
to the
National Economists Club and Society of Government Economists

Dr. N. Gregory Mankiw
Chairman
Council of Economic Advisers
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I am here today to discuss the latest Economic Report of the President, together with the Annual Report of the Council of Economic Advisers.

One role of the Council of Economic Advisers is to provide rigorous economic analysis that contributes to and advances ongoing debates over economic policy. Our annual Report offers such analysis in a form that is accessible to those who are not professional economists.

The Report does not propose any new policy initiatives but, instead, uses the tools of economic analysis to shed light on recent developments in the economy, the challenges facing economic policymakers, and the intellectual foundation for Administration policies.

This year's report contains 14 chapters on a wide range of topics. For example, you can read about

- The recent business cycle and economic outlook
- The hardships faced by many manufacturing industries during this downturn
- The analysis of tax policy
- The need for social security reform
- The proper use of regulation to protect the environment and ensure reliable energy
- The problems with our tort system
- The strengths and weakness of our system of health care
- The case for an open and unfettered system for world trade and international flows of capital.

The Report also contains a number of boxes that briefly examine special topics related to current economic issues. Many of these are designed to provoke thought and, in some cases, we hope, additional research by others. Let me take a few minutes to highlight some of these.

Two Surveys of Employment

One box discusses the growing discrepancy between the two labor market surveys conducted by the Bureau of Labor Statistics. Since January of 2001, the survey of businesses, called the payroll or establishment survey, shows that the economy has lost 2.2 million jobs. The survey of households shows that, over the same period, the economy has gained 776,000 jobs. This discrepancy of 3 million jobs is huge.

To some extent, conceptual differences explain the difference between the two data series. By design, the payroll survey excludes the self-employed, while the household survey includes them. Over time, the extent of self-employment can and has changed. Since January 2001, the number of self-employed has increased significantly—by 326,000 workers, which represents a rise of about 3 percent. By itself, however, self-employment explains only a fraction of the discrepancy between the two data series.

Another possibility is that the discrepancy is related to undocumented workers. It could be that tighter border controls in the aftermath of 9/11 and the weak labor market may have reduced the number of undocumented people entering our Nation. If so, population estimates may be overstated. Because household employment is based on these population estimates, it would be overstated as well. If this undocumented-worker hypothesis is correct, the payroll data would accurately reflect the number of job losses in U.S. labor markets, but it would overstate the number of job losses by American workers. This hypothesis is hard to evaluate because, for obvious reasons, good data on undocumented workers are not readily available.

At this point, the gap between the payroll and household data continues to be a puzzle. I hope that we will see more research on this topic. It is important to keep in mind what every economist knows to be true: all economic statistics are imperfect. Both the payroll survey and the household survey contain valuable information about current economic developments. To understand what is going on in the economy, we have to look at all the data to discern the broad patterns and trends.

The Definition of Manufacturing

This year's Report contains a chapter on the challenges facing manufacturing, discussing both the longer-term trends and the recent business cycle downturn. There is no question that the recent downturn was particularly hard on manufacturing industries. Manufacturing was affected by the latest economic slowdown earlier, longer, and harder than other sectors of the economy. We discuss why this has been the case and how the President's policies will help to restore and maintain growth in manufacturing and other job-creating industries.

A box in the Economic Report discusses an important consideration in assessing policies that apply to manufacturing: the definition of what constitutes manufacturing is far from clear. For example, when a fast-food restaurant sells a hamburger, is it providing a service or combining inputs to manufacture a product?

The government agencies that collect data on manufacturing are well aware that the distinction is blurry. According to the Bureau of Labor Statistics, bakeries, candy stores, and custom tailors are all part of manufacturing. But one could walk into such a retailer and see many service activities taking place. Sometimes subtle differences can change how an activity is classified. Mixing water and concentrate to produce a soft drink is classified as manufacturing. If that activity is performed at a snack bar, however, it is considered a service.

In the past, it has not mattered to firm owners whether government data collectors classified a business as a manufacturing firm or a service provider. But the blurriness of the definition would matter if policies were based on it.

The Problem of the Uninsured

This year's Economic Report has a chapter on the U.S. health care system. It discusses how the United States is a world leader in producing innovative health care products, with benefits to both American citizens and to others around the world. The chapter also discusses our system of health insurance.

A commonly cited statistic is that 43.6 million people do not have health insurance. A box in the chapter goes into more detail about this aggregate number.

You may have in your mind an image of what a typical uninsured person looks like. If so, you are wrong. There is no typical uninsured person. A close look at the data reveals that the uninsured are an extremely heterogeneous group.

Here are some of the noteworthy facts:

- Most of the uninsured lack health coverage, but about a quarter of them have coverage through Medicaid. People who are eligible for Medicaid are often counted as uninsured because, when surveyed, they did not think of Medicaid as insurance or because they had not yet enrolled in the program, perhaps because they have been healthy. If they were to become sick and go to a hospital or doctor, however, they could enroll and be covered.

- Many of the uninsured are in low-income families, and this group is an important focus of policy. The President has proposed several initiatives to help low-income families obtain insurance. What might be surprising is that 32 percent of the uninsured report household income of $50,000 or more.

- Although most of the uninsured are Americans, more than 20 percent are foreign-born, including both legal immigrants and undocumented individuals.

- Although some people are uninsured for long durations, about half of all new spells of uninsurance end within four months.

The uninsured are a diverse group. That is why the President has proposed a variety of policies aimed at reducing the number of people without insurance.

New Challenges to the World Trading System

I would like to turn now to discuss some of the new challenges facing the world trading system. I made some news last week with some injudiciously worded comments about international trade. I learned an important lesson from that experience: economists and non-economists speak very different languages. The two languages share many words in common, but they are often interpreted in different ways. Last week, some comments I made about the benefits of international trade were far from clear, and were misinterpreted to suggest that I was praising U.S. job losses. Nothing could be farther from my views. Creating an environment for robust job creation is a paramount goal of the President and his economic team.

An open system of world trade raises living standards both in the United States and in other nations. This conclusion commands near unanimity among economists. Yet some observers have called into question the value of international trade, in part because the labor market has been weak.

Concerns about job losses in the United States are important. The President has stated that his number one economic priority is making sure that everyone who wants a job can find one.

Since the middle of 2000, the U.S. economy has gone through a hard time because of a series of contractionary shocks—the end of a stock market bubble, corporate governance and accounting scandals, terrorist attacks, and slow growth among our major trading partners, notably Japan and much of Europe.

The resulting downturn was mild as judged by the fall in GDP, but some industries were hit particularly hard. The impact on manufacturing was especially severe.

As in all downturns, much of the pain was felt in the labor market. With fewer customers coming through their doors, businesses laid off workers. A job loss is always an awful experience, and very often causes hardship for a worker and his or her family.

Policymakers responded forcefully to these events. Interest rate cuts by the Federal Reserve and tax relief proposed by the President and enacted by Congress were the right actions to jumpstart the economy. We are starting to see the results. Growth in the last half of 2003 was the strongest in nearly 20 years. Over the past five months, employment has risen by 366,000, as measured by the payroll survey. The unemployment rate has fallen from its peak of 6.3 percent to 5.6 percent.

These macroeconomic events were not driven primarily by changes in the world trading system. Competition from imports played a secondary role in the job losses over the past few years; more important were the declines in domestic investment and weak exports. The five industries that have contributed most significantly to manufacturing job losses are export-intensive industries in the United States: computer and electronic equipment, machinery, transportation equipment, fabricated metal products, and semiconductor and electronic components.

There is reason to be optimistic about future prospects in these industries. Business investment began to rebound in the second half of 2003 following the passage of the Jobs and Growth bill. Exports have begun to rebound as well. Growth in our major trading partners is starting to pick up, but it still lags behind growth in the United States.

At the same time, changes in the world trading system are occurring, largely because of the Internet and advances in telecommunications. We are all used to goods being produced in one country and transported to another on ships or planes. We are less used to services being produced in one country and sent to another over fiber optic cable. Advances in technology have expanded the range of commercial activities that can be traded internationally.

The basic laws of economics, however, have not changed. Free markets remain the best way to promote growth, create good jobs, and ensure rising living standards. That is why the President has actively sought to open markets.

Some would respond to the recent challenges facing the economy by erecting trade barriers. History teaches that a retreat to economic isolationism is a recipe for economic decline. The Smoot-Hawley tariffs of the 1930s, for example, contributed to the hardship of that period.

Although it is impossible to say precisely what changes lie ahead for the U.S. economy, it is important to harness the forces of change for the betterment of all Americans. Over the past half century, as new technology led to great advances in farm productivity, the number of Americans working on farms declined from almost 20 percent of the workforce in 1940 to about 2 percent today. In 1940, no one could have predicted that some of the grandchildren of farmers would become website designers and CAT scan operators. But they did, and at much higher wages and incomes. Farming remains a vital sector of the economy, but we would be far poorer today if public policy in 1940 had stifled the forces of change in order to keep 20 percent of Americans on farms.

It is natural to ask what new jobs will be created in the future. That question is best answered by market forces. Policymakers should create an environment in which businesses will expand and jobs will be created. But they should not try to determine precisely which jobs are created, or which industries will grow. If government bureaucrats were capable of such foresight, the Soviet Union would have succeeded as a centrally planned economy. It did not, providing perhaps the best evidence that free markets are the bedrock of economic prosperity.

At the same time that we recognize the gains from free and open markets, we must appreciate that any economic change, whether arising from trade or technology, can cause painful dislocations for some workers and their families. Public policy should help workers prepare for the global economy and the jobs of the future.

The President's policies are aimed at doing exactly that. He has proposed a "Jobs for the 21st Century" initiative to help prepare U.S. workers to take advantage of better skilled, higher paying jobs. Among other programs, his strong support for community colleges, where much training takes place, is an important part of helping workers gain new skills.

The President's policies will also create an environment in which businesses will expand and create jobs in the United States. Reforming the tort system, ensuring a reliable energy supply, and reducing the burden of regulations will all promote economic growth.

Like the President, I have great confidence in the future of the American economy. As the Economic Report discusses, we have the right institutions and policies to create good jobs and foster economic growth. In the years ahead, the creativity of the American people and their spirit of entrepreneurship will continue to lead to higher living standards for all American families.

Thank you.