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THE EMPLOYMENT SITUATION: JANUARY 2006

HEARING

BEFORE THE

JOINT ECONOMIC COMMITTEE
CONGRESS OF THE UNITED STATES

ONE HUNDRED NINTH CONGRESS

SECOND SESSION

FEBRUARY 3, 2006

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JOINT ECONOMIC COMMITTEE

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THE EMPLOYMENT SITUATION: JANUARY 2006

FRIDAY, FEBRUARY 3, 2006

CONGRESS OF THE UNITED STATES,
JOINT ECONOMIC COMMITTEE,
Washington, DC

The Committee met, pursuant to notice, at 9:30 a.m., in room 2212, Rayburn House Office Building, Hon. Jim Saxton, Chairman of the Committee, presiding.

Present: Representative Saxton; Senator Sessions.

Staff Present: Chris Frenze, Colleen Healy, Brian Higginbotham, John Kachtik, Jeff Schlagenhauf, Nan Gibson, Matthew Salomon, Chad Stone and Rachel Thomson.

OPENING STATEMENT OF HON. JIM SAXTON, CHAIRMAN, A U.S. REPRESENTATIVE FROM NEW JERSEY

Representative Saxton. Good morning. It is a pleasure to welcome Commissioner Utgoff and her colleagues before the Committee this morning to discuss the latest employment data.

The January employment data are good news for American workers. According to the payroll survey, employment has increased by 193,000 jobs in January. Since May 2003, more than 4.7 million jobs have been created. According to the household survey, employment also advanced, while the unemployment rate fell to 4.7 percent. Over the last year, most of the net increase in employment has been in occupations that pay in the middle range or higher.

The employment data are consistent with other data showing that the economy continues to grow. In 2005, the real GDP increased 3.5 percent. Although economic growth slowed to only 1.1 percent in the fourth quarter of 2005, this advance figure is incomplete and may be revived upward. Most forecasters project a rebound in economic growth in the first quarter of 2006.

As an important Federal Reserve policy statement recently noted, the expansion in economic activity appears solid. According to the Federal Reserve, the Congressional Budget Office and private economists, economic growth this year will be comparable to the healthy pace set in 2005.

The economy seems to have weathered the recent rise in oil prices quite well, although oil prices have probably had some negative impact on growth. Inflation appears to be contained over the long run, as the Fed recently stated. In conclusion, U.S. economic growth has been healthy in recent years and significantly higher than most other advanced economies.

The U.S. unemployment rate also remains below comparable rates in many other economies. Most recent forecasters expect good economic and employment growth to continue.

Commissioner Utgoff, we are pleased that you are here this morning, and we look forward to hearing your statement.

[The prepared statement of Representative Jim Saxton appears in the Submissions for the Record on page 9.]

STATEMENT OF HON. KATHLEEN P. UTGOFF, COMMISSIONER, BUREAU OF LABOR STATISTICS; ACCOMPANIED BY JOHN S. GREENLEES AND JOHN M. GALVIN

Commissioner Utgoff. Thank you, Mr. Chairman. I appreciate this opportunity to comment on the labor market data we released this morning.

Nonfarm payroll employment increased by 193,000 in January, and the unemployment rate fell to 4.7 percent. Payroll employment was up by 140,000 in December and by 354,000 in November. Over the year, payroll employment increased by 2.1 million. In January, employment growth occurred in construction, mining, and in several service-producing industries.

Employment in construction rose by 46,000 over the month and by 345,000 over the year. Above-average temperatures in most of the country may have contributed to fewer seasonal layoffs than usual in January.

Manufacturing employment was little changed in January. A few manufacturing industries have some small job gains in recent months, including wood products, fabricated metals, and electrical equipment.

Mining added 6,000 jobs in January. Since its most recent low in April 2003, mining employment has increased by 91,000.

In the service-providing sector, employment growth continued in health care over the month. Jobs were added in doctors' offices, hospitals and nursing and residential care facilities.

In January, employment in food services and drinking places grew by 31,000. Over the year, this industry has added 214,000 jobs.

Employment in professional and business services was up by 24,000 in January, following 2 months of unusually large gains that totaled 138,000. In January, accounting services lost jobs, while employment trended up in computer systems design and in management and consulting services.

In January, financial activities added 21,000 jobs. Wholesale trade employment was up by 15,000, while retail employment was little changed.

Average hourly earnings for production or nonsupervisory workers on private payrolls rose by 7 cents in January to $16.41. Over the year average hourly earnings grew by 3.3 percent.

The establishment survey data released today reflect the incorporation of annual benchmark revisions and updated seasonal adjustment factors. Each year we anchor our sample-based survey estimate to full universe counts of employment derived principally from administrative records of the unemployment insurance tax system.

The benchmark revision increased the level of nonfarm payroll employment in March 2005 by 158,000, or about 1⁄10th of 1 percent. Over the past decade, benchmark revisions have averaged plus or minus 2⁄10th of 1 percent. The seasonally adjusted establishment survey data from January 2001 forward have been revised to incorporate updated seasonal adjustment factors.

Turning now to measures from our household survey, the unemployment rate declined to 4.7 percent in January, and the number of unemployed persons fell to 7 million. The number of long-term unemployed persons, those unemployed for 27 weeks or more, declined to 1.2 million in January. They constituted 16.3 percent of all unemployed persons down from 21 percent a year earlier. The number of discouraged workers fell over the year to 396,000. Discouraged workers are those persons outside the labor force who had stopped looking for work because they believed their job search efforts would be unsuccessful.

With today's release, we again report on the labor force status of survey respondents who evacuated from their homes due to Hurricane Katrina. The data are derived from a special set of questions that have been included in the household survey since October to identify and gather information from evacuees. The estimates do not account for all persons who evacuated from their homes due to Hurricane Katrina. We do not gather information on those evacuees who remain outside the scope of the survey, such as those currently living in hotels or shelters.

The January data indicate that there were about 1.2 million persons age 16 and over who have evacuated from their August residence due to Hurricane Katrina. By January, about one-half of the evacuees had returned to the homes they vacated in August. Among Katrina evacuees in January, 56.8 percent were in the labor force, and their unemployment rate was 14.7 percent. Unemployment rates were much lower for those evacuees who had returned home than for those evacuees who had not. The January unemployment rate for those who had returned was 2.9 percent. It was 26.3 percent for those who had not yet returned to their residences.

To summarize, the labor market data for January payroll employment rose by 193,000, and the unemployment rate declined to 4.7 percent.

My colleagues and I would be happy to answer any of your questions.

[The prepared statement of Commissioner Utgoff appears in the Submissions for the Record on page 11.]

Representative Saxton. Commissioner, thank you again for being with us again this month.

As I noted in my opening statement, the economy's growth in the fourth quarter of last year fell to 1.1 percent, and, in spite of that, we continued to see significant job growth through most of that quarter.

Can you review with us the number of jobs created during the fourth quarter of last year?

Commissioner Utgoff. Five hundred thirty-one thousand.

Representative Saxton. Five hundred thirty-one thousand jobs were created during the fourth quarter, and yet GDP sunk to—I think it was 1.1 percent.

Do you expect that there will be some revisions in the GDP number for the fourth quarter of last year?

Commissioner Utgoff. Yes.

Representative Saxton. Can you shed any light on that at this point, or is it too early for us to?

Commissioner Utgoff. It is too early.

Representative Saxton. What are the factors that would account for the revision of GDP growth in the fourth quarter of last year?

Commissioner Utgoff. New information on wages and salaries, new information on exports and imports, new information on all the components of GDP.

Representative Saxton. Can you give us any idea what those adjustments might look like as they begin to come in?

Commissioner Utgoff. I can't predict whether those adjustments will be upward or downward.

Representative Saxton. Right. But we expect, as a normal course of events that there will be some adjustments in the GDP figure from the fourth quarter.

Commissioner Utgoff. Yes. This is called a preliminary GDP number, and for good reason.

Representative Saxton. And do you have any idea as to when we may see those adjustments take place?

Commissioner Utgoff. Approximately 3 weeks.

Representative Saxton. Is the increase in January payroll employment a solid number, or is it significantly inflated by special factors?

Commissioner Utgoff. It is a solid number, and with the upward revisions that we had for the previous 2 months from late reporters, it is a very solid report.

Representative Saxton. And once again, what was the number of jobs created in January?

Commissioner Utgoff. One hundred ninety-three thousand.

Representative Saxton. One hundred ninety-three thousand. And is that a significant number?

How much did the revisions in November and December of 2005 payroll employment figures add to total employment for those months?

Commissioner Utgoff. Eighty-one thousand.

Representative Saxton. Eighty-one thousand.

And so once again when we talk about preliminary numbers and adjusted numbers, we may see this number revise upward?

Commissioner Utgoff. Yes.

Representative Saxton. In January the diffusion index rose to 60.6 percent. What does this figure say about the breadth of job gains in January?

Commissioner Utgoff. It says that they were widespread.

Representative Saxton. So we are not seeing job growth confined to a specific sector, but it is widespread throughout the economy?

Commissioner Utgoff. That is correct.

Representative Saxton. Is the decline in unemployment to 4.7 percent statistically significant?

Commissioner Utgoff. Yes.

Representative Saxton. And when we talk about the 4.7 percent unemployment rate, can you give us an idea as to how that compares with the unemployment rate over the last, let's say, 3 years?

Commissioner Utgoff. It is the lowest rate since January—July 2001.

Representative Saxton. July of 2001.

Commissioner Utgoff. Yes.

Representative Saxton. So that obviously is also good news.

What is the unemployment rate for men 20 and over?

Commissioner Utgoff. 4.0.

Representative Saxton. So we continue to have good news there.

What is the unemployment rate for women aged 20 and over?

Commissioner Utgoff. 4.3 percent.

Representative Saxton. 4.3 percent.

We used to say that when we got to these low levels—we used to talk about that being full employment. Are we reaching what you would consider full employment?

Commissioner Utgoff. These are the lowest unemployment rates for men and women since summer 2001.

Representative Saxton. Historically low unemployment rates. Very good.

At this point how would you interpret the apparent effects of the hurricanes on payroll employment over the last 5 months?

Commissioner Utgoff. There were 2 months, September and October, where the unemployment rate was clearly held down by the effects of Hurricane Katrina. In the subsequent months, the economy appears to have recovered, and job growth has been—job growth has been substantial.

Representative Saxton. Could you spend a few moments explaining the benchmark revisions to the payroll employment survey?

Commissioner Utgoff. Yes. Let me see if I can do this simply is we have—when I testify before you each month, we have an estimate of payroll employment that comes from a sample of 400,000 establishments. That is large, but that is not all the establishments.

Once a year we take a census of all establishments largely taken from unemployment insurance records, and we tie the census to the sample so that in this year and March they are the same, and then adjust the other numbers to meet that census number.

Representative Saxton. Thank you.

Mr. Sessions.

Senator Sessions. Thank you, Mr. Chairman, and, Commissioner, I am pleased to welcome you here and to see continued good news.

I guess, Mr. Chairman, good news doesn't attract as many Members as bad news.

Representative Saxton. Airplanes attract Members on Fridays.

Senator Sessions. Maybe you are right, airplanes attract Members.

Commissioner, we are having a little excitement in Alabama. Everybody is trying to claim credit for the unemployment rate. Our unemployment rate, Mr. Chairman, is 3.5 percent, the lowest ever recorded in the State. Job training program is first rate and been ranked, I think, No. 1 one in the country, but now is the challenge to get people trained for the good jobs that are out there.

Have you had occasion, Commissioner, to be able to consider whether if we could get people trained quicker, turn them around more readily with skills that are needed in the workplace, we could not only find more jobs, but we could move people up into higher-paying jobs and better benefits?

Commissioner Utgoff. Yes.

Senator Sessions. What could you tell us about your observation there? I think the reason I raise that is I don't think it is a coincidence that Alabama's low unemployment rate coincides with the fact that the job training program for the State was rated No. 1 in the country. Do you have any thoughts about that?

Commissioner Utgoff. Yes. Job training programs are incredibly important in getting people into their first jobs, which is important, and then moving them up into higher-paying jobs. And the one-stop centers have been doing an excellent job in taking in people and moving them through the entire process of getting them into good jobs.

Senator Sessions. There has been a good bit of interest on behalf of Governors in consolidating Federal workforce programs. And we are trying to do that, although our Senate bill is not as good as I would like; frankly, I think it is far short of what the Governor has requested, but I remain hopeful.

Do you have any information and received any feedback from the fact that a lot of these stovepipe programs are contradictory and duplicative and would be much more efficient if they were merged together?

Commissioner Utgoff. Yes. There are duplicative programs for the same groups of people, and moving them together will allow better service for these people. I have to say that I, from the BLS, am well aware of the work that the Employment and Training Administration is doing to improve the training, and particularly tie training to the local workforce needs. But I think the Assistant Secretary for Employment Training would be a better witness for all of the things that are going on in that area.

Senator Sessions. Well, I think we can do better. Our commissioner, Dr. Roy Johnson, the chancellor of the system, made this statement to me as we were going to a meeting, and he said, an individual 28 years old with 2 kids can't go—he is chairman of the community college system in the State, where you have 2-year programs for the most part traditionally, when you think in terms of the 2-year program—they don't have 2 years. What we need to do, he says, and he is doing, is create specific programs that prepare people in 6 months or less for a high-paying job, and he believes it can be done and is doing that.

Would you agree that that has an important role in our system—as well as our classical interest in degrees in 4 years and 2-year degrees—but this kind of more specific focus on training persons for a job that exists in that community, can we do better than that?

Commissioner Utgoff. Yes. We can do better than that.

Senator Sessions. And would you share with us some thoughts on that subject?

Commissioner Utgoff. Well, I would note that in the military people are taken in for specific jobs and trained in far less than 2 years for specific jobs and come out with skills that are often good for the private sector, and that we can't afford to have someone in for 4 years of service spending 2 years in a job training program. So that 6 months is certainly a much better target period than for 2 years, especially for someone who is 28 years old and has 2 children.

Senator Sessions. I think that was a very insightful comment. I hadn't thought about the military. They absolutely don't have—they can't spend 2 years preparing somebody, and they train them for highly technical jobs in very short order, and then when they get out, businesses line up to hire them. They are very pleased to have them because of the way they have been trained.

Mr. Chairman, I was just looking at the February 2 *New York Times* article by David Brooks that made this point. And I think in our country, we get a little too down on ourselves, and when things are good, people start thinking, well, next week it is going to be bad; you know, it can't stay good. But look at this. David Brooks points out, has the American economy shrunk as a part of the world economy? In 1971, the United States economy accounted for 30.52 percent of the world's GDP. 30.52.

Now, we have seen China surge; Japan really over the last 30 years has been a tremendous force; India, the Asian tigers; production in Europe and all; and today, he notes, our percentage of GDP is 30.74, a larger percentage of the world's GDP in the United States today than it was 30 years ago. And if you listen to a lot of our commentators out there, you would think the United States is in a period of decline.

That is a phenomenal achievement in light of the productivity growth in other areas of the world. It is not as if they shrank. They have been surging, and we still are doing that, and our job numbers are going down. And we only have a couple of things to fear, I think, and that is making sure our children are properly trained and educated and really motivated to take advantage of this economy, and to be positive and to see that if they work hard, they can actually sustain a good lifestyle for themselves and their children in the future.

Thank you for your leadership, Mr. Chairman, and I was pleased to be here today. And, Commissioner, you should take a bow on the job growth, too. Everybody else is. I am trying to. If it were going up, they would blame me, so I might as well claim some credit.

[The New York Times article entitled, "The Nation of the Future," appears in the Submissions for the Record on page 46.]

Representative Saxton. Thank you very much, Senator. I have said in jest a couple of times that people were running for airplanes. Actually, the Democrat Minority party has their retreat today, and so that is the reason that they are not here. And so I just wanted to make that part of the record.

Let me just ask one final short question. Manufacturing employment has been a concern to the Members of the Committee, and I am sure to you, also, Commissioner, over the last several years. But manufacturing employment showed some small increases in January, and I am curious to know in what sectors of manufacturing did job gains actually take place. Can you talk about that a little bit?

Commissioner Utgoff. Wood products, electrical equipment, and there was one other, fabricated metals.

Representative Saxton. And what percentage of the manufacturing sector would that involve? Can you give us an estimate?

Commissioner Utgoff. I can't give you that estimate now, but I will—we will provide that to you in a letter.

[The response from Commissioner Utgoff to Chairman Saxton appears in the Submissions for the Record on page 43.]

Representative Saxton. We would certainly appreciate that.

But in general, the manufacturing sector showed some job gains in January; is that right?

Commissioner Utgoff. Yes. Yes.

Representative Saxton. And was it statistically significant?

Commissioner Utgoff. No.

Representative Saxton. But it was an indicator that there is life in terms of growth in the manufacturing sector?

Commissioner Utgoff. Yes.

Representative Saxton. Thank you. I have no other questions at this point, and we want to thank you for being with us here today. It is always a pleasure to see you, and it is even more of a pleasure when you have good news like the news you brought us today. Thank you very much.

Commissioner Utgoff. I hope it will continue.

Representative Saxton. We do, too. Thank you.

[Whereupon, at 9:56 a.m., the Committee was adjourned.]

Submissions for the Record

CONGRESS OF THE UNITED STATES

JOINT ECONOMIC COMMITTEE

CHAIRMAN JIM SAXTON

PRESS RELEASE

For Immediate Release
February 3, 2006

STATEMENT OF CHAIRMAN JIM SAXTON

Press Release #109-57
Contact: Christopher Frenze
Executive Director
(202) 225-3923

JANUARY EMPLOYMENT SITUATION

WASHINGTON, D.C. – It is a pleasure to welcome Commissioner Utgoff and her colleagues before the Committee this morning to discuss the latest employment data.

The January employment data are good news for American workers. According to the payroll survey, employment increased by 193,000 jobs in January. Since May of 2003, more than 4.7 million jobs have been created.

According to the household survey, employment also advanced, while the unemployment rate fell to 4.7 percent. Over the last year, most of the net increase in employment has been in occupations that pay in the middle range and higher.

The employment data are consistent with other data showing that the economy continues to grow. In 2005, real GDP increased 3.5 percent. Although economic growth slowed to only 1.1 percent in the fourth quarter of 2005, this advance figure is incomplete and may be revised upward. Most forecasters project a rebound of economic growth in the first quarter of 2006.

As an important Federal Reserve policy statement recently noted, "the expansion in economic activity appears solid." According to the Federal Reserve, the Congressional Budget Office and private economists, economic growth this year will be comparable to the healthy pace set in 2005.

The economy seems to have weathered the recent rise in oil prices quite well, although oil prices have probably had some negative impact on growth. Inflation appears to be contained over the long term, as the Fed recently stated.

In conclusion, U.S. economic growth has been healthy in recent years, and significantly higher than in most other advanced economies. The U.S. unemployment rate also remains below comparable rates in many other major economies. Most economic forecasters expect good economic and employment growth to continue through 2006.

SEN. JACK REED (RI)
RANKING DEMOCRAT

SEN. EDWARD M. KENNEDY (MA)
SEN. PAUL S. SARBANES (MD)
SEN. JEFF BINGAMAN (NM)
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Congress of the United States
Joint Economic Committee
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CHAD STONE
STAFF DIRECTOR

Opening Statement
Senator Jack Reed
Joint Economic Committee Hearing
February 3, 2006

Thank you, Chairman Saxton. I want to welcome Commissioner Utgoff and thank her for testifying here today.

Today's report that 193,000 payrolls were created in January is welcome news. However, there is still a lot of catching up to do in a labor market that went through the most protracted jobs slump in decades. At this point in the last recovery, the economy had created nearly five million more jobs than we have seen in this recovery. Moreover, workers haven't seen any recovery in their paychecks.

Overall growth in payroll employment has been modest by the standards of most economic recoveries. The 4.8 million jobs created since job losses peaked in August 2003 works out to only about 164,000 per month—not much more than what is necessary just to keep up with normal growth in the labor force.

While the jobless rate has come down, unemployment remains higher than it was when President Bush took office, long-term unemployment persists, and evidence of hidden unemployment is reflected in the continued depressed levels of the labor force participation rate and the fraction of the population with a job.

Corporate profits and worker productivity have been growing, but wages are not keeping pace with inflation. Average hourly earnings were stagnant during 2003 and have fallen during each of the past two years, after adjusting for inflation. Paychecks are being stretched thinner as families face higher prices for gasoline, home heating, health care, and education.

The President's assertion in his State of the Union address that the economy is strong simply belies the experience of many working families, who are still waiting to benefit from the Bush economic policies. Clearly, America can do better.

I look forward to Commissioner Utgoff's statement and to a further discussion of the January employment situation.

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Statement of

Kathleen P. Utgoff
Commissioner
Bureau of Labor Statistics

before the

Joint Economic Committee

UNITED STATES CONGRESS

Friday, February 3, 2006

Mr. Chairman and Members of the Committee:

I appreciate this opportunity to comment on the labor market data we released this morning.

Nonfarm payroll employment increased by 193,000 in January, and the unemployment rate fell to 4.7 percent. Payroll employment was up by 140,000 in December and by 354,000 in November (as revised). Over the year, payroll employment increased by 2.1 million. In January, employment growth occurred in construction, mining, and in several service-providing industries.

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The benchmark revision decreased the level of nonfarm payroll employment in March 2005 by 158,000 (not seasonally adjusted), or about one-tenth of one percent. Over the past decade, benchmark revisions have averaged plus or minus two-tenths of one percent. The seasonally adjusted establishment survey data from January 2001 forward have been revised to incorporate updated seasonal adjustment factors.

Turning now to the measures from our household survey, the unemployment rate declined to 4.7 percent in January, and the number of unemployed persons fell to 7.0 million. The number of long-term unemployed persons--those unemployed for 27 weeks or more--declined to 1.2 million in January. They constituted 16.3 percent of all unemployed persons, down from 21.0 percent a year earlier. The number of discouraged workers fell over the year to 396,000 (not seasonally adjusted). Discouraged workers are those persons outside the labor force who had stopped looking for work because they believed their job search efforts would be unsuccessful.

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The January data indicate that there were about 1.2 million persons age 16 and over who evacuated from their August residence due to Hurricane Katrina. By January, about one-half of evacuees had returned to the homes they vacated in August. Among Katrina evacuees in January, 56.8 percent were in the labor force, and their unemployment rate was 14.7 percent. Unemployment rates were much lower for those evacuees who had returned home than for those evacuees who had not. The January unemployment rate for those who had returned was 2.9 percent; it was 26.3 percent for those who had not yet returned to their residences.

To summarize the labor market data for January, payroll employment rose by 193,000, and the unemployment rate declined to 4.7 percent.

My colleagues and I now would be glad to address your questions.

News United States Department of Labor

Bureau of Labor Statistics **Washington, D.C. 20212**

Technical information:
Household data: (202) 691-6378 http://www.bls.gov/cps/
Establishment data: 691-6555 http://www.bls.gov/ces/
Media contact: 691-5902

USDL 06-160

Transmission of material in this release is embargoed until 8:30 A.M. (EST), Friday, February 3, 2006.

THE EMPLOYMENT SITUATION: JANUARY 2006

Nonfarm payroll employment increased by 193,000 in January, and the unemployment rate fell to 4.7 percent, the Bureau of Labor Statistics of the U.S. Department of Labor reported today. Job gains occurred in several industries, including construction, mining, food services and drinking places, health care, and financial activities.

Chart 1. Unemployment rate, seasonally adjusted, February 2003 – January 2006

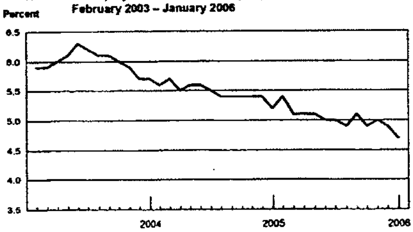
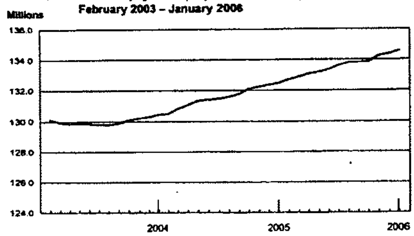


Chart 2. Nonfarm payroll employment, seasonally adjusted, February 2003 – January 2006



Unemployment (Household Survey Data)

The number of unemployed persons fell to 7.0 million in January, and the unemployment rate decreased to 4.7 percent, seasonally adjusted. The unemployment rate had ranged from 4.9 to 5.1 percent during most of 2005. The jobless rate for adult men declined to 4.0 percent in January. For other major worker groups—adult women (4.3 percent), teenagers (15.3 percent), whites (4.1 percent), blacks (8.9 percent),

Establishment and Household Data Changes

The establishment survey data in this release have been revised as a result of the annual benchmarking process and the updating of seasonal adjustment factors. See the note beginning on page 6 for more information on the revisions.

In addition, household survey data for January 2006 reflect updated population controls. See the note on page 7 for more information. Also, new seasonally adjusted employment data for multiple jobholders have been added to table A-6 of this release.

and Hispanics (5.8 percent)—unemployment rates were essentially unchanged. The rate for black teens, which had an unusually large decline in December, rose to 31.4 percent in January. The unemployment rate for Asians was 3.2 percent, not seasonally adjusted. (See tables A-1, A-2, and A-3.)

In January, 16.3 percent of the unemployed had been without a job for 27 weeks or longer, down from 18.2 percent in the prior month. In January 2005, the proportion was 21.0 percent. (See table A-9.)

Total Employment and the Labor Force (Household Survey Data)

Total employment continued to trend upward in January. The labor force participation rate and the employment-population ratio showed little or no change over the month, at 66.0 and 62.9 percent, respectively. (See table A-1.)

Persons Not in the Labor Force (Household Survey Data)

About 1.6 million persons (not seasonally adjusted) were marginally attached to the labor force in January, down from 1.8 million a year earlier. These were people who wanted and were available for work and had looked for a job sometime in the prior 12 months but were not counted as unemployed because they had not searched for work in the 4 weeks preceding the survey. The number of discouraged workers—a subset of the marginally attached who were not currently looking for work specifically because they believed no jobs were available for them—was 396,000 in January, a decrease of 119,000 from a year earlier. (See table A-13.)

Employment Status of Hurricane Katrina Evacuees (Household Survey Data)

Beginning in October, questions were added to the household survey to identify persons who evacuated from their homes, even temporarily, due to Hurricane Katrina. Data collected through these questions do not account for all evacuees; persons living outside of the scope of the survey—such as those living in hotels or shelters—are not included. The questions were asked of persons in the household survey sample throughout the country, since some evacuees relocated far from the storm-affected areas. An additional question determined whether evacuees had returned to their homes by the time of the survey.

These additional questions provided information to analyze the employment status of this subgroup of evacuees. The total number of evacuees estimated from the household survey may change from month to month as people move in and out of the scope of the survey.

Information gathered in January showed that about 1.2 million persons age 16 and over had evacuated from where they were living in August due to Hurricane Katrina. These evacuees either had returned to their homes or were living in other residential units covered in the survey in January. About 600,000 of the evacuees had returned to their August 2005 residences. Of all evacuees identified, 56.8 percent were in the labor force in January. The employment-population ratio for these evacuees was 48.4 percent. The unemployment rate for persons identified as evacuees was 14.7 percent; it was much higher for evacuees who had not returned home (26.3 percent) than for those who had returned (2.9 percent). (See table B.)

Table A. Major indicators of labor market activity, seasonally adjusted

(Numbers in thousands)

Category	Quarterly averages 2005 III	Quarterly averages 2005 IV	Monthly data 2005 Nov.	Monthly data 2005 Dec.	Monthly data 2006 Jan.	Dec.-Jan. change
HOUSEHOLD DATA	Labor force status					
Civilian labor force	149,827	150,126	150,183	150,153	150,114	(1)
Employment	142,324	142,671	142,611	142,779	143,074	(1)
Unemployment	7,503	7,455	7,572	7,375	7,040	(1)
Not in labor force	76,595	77,070	77,021	77,271	77,439	(1)
	Unemployment rates					
All workers	5.0	5.0	5.0	4.9	4.7	-0.2
Adult men	4.4	4.3	4.3	4.3	4.0	-.3
Adult women	4.6	4.5	4.6	4.5	4.3	-.2
Teenagers	16.1	16.1	17.1	15.2	15.3	.1
White	4.3	4.3	4.2	4.3	4.1	-.2
Black or African American	9.5	9.7	10.6	9.3	8.9	-.4
Hispanic or Latino ethnicity	6.0	6.0	6.1	6.0	5.8	-.2
ESTABLISHMENT DATA [2]	Employment					
Nonfarm employment	133,750	p134,160	134,231	p134,371	p134,564	p193
Goods-producing [3]	22,140	p22,239	22,264	p22,273	p22,331	p58
Construction	7,305	p7,390	7,409	p7,414	p7,460	p46
Manufacturing	14,208	p14,208	14,214	p14,213	p14,220	p7
Service-providing [3]	111,610	p111,921	111,967	p112,098	p112,233	p135
Retail trade [4]	15,297	p15,285	15,293	p15,302	p15,301	p-2
Professional and business services	16,942	p17,060	17,061	p17,129	p17,153	p24
Education and health services	17,411	p17,475	17,481	p17,503	p17,542	p39
Leisure and hospitality	12,840	p12,872	12,881	p12,896	p12,922	p26
Government	21,843	p21,869	21,880	p21,875	p21,874	p-1
	Hours of work [5]					
Total private	33.8	p33.8	33.8	p33.8	p33.8	p0.0
Manufacturing	40.6	p40.9	40.8	p40.8	p40.8	p.0
Overtime	4.5	p4.6	4.6	p4.5	p4.5	p.0
	Indexes of aggregate weekly hours (2002=100) [5]					
Total private	102.9	p103.4	103.5	p103.7	p103.9	p0.2
	Earnings [5]					
Average hourly earnings, total private	$16.16	p$16.30	$16.28	p$16.34	p$16.41	p$0.07
Average weekly earnings, total private	545.78	p550.94	550.26	p552.29	p554.66	p2.37

[1] Changes in household data levels are not shown due to the introduction of updated population controls. See the note on page 7 for more information.

[2] Establishment data have been revised to reflect March 2005 benchmark levels and updated seasonal adjustment factors. See the note on page 6 for more information.

[3] Includes other industries, not shown separately.

[4] Quarterly averages and the over-the-month change are calculated using unrounded data.

[5] Data relate to private production or nonsupervisory workers.

p = preliminary.

Table B. Employment status in January 2006 of persons 16 years and over who evacuated from their August residence, even temporarily, due to Hurricane Katrina [1]

(Numbers in thousands, not seasonally adjusted)

Employment status in January 2006	Total	Residence in January: Same as in August	Residence in January: Different than in August
Civilian noninstitutional population	1,245	575	670
Civilian labor force	707	351	355
Participation rate	56.8	61.1	53.1
Employed	603	341	262
Employment-population ratio	48.4	59.3	39.1
Unemployed	104	10	94
Unemployment rate	14.7	2.9	26.3
Not in labor force	538	224	314

[1] Represents persons in the civilian noninstitutional population age 16 and over who resided in households that were eligible to be selected for the Current Population Survey (CPS). These data are not representative of the total evacuee population because they do not include children or people residing in shelters, hotels, places of worship, or other units outside the scope of the CPS. The total number of evacuees estimated from the CPS may change from month to month as people move in and out of the scope of the survey and because of sampling variability.

NOTE: These data use population controls that have been adjusted to account for interstate moves by evacuees.

Industry Payroll Employment (Establishment Survey Data)

Total nonfarm payroll employment rose by 193,000 in January to 134.6 million, seasonally adjusted. This followed job gains of 354,000 in November and 140,000 in December (as revised). Since January 2005, job gains have averaged 174,000 per month. (See table B-1.)

In January, construction employment increased by 46,000; over the year, construction employment has risen by 345,000. Specialty trade contractors added 28,000 jobs over the month, while residential building and heavy and civil engineering construction added 8,000 each. Mining continued its upward trend in January, adding 6,000 jobs. Support activities for mining, particularly those related to oil and gas, accounted for two-thirds of the over-the-month gain.

Elsewhere in the goods-producing sector, manufacturing employment was little changed for the second month in a row. Within durable goods, employment gains in nonmetallic mineral products (6,000) and primary metals (3,000) were partially offset by a decline in computer and electronic products (-6,000).

In the service-providing sector, employment in health care and social assistance rose by 38,000 in January. Ambulatory health care services (which includes doctors' offices and home health care) added 15,000 jobs. Job growth also occurred in hospitals (7,000) and in nursing and residential care facilities (7,000). Health care employment has increased by 287,000 over the year. Employment in social assistance continued to trend up in January and has grown by 77,000 over the year.

Over the month, financial activities employment was up by 21,000, following little change in December. Credit intermediation added 11,000 jobs in January, and real estate employment rose by 10,000.

Employment in food services and drinking places grew by 31,000 in January; over the year, this industry has added 214,000 jobs. In January, wholesale trade employment increased by 15,000. Employment in retail trade was flat over the month and has shown no net growth since July 2005.

Employment in professional and business services continued to trend up over the month (24,000); the number of jobs in the industry has increased by 515,000 over the year. In January, computer systems design services gained 7,000 jobs. Temporary help services employment was little changed over the month but has increased by 187,000 over the year. Following a strong employment increase in December, accounting and bookkeeping services lost 18,000 jobs in January.

Weekly Hours (Establishment Survey Data)

The average workweek for production or nonsupervisory workers on private nonfarm payrolls was unchanged at 33.8 hours in January, seasonally adjusted. The manufacturing workweek and factory overtime also were unchanged at 40.8 hours and 4.5 hours, respectively. (See table B-2.)

The index of aggregate weekly hours of production or nonsupervisory workers on private nonfarm payrolls increased by 0.2 percent in January to 103.9 (2002=100). The manufacturing index also increased by 0.2 percent over the month to 94.9. (See table B-5.)

Hourly and Weekly Earnings (Establishment Survey Data)

Average hourly earnings of production or nonsupervisory workers on private nonfarm payrolls increased by 7 cents in January to $16.41, seasonally adjusted. Average weekly earnings increased by 0.4 percent over the month to $554.66. Over the year, average hourly earnings increased by 3.3 percent and average weekly earnings increased by 3.6 percent. (See table B-3.)

The Employment Situation for February 2006 is scheduled to be released on Friday, March 10, at 8:30 A.M. (EST).

Revisions to Establishment Survey Data

In accordance with annual practice, the establishment survey data have been revised to reflect comprehensive universe counts of payroll jobs, or benchmarks. These counts are derived principally from unemployment insurance tax records for March 2005. As a result of the benchmark process, all not seasonally adjusted data series were subject to revision from April 2004 forward, the time period since the last benchmark was established. In addition, with this release, the seasonally adjusted establishment survey data from January 2001 forward were subject to revision due to the introduction of updated seasonal adjustment factors.

Table C presents revised total nonfarm employment data on a seasonally adjusted basis for January through December 2005. The revised data for April 2005 forward incorporate the effect of applying the rate of change measured by the sample to the new benchmark level, as well as updated net business birth/death model adjustments and new seasonal adjustment factors. The November and December 2005 revisions also reflect the routine incorporation of additional sample receipts into the November final and December second preliminary estimates. The total nonfarm employment level for March 2005 was revised downward by 158,000 (119,000 on a seasonally adjusted basis). The previously published level for December 2005 was revised downward by 144,000 (97,000 on a seasonally adjusted basis).

The February 2006 issue of *Employment and Earnings* will contain an article that discusses the benchmark and post-benchmark revisions. This issue also will provide revised estimates for all regularly published tables containing national establishment survey data on employment, hours, and earnings.

LABSTAT, the BLS public database on the Internet, contains all revised historical Current Employment Statistics (CES) data. The data can be accessed through the CES homepage at http://www.bls.gov/ces/.

Further information on the revisions released today may be obtained by calling 202-691-6555 or via the Internet on the CES homepage.

Table C. Revisions in total nonfarm employment, seasonally adjusted, January-December 2005
(In thousands)

Year and month	Levels		Over-the-month changes		
	As previously published	As revised	As previously published	As revised	Difference
2005					
January	132,573	132,471	124	76	-48
February	132,873	132,736	300	265	-35
March	132,995	132,876	122	140	18
April	133,287	133,104	292	228	-64
May	133,413	133,210	126	106	-20
June	133,588	133,376	175	166	-9
July	133,865	133,617	277	241	-36
August	134,013	133,792	148	175	27
September	134,030	133,840	17	48	31
October	134,055	133,877	25	37	12
November	134,360	134,231	305	354	49
December p	134,468	134,371	108	140	32

p = preliminary.

Adjustments to Population Estimates for the Household Survey

Effective with the data for January 2006, updated population controls have been used in the household survey. Population controls for the household survey are developed by the U.S. Census Bureau. Each year, the Census Bureau updates the controls to reflect new information and assumptions about the growth of the population. The change in population reflected in the new controls results from adjustments to the estimates of net international migration and updated vital statistics information.

Official population and labor force estimates for December 2005 and earlier months will not be revised. To assess the impact of the updated population controls on trend growth, however, December 2005 estimates for selected data series (not seasonally adjusted) were recalculated using the new controls, and the differences from estimates based on the old controls are shown in table D. The adjustments decreased the estimated size of the civilian noninstitutional population by 67,000, of the civilian labor force by 130,000, and of employment by 123,000; the new population controls had a negligible impact on unemployment rates and other percentage estimates. More detailed information on the population adjustments and their effect on national labor force estimates are available at http://www.bls.gov/cps/cps06adj.pdf on the Internet and also will be published in the February 2006 issue of *Employment and Earnings*.

Table D. Effect of the revised population controls on December 2005 estimates by sex, race, and Hispanic or Latino ethnicity, not seasonally adjusted

(Numbers in thousands)

Category	Total	Men	Women	White	Black or African American	Asian	Hispanic or Latino ethnicity
Civilian noninstitutional population	-67	-31	-36	-12	7	-70	-108
Civilian labor force	-130	-67	-64	-89	3	-49	-87
Employed	-123	-61	-62	-82	2	-47	-81
Unemployed	-8	-6	-2	-7	1	-2	-6
Unemployment rate	.0	.0	.0	.0	.0	.0	.0

NOTE: Detail for men and women may not sum to totals because of rounding. Estimates for the above race groups (white, black or African American, and Asian) do not sum to totals because data are not presented for all races. In addition, persons whose ethnicity is identified as Hispanic or Latino may be of any race and, therefore, are classified by ethnicity as well as by race.

Explanatory Note

This news release presents statistics from two major surveys, the Current Population Survey (household survey) and the Current Employment Statistics survey (establishment survey). The household survey provides the information on the labor force, employment, and unemployment that appears in the A tables, marked HOUSEHOLD DATA. It is a sample survey of about 60,000 households conducted by the U.S. Census Bureau for the Bureau of Labor Statistics (BLS).

The establishment survey provides the information on the employment, hours, and earnings of workers on nonfarm payrolls that appears in the B tables, marked ESTABLISHMENT DATA. This information is collected from payroll records by BLS in cooperation with state agencies. The sample includes about 160,000 businesses and government agencies covering approximately 400,000 individual worksites. The active sample includes about one-third of all nonfarm payroll workers. The sample is drawn from a sampling frame of unemployment insurance tax accounts.

For both surveys, the data for a given month relate to a particular week or pay period. In the household survey, the reference week is generally the calendar week that contains the 12th day of the month. In the establishment survey, the reference period is the pay period including the 12th, which may or may not correspond directly to the calendar week.

Coverage, definitions, and differences between surveys

Household survey. The sample is selected to reflect the entire civilian noninstitutional population. Based on responses to a series of questions on work and job search activities, each person 16 years and over in a sample household is classified as employed, unemployed, or not in the labor force.

People are classified as *employed* if they did any work at all as paid employees during the reference week; worked in their own business, profession, or on their own farm; or worked without pay at least 15 hours in a family business or farm. People are also counted as employed if they were temporarily absent from their jobs because of illness, bad weather, vacation, labor-management disputes, or personal reasons.

People are classified as *unemployed* if they meet all of the following criteria: They had no employment during the reference week; they were available for work at that time; and they made specific efforts to find employment sometime during the 4-week period ending with the reference week. Persons laid off from a job and expecting recall need not be looking for work to be counted as unemployed. The unemployment data derived from the household survey in no way depend upon the eligibility for or receipt of unemployment insurance benefits.

The *civilian labor force* is the sum of employed and unemployed persons. Those not classified as employed or unemployed are *not in the labor force*. The *unemployment rate* is the number unemployed as a percent of the labor force. The *labor force participation rate* is the labor force as a percent of the population, and the *employment-population ratio* is the employed as a percent of the population.

Establishment survey. The sample establishments are drawn from private nonfarm businesses such as factories, offices, and stores, as well as federal, state, and local government entities. *Employees on nonfarm payrolls* are those who received pay for any part of the reference pay period, including persons on paid leave. Persons are counted in each job they hold. *Hours and earnings* data are for private businesses and relate only to production workers in the goods-producing sector and nonsupervisory workers in the service-providing sector. Industries are classified on the basis of their principal activity in accordance with the 2002 version of the North American Industry Classification System.

Differences in employment estimates. The numerous conceptual and methodological differences between the household and establishment surveys result in important distinctions in the employment estimates derived from the surveys. Among these are:

- The household survey includes agricultural workers, the self-employed, unpaid family workers, and private household workers among the employed. These groups are excluded from the establishment survey.
- The household survey includes people on unpaid leave among the employed. The establishment survey does not.
- The household survey is limited to workers 16 years of age and older. The establishment survey is not limited by age.
- The household survey has no duplication of individuals, because individuals are counted only once, even if they hold more than one job. In the establishment survey, employees working at more than one job and thus appearing on more than one payroll would be counted separately for each appearance.

Seasonal adjustment

Over the course of a year, the size of the nation's labor force and the levels of employment and unemployment undergo sharp fluctuations due to such seasonal events as changes in weather, reduced or expanded production, harvests, major holidays, and the opening and closing of schools. The effect of such seasonal variation can be very large; seasonal fluctuations may account for as much as 95 percent of the month-to-month changes in unemployment.

Because these seasonal events follow a more or less regular pattern each year, their influence on statistical trends can be eliminated by adjusting the statistics from month to month. These adjustments make nonseasonal developments, such as declines in economic activity or increases in the participation of women in the labor force, easier to spot. For example, the large number of youth entering the labor force each June is likely to obscure any other changes that have taken place relative to May, making it difficult to determine if the level of economic activity has risen or declined. However, because the effect of students finishing school in previous years is known, the statistics for the current year can be adjusted to allow for a comparable change. Insofar as the seasonal adjustment is made correctly, the adjusted figure provides a more useful tool with which to analyze changes in economic activity.

Most seasonally adjusted series are independently adjusted in both the household and establishment surveys. However, the adjusted series for many major estimates, such as total payroll employment, employment in most supersectors, total employment, and unemployment are computed by aggregating independently adjusted component series. For example, total unemployment is derived by summing the adjusted series for four major age-sex components; this differs from the unemployment estimate that would be obtained by directly adjusting the total or by combining the duration, reasons, or more detailed age categories.

For both the household and establishment surveys, a concurrent seasonal adjustment methodology is used in which new seasonal factors are calculated each month, using all relevant data, up to and including the data for the current month. In the household survey, new seasonal factors are used to adjust only the current month's data. In the establishment survey, however, new seasonal factors are used each month to adjust the three most recent monthly estimates. In both surveys, revisions to historical data are made once a year.

Reliability of the estimates

Statistics based on the household and establishment surveys are subject to both sampling and nonsampling error. When a sample rather than the entire population is surveyed, there is a chance that the sample estimates may differ from the "true" population values they represent. The exact difference, or *sampling error*, varies depending on the particular sample selected, and this variability is measured by the standard error of the estimate. There is about a 90-percent chance, or level of confidence, that an estimate based on a sample will differ by no more than 1.6 standard errors from the "true" population value because of sampling error. BLS analyses are generally conducted at the 90-percent level of confidence.

For example, the confidence interval for the monthly change in total employment from the household survey is on the order of plus or minus 430,000. Suppose the estimate of total employment increases by 100,000 from one month to the next. The 90-percent confidence interval on the monthly change would range from -330,000 to 530,000 (100,000 +/- 430,000). These figures do not mean that the sample results are off by these magnitudes, but rather that there is about a 90-percent chance that the "true" over-the-month change lies within this interval. Since this range includes values of less than zero, we could not say with confidence that employment had, in fact, increased. If, however, the reported employment rise was half a million, then all of the values within the 90-percent confidence interval would be greater than zero. In this case, it is likely (at least a 90-percent chance) that an employment rise had, in fact, occurred. At an unemployment rate of around 5.5 percent, the 90-percent confidence interval for the monthly change in unemployment is about +/- 280,000, and for the monthly change in the unemployment rate it is about +/- .19 percentage point.

In general, estimates involving many individuals or establishments have lower standard errors (relative to the size of the estimate) than estimates which are based on a small number of observations. The precision of estimates is also improved when the data are cumulated over time such as for quarterly and annual averages. The seasonal adjustment process can also improve the stability of the monthly estimates.

The household and establishment surveys are also affected by *nonsampling error*. Nonsampling errors can occur for many reasons, including the failure to sample a segment of the population, inability to obtain information for all respondents in the sample, inability or unwillingness of respondents to provide correct information on a timely basis, mistakes made by respondents, and errors made in the collection or processing of the data.

For example, in the establishment survey, estimates for the most recent 2 months are based on incomplete returns; for this reason, these estimates are labeled preliminary in the tables. It is only after two successive revisions to a monthly estimate, when nearly all sample reports have been received, that the estimate is considered final.

Another major source of nonsampling error in the establishment survey is the inability to capture, on a timely basis, employment generated by new firms. To correct for this systematic underestimation of employment growth, an estimation procedure with two components is used to account for business births. The first component uses business deaths to impute employment for business births. This is incorporated into the sample-based link relative estimate procedure by simply not reflecting sample units going out of business, but imputing to them the same trend as the other firms in the sample. The second component is an ARIMA time series model designed to estimate the residual net birth/death employment not accounted for by the imputation. The historical time series used to create and test the ARIMA model was derived from the unemployment insurance universe micro-level database, and reflects the actual residual net of births and deaths over the past five years.

The sample-based estimates from the establishment survey are adjusted once a year (on a lagged basis) to universe counts of payroll employment obtained from administrative records of the unemployment insurance program. The difference between the March sample-based employment estimates and the March universe counts is known as a benchmark revision, and serves as a rough proxy for total survey error. The new benchmarks also incorporate changes in the classification of industries. Over the past decade, the benchmark revision for total nonfarm employment has averaged 0.2 percent, ranging from less than 0.05 percent to 0.4 percent.

Additional statistics and other information

More comprehensive statistics are contained in *Employment and Earnings*, published each month by BLS. It is available for $27.00 per issue or $53.00 per year from the U.S. Government Printing Office, Washington, DC 20402. All orders must be prepaid by sending a check or money order payable to the Superintendent of Documents, or by charging to Mastercard or Visa.

Employment and Earnings also provides measures of sampling error for the household and establishment survey data published in this release. For unemployment and other labor force categories, these measures appear in tables 1-B through 1-D of its "Explanatory Notes." For the establishment survey data, the sampling error measures and the actual size of revisions due to benchmark adjustments appear in tables 2-B through 2-F of *Employment and Earnings*.

Information in this release will be made available to sensory impaired individuals upon request. Voice phone: 202-691-5200; TDD message referral phone: 1-800-877-8339.

Table A-1. Employment status of the civilian population by sex and age

(Numbers in thousands)

Employment status, sex, and age	Not seasonally adjusted			Seasonally adjusted [1]					
	Jan. 2005	Dec. 2005	Jan. 2006	Jan. 2005	Sept. 2005	Oct. 2005	Nov. 2005	Dec. 2005	Jan. 2006
TOTAL									
Civilian noninstitutional population	224,837	227,425	227,553	224,837	226,693	226,959	227,204	227,425	227,553
Civilian labor force	147,125	149,874	149,090	147,956	150,083	150,043	150,183	150,153	150,114
Participation rate	65.4	65.9	65.5	65.8	66.2	66.1	66.1	66.0	66.0
Employed	138,682	142,918	141,481	140,234	142,435	142,625	142,611	142,779	143,074
Employment-population ratio	61.7	62.8	62.2	62.4	62.8	62.8	62.8	62.8	62.9
Unemployed	8,444	6,956	7,608	7,723	7,648	7,418	7,572	7,375	7,040
Unemployment rate	5.7	4.6	5.1	5.2	5.1	4.9	5.0	4.9	4.7
Not in labor force	77,712	77,550	78,463	76,881	76,610	76,916	77,021	77,271	77,439
Persons who currently want a job	5,136	4,808	5,095	4,974	4,945	4,994	4,887	5,167	4,962
Men, 16 years and over									
Civilian noninstitutional population	108,489	109,863	109,936	108,489	109,475	109,616	109,745	109,863	109,936
Civilian labor force	78,574	80,140	79,814	79,177	80,333	80,249	80,394	80,431	80,525
Participation rate	72.4	72.9	72.6	73.0	73.4	73.2	73.3	73.2	73.2
Employed	73,728	76,287	75,605	74,980	76,257	76,396	76,410	76,529	76,857
Employment-population ratio	68.0	69.4	68.8	69.1	69.7	69.7	69.6	69.7	69.9
Unemployed	4,846	3,854	4,209	4,197	4,076	3,853	3,984	3,902	3,668
Unemployment rate	6.2	4.8	5.3	5.3	5.1	4.8	5.0	4.9	4.6
Not in labor force	29,914	29,722	30,122	29,311	29,142	29,367	29,351	29,432	29,411
Men, 20 years and over									
Civilian noninstitutional population	100,219	101,489	101,560	100,219	101,136	101,265	101,383	101,489	101,560
Civilian labor force	75,322	76,670	76,513	75,650	76,792	76,780	76,722	76,786	76,928
Participation rate	75.2	75.5	75.3	75.5	75.9	75.8	75.7	75.7	75.7
Employed	71,104	73,315	72,864	72,092	73,331	73,500	73,441	73,468	73,844
Employment-population ratio	70.9	72.2	71.7	71.9	72.5	72.6	72.4	72.4	72.7
Unemployed	4,218	3,355	3,648	3,558	3,461	3,281	3,282	3,318	3,084
Unemployment rate	5.6	4.4	4.8	4.7	4.5	4.3	4.3	4.3	4.0
Not in labor force	24,897	24,819	25,047	24,569	24,344	24,485	24,660	24,703	24,631
Women, 16 years and over									
Civilian noninstitutional population	116,348	117,562	117,617	116,348	117,218	117,343	117,459	117,562	117,617
Civilian labor force	68,551	69,734	69,276	68,779	69,750	69,794	69,789	69,722	69,589
Participation rate	58.9	59.3	58.9	59.1	59.5	59.5	59.4	59.3	59.2
Employed	64,953	66,631	65,876	65,254	66,178	66,229	66,200	66,250	66,217
Employment-population ratio	55.8	56.7	56.0	56.1	56.5	56.4	56.4	56.4	56.3
Unemployed	3,598	3,102	3,399	3,525	3,572	3,565	3,588	3,473	3,372
Unemployment rate	5.2	4.4	4.9	5.1	5.1	5.1	5.1	5.0	4.8
Not in labor force	47,798	47,828	48,341	47,569	47,468	47,549	47,670	47,840	48,028
Women, 20 years and over									
Civilian noninstitutional population	108,318	109,425	109,478	108,316	109,114	109,228	109,332	109,425	109,478
Civilian labor force	65,253	66,376	65,929	65,260	66,129	66,175	66,223	66,215	66,022
Participation rate	60.2	60.7	60.2	60.2	60.6	60.6	60.6	60.5	60.3
Employed	62,117	63,669	62,997	62,236	63,074	63,162	63,170	63,249	63,163
Employment-population ratio	57.3	58.2	57.5	57.5	57.8	57.8	57.8	57.8	57.7
Unemployed	3,136	2,707	2,933	3,024	3,055	3,013	3,053	2,966	2,859
Unemployment rate	4.8	4.1	4.4	4.6	4.6	4.6	4.6	4.5	4.3
Not in labor force	43,063	43,048	43,548	43,056	42,985	43,053	43,109	43,209	43,456
Both sexes, 16 to 19 years									
Civilian noninstitutional population	16,302	16,511	16,515	16,302	16,443	16,465	16,489	16,511	16,515
Civilian labor force	6,550	6,828	6,648	7,046	7,163	7,088	7,238	7,152	7,164
Participation rate	40.2	41.4	40.3	43.2	43.6	43.0	43.9	43.3	43.4
Employed	5,460	5,934	5,620	5,906	6,030	5,964	6,000	6,061	6,067
Employment-population ratio	33.5	35.9	34.0	36.2	36.7	36.2	36.4	36.7	36.7
Unemployed	1,090	894	1,028	1,140	1,133	1,124	1,238	1,091	1,097
Unemployment rate	16.6	13.1	15.5	16.2	15.8	15.9	17.1	15.2	15.3
Not in labor force	9,752	9,683	9,867	9,256	9,281	9,377	9,251	9,359	9,352

[1] The population figures are not adjusted for seasonal variation; therefore, identical numbers appear in the unadjusted and seasonally adjusted columns.

NOTE: Beginning in January 2006, data reflect revised population controls used in the household survey.

Table A-2. Employment status of the civilian population by race, sex, and age

(Numbers in thousands)

Employment status, race, sex, and age	Not seasonally adjusted			Seasonally adjusted [1]					
	Jan. 2005	Dec. 2005	Jan. 2006	Jan. 2005	Sept. 2005	Oct. 2005	Nov. 2005	Dec. 2005	Jan. 2006
WHITE									
Civilian noninstitutional population	183,640	185,327	185,436	183,640	184,851	185,028	185,187	185,327	185,436
Civilian labor force	120,778	122,752	122,351	121,490	122,843	122,810	122,813	122,994	123,168
Participation rate	65.8	66.2	66.0	66.2	66.5	66.4	66.3	66.4	66.4
Employed	114,756	117,803	116,745	116,072	117,354	117,396	117,598	117,729	118,071
Employment-population ratio	62.5	63.6	63.0	63.2	63.5	63.4	63.5	63.5	63.7
Unemployed	6,023	4,949	5,605	5,419	5,489	5,415	5,215	5,264	5,097
Unemployment rate	5.0	4.0	4.6	4.5	4.5	4.4	4.2	4.3	4.1
Not in labor force	62,862	62,575	63,085	62,150	62,008	62,218	62,374	62,333	62,268
Men, 20 years and over									
Civilian labor force	62,929	63,925	63,890	63,264	63,849	63,901	63,827	64,028	64,250
Participation rate	75.7	76.1	76.0	76.1	76.2	76.2	76.0	76.2	76.4
Employed	59,849	61,455	61,100	60,713	61,280	61,465	61,498	61,586	61,924
Employment-population ratio	72.0	73.2	72.7	73.0	73.2	73.3	73.3	73.3	73.7
Unemployed	3,080	2,470	2,790	2,551	2,568	2,436	2,328	2,441	2,326
Unemployment rate	4.9	3.9	4.4	4.0	4.0	3.8	3.6	3.8	3.6
Women, 20 years and over									
Civilian labor force	52,399	53,175	52,900	52,335	52,971	52,998	53,037	53,067	52,913
Participation rate	59.6	60.0	59.7	59.6	59.9	59.9	59.9	59.9	59.7
Employed	50,272	51,365	50,847	50,301	50,851	50,856	50,976	51,034	50,938
Employment-population ratio	57.2	58.0	57.4	57.2	57.5	57.5	57.6	57.6	57.5
Unemployed	2,128	1,810	2,052	2,034	2,120	2,141	2,061	2,034	1,974
Unemployment rate	4.1	3.4	3.9	3.9	4.0	4.0	3.9	3.8	3.7
Both sexes, 16 to 19 years									
Civilian labor force	5,450	5,651	5,561	5,692	6,023	5,912	5,949	5,899	6,005
Participation rate	43.1	44.3	43.6	46.8	47.4	46.5	46.7	46.3	47.1
Employed	4,636	4,983	4,798	5,058	5,222	5,074	5,123	5,110	5,209
Employment-population ratio	36.7	39.1	37.6	40.0	41.1	39.9	40.2	40.1	40.8
Unemployed	815	669	763	834	801	838	826	789	797
Unemployment rate	14.9	11.8	13.7	14.2	13.3	14.2	13.9	13.4	13.3
BLACK OR AFRICAN AMERICAN									
Civilian noninstitutional population	26,306	26,744	26,788	26,306	26,618	26,663	26,705	26,744	26,788
Civilian labor force	16,538	17,001	16,764	16,723	17,068	17,150	17,118	16,979	16,982
Participation rate	62.9	63.6	62.6	63.6	64.1	64.3	64.1	63.5	63.4
Employed	14,720	15,487	15,231	14,965	15,455	15,591	15,299	15,397	15,476
Employment-population ratio	56.0	57.9	56.9	56.9	58.1	58.5	57.3	57.6	57.8
Unemployed	1,818	1,514	1,532	1,758	1,613	1,559	1,819	1,582	1,506
Unemployment rate	11.0	8.9	9.1	10.5	9.5	9.1	10.6	9.3	8.9
Not in labor force	9,768	9,743	10,024	9,584	9,549	9,513	9,587	9,766	9,806
Men, 20 years and over									
Civilian labor force	7,383	7,580	7,473	7,402	7,672	7,659	7,556	7,553	7,520
Participation rate	69.9	70.3	69.4	70.0	71.7	71.4	70.4	70.2	69.8
Employed	6,526	6,897	6,840	6,641	7,006	7,006	6,849	6,903	6,959
Employment-population ratio	61.7	64.1	63.5	62.8	65.5	65.3	63.8	64.2	64.6
Unemployed	858	663	633	761	666	653	707	651	561
Unemployment rate	11.6	8.8	8.5	10.3	8.7	8.5	9.4	8.6	7.5
Women, 20 years and over									
Civilian labor force	8,439	8,667	8,587	8,532	8,664	8,726	8,714	8,633	8,681
Participation rate	63.5	64.3	63.7	64.2	64.6	64.9	64.8	64.1	64.4
Employed	7,683	7,965	7,892	7,777	7,959	8,069	7,927	7,896	7,981
Employment-population ratio	57.8	59.1	58.5	58.5	59.3	60.0	58.9	58.6	59.2
Unemployed	756	702	695	755	705	658	787	738	700
Unemployment rate	9.0	8.1	8.1	8.8	8.1	7.5	9.0	8.5	8.1
Both sexes, 16 to 19 years									
Civilian labor force	716	774	703	789	733	765	848	792	781
Participation rate	29.2	30.7	27.9	32.2	29.4	30.6	33.8	31.5	30.9
Employed	512	624	499	548	490	517	523	598	536
Employment-population ratio	20.9	24.8	19.8	22.3	19.7	20.7	20.8	23.8	21.2
Unemployed	204	150	204	242	242	248	326	194	245
Unemployment rate	28.6	19.3	29.0	30.7	33.1	32.4	38.4	24.4	31.4
ASIAN									
Civilian noninstitutional population	9,681	10,036	9,990	(2)	(2)	(2)	(2)	(2)	(2)
Civilian labor force	6,386	6,652	6,565	(2)	(2)	(2)	(2)	(2)	(2)
Participation rate	66.1	66.3	65.7	(2)	(2)	(2)	(2)	(2)	(2)
Employed	6,115	6,400	6,357	(2)	(2)	(2)	(2)	(2)	(2)
Employment-population ratio	63.3	63.8	63.6	(2)	(2)	(2)	(2)	(2)	(2)
Unemployed	271	252	208	(2)	(2)	(2)	(2)	(2)	(2)
Unemployment rate	4.2	3.8	3.2	(2)	(2)	(2)	(2)	(2)	(2)
Not in labor force	3,274	3,384	3,425	(2)	(2)	(2)	(2)	(2)	(2)

[1] The population figures are not adjusted for seasonal variation; therefore, identical numbers appear in the unadjusted and seasonally adjusted columns.
[2] Data not available.

NOTE: Estimates for the above race groups will not sum to totals shown in table A-1 because data are not presented for all races. Beginning in January 2006, data reflect revised population controls used in the household survey.

Table A-3. Employment status of the Hispanic or Latino population by sex and age

(Numbers in thousands)

Employment status, sex, and age	Not seasonally adjusted			Seasonally adjusted [1]					
	Jan. 2005	Dec. 2005	Jan. 2006	Jan. 2005	Sept. 2005	Oct. 2005	Nov. 2005	Dec. 2005	Jan. 2006
HISPANIC OR LATINO ETHNICITY									
Civilian noninstitutional population	28,642	29,645	29,822	28,642	29,361	29,456	29,562	29,645	29,622
Civilian labor force	19,170	20,316	20,272	19,402	19,944	20,047	20,214	20,292	20,528
Participation rate	66.9	68.5	68.4	67.7	67.9	68.1	68.4	68.4	69.3
Employed	17,839	19,084	18,969	18,208	18,647	18,871	18,991	19,066	19,344
Employment-population ratio	62.3	64.4	64.0	63.6	63.5	64.1	64.3	64.3	65.3
Unemployed	1,331	1,232	1,303	1,194	1,297	1,176	1,223	1,226	1,184
Unemployment rate	6.9	6.1	6.4	6.2	6.5	5.9	6.1	6.0	5.8
Not in labor force	9,472	9,329	9,349	9,239	9,417	9,409	9,338	9,353	9,094
Men, 20 years and over									
Civilian labor force	11,089	11,664	11,647	(2)	(2)	(2)	(2)	(2)	(2)
Participation rate	83.1	84.3	84.3	(2)	(2)	(2)	(2)	(2)	(2)
Employed	10,404	11,071	11,002	(2)	(2)	(2)	(2)	(2)	(2)
Employment-population ratio	78.0	80.0	79.6	(2)	(2)	(2)	(2)	(2)	(2)
Unemployed	685	593	645	(2)	(2)	(2)	(2)	(2)	(2)
Unemployment rate	6.2	5.1	5.5	(2)	(2)	(2)	(2)	(2)	(2)
Women, 20 years and over									
Civilian labor force	7,188	7,590	7,605	(2)	(2)	(2)	(2)	(2)	(2)
Participation rate	56.8	58.1	58.2	(2)	(2)	(2)	(2)	(2)	(2)
Employed	6,717	7,135	7,142	(2)	(2)	(2)	(2)	(2)	(2)
Employment-population ratio	53.1	54.6	54.7	(2)	(2)	(2)	(2)	(2)	(2)
Unemployed	471	455	464	(2)	(2)	(2)	(2)	(2)	(2)
Unemployment rate	6.5	6.0	6.1	(2)	(2)	(2)	(2)	(2)	(2)
Both sexes, 16 to 19 years									
Civilian labor force	893	1,061	1,020	(2)	(2)	(2)	(2)	(2)	(2)
Participation rate	33.7	38.7	37.3	(2)	(2)	(2)	(2)	(2)	(2)
Employed	718	878	825	(2)	(2)	(2)	(2)	(2)	(2)
Employment-population ratio	27.1	32.0	30.2	(2)	(2)	(2)	(2)	(2)	(2)
Unemployed	175	184	195	(2)	(2)	(2)	(2)	(2)	(2)
Unemployment rate	19.6	17.3	19.1	(2)	(2)	(2)	(2)	(2)	(2)

[1] The population figures are not adjusted for seasonal variation; therefore, identical numbers appear in the unadjusted and seasonally adjusted columns.
[2] Data not available.

NOTE: Persons whose ethnicity is identified as Hispanic or Latino may be of any race. Beginning in January 2006, data reflect revised population controls used in the household survey.

Table A-4. Employment status of the civilian population 25 years and over by educational attainment

(Numbers in thousands)

Educational attainment	Not seasonally adjusted			Seasonally adjusted					
	Jan. 2005	Dec. 2005	Jan. 2006	Jan. 2005	Sept. 2005	Oct. 2005	Nov. 2005	Dec. 2005	Jan. 2006
Less than a high school diploma									
Civilian labor force	12,562	12,490	12,621	12,597	12,729	12,502	12,529	12,388	12,628
Participation rate	44.7	45.6	45.9	44.8	45.2	45.4	45.4	45.3	46.0
Employed	11,417	11,499	11,580	11,638	11,690	11,611	11,602	11,465	11,742
Employment-population ratio	40.6	42.0	42.1	41.4	41.5	42.1	42.1	41.9	42.7
Unemployed	1,144	991	1,041	959	1,039	891	927	923	886
Unemployment rate	9.1	7.9	8.2	7.6	8.2	7.1	7.4	7.5	7.0
High school graduates, no college [1]									
Civilian labor force	38,002	38,167	38,018	37,870	38,324	38,487	38,372	38,173	38,001
Participation rate	62.6	63.1	62.5	62.4	63.9	63.8	63.4	63.1	62.5
Employed	35,907	36,445	36,075	36,086	36,404	36,627	36,547	36,417	36,324
Employment-population ratio	59.2	60.3	59.3	59.5	60.7	60.8	60.4	60.2	59.7
Unemployed	2,098	1,722	1,943	1,784	1,921	1,840	1,825	1,756	1,678
Unemployment rate	5.5	4.5	5.1	4.7	5.0	4.8	4.8	4.6	4.4
Some college or associate degree									
Civilian labor force	34,254	35,329	35,265	34,523	35,148	35,310	35,411	35,498	35,535
Participation rate	72.4	72.0	71.9	73.0	72.4	72.3	72.3	72.4	72.5
Employed	32,740	33,978	33,917	33,125	33,866	33,967	34,059	34,115	34,290
Employment-population ratio	69.2	69.3	69.2	70.0	69.8	69.6	69.5	69.6	69.9
Unemployed	1,514	1,350	1,348	1,398	1,282	1,343	1,352	1,383	1,246
Unemployment rate	4.4	3.8	3.8	4.1	3.6	3.8	3.8	3.9	3.5
Bachelor's degree and higher [2]									
Civilian labor force	40,789	42,100	41,818	40,764	41,558	41,616	41,600	42,097	41,837
Participation rate	78.2	78.4	78.2	78.1	78.1	77.7	78.1	78.4	78.3
Employed	39,760	41,262	40,907	39,777	40,588	40,670	40,665	41,187	40,955
Employment-population ratio	76.2	76.6	76.5	76.2	76.3	75.9	76.3	76.7	76.6
Unemployed	1,029	838	911	987	970	946	936	910	882
Unemployment rate	2.5	2.0	2.2	2.4	2.3	2.3	2.2	2.2	2.1

[1] Includes persons with a high school diploma or equivalent.
[2] Includes persons with bachelor's, master's, professional, and doctoral degrees.

NOTE: Beginning in January 2006, data reflect revised population controls used in the household survey.

Table A-5. Employed persons by class of worker and part-time status

(In thousands)

Category	Not seasonally adjusted			Seasonally adjusted					
	Jan. 2005	Dec. 2005	Jan. 2006	Jan. 2005	Sept. 2005	Oct. 2005	Nov. 2005	Dec. 2005	Jan. 2006
CLASS OF WORKER									
Agriculture and related industries	1,920	1,942	1,970	2,138	2,140	2,126	2,154	2,130	2,198
Wage and salary workers	1,042	1,058	1,118	1,197	1,118	1,161	1,187	1,187	1,268
Self-employed workers	865	868	834	915	978	936	928	921	897
Unpaid family workers	13	15	17	([1])	([1])	([1])	([1])	([1])	([1])
Nonagricultural industries	136,761	140,978 r	139,512	138,076	140,421	140,577	140,427	140,638	140,862
Wage and salary workers	127,208	131,616	129,918	128,438	130,937	131,123	131,001	131,170	131,185
Government	20,363	20,252	19,970	20,312	20,255	20,330	20,224	20,192	19,952
Private industries	106,846	111,364	109,948	108,173	110,688	110,799	110,787	111,021	111,268
Private households	800	782	839	([1])	([1])	([1])	([1])	([1])	([1])
Other industries	106,045	110,582	109,109	107,372	109,858	109,968	110,039	110,261	110,440
Self-employed workers	9,449	9,294	9,534	9,545	9,359	9,356	9,274	9,370	9,550
Unpaid family workers	104	66	59	([1])	([1])	([1])	([1])	([1])	([1])
PERSONS AT WORK PART TIME [2]									
All industries:									
Part time for economic reasons	4,903	4,183	4,597	4,395	4,565	4,240	4,175	4,138	4,133
Slack work or business conditions	3,214	2,654	3,108	2,759	2,893	2,643	2,595	2,541	2,649
Could only find part-time work	1,314	1,132	1,182	1,332	1,331	1,299	1,246	1,248	1,226
Part time for noneconomic reasons	19,207	20,420	19,906	19,088	19,581	19,696	19,612	19,582	19,706
Nonagricultural industries:									
Part time for economic reasons	4,793	4,069	4,513	4,303	4,500	4,161	4,105	4,051	4,064
Slack work or business conditions	3,145	2,591	3,063	2,686	2,846	2,592	2,567	2,508	2,606
Could only find part-time work	1,304	1,129	1,170	1,318	1,335	1,284	1,230	1,230	1,198
Part time for noneconomic reasons	18,866	20,040	19,545	18,738	19,207	19,255	19,235	19,214	19,368

[1] Data not available.

[2] Persons at work excludes employed persons who were absent from their jobs during the entire reference week for reasons such as vacation, illness, or industrial dispute. Part time for noneconomic reasons excludes persons who usually work full time but worked only 1 to 34 hours during the reference week for reasons such as holidays, illness, and bad weather.

NOTE: Detail for the seasonally adjusted data shown in this table will not necessarily add to totals because of the independent seasonal adjustment of the various series. Beginning in January 2006, data reflect revised population controls used in the household survey.

Table A-6. Selected employment indicators

(In thousands)

Characteristic	Not seasonally adjusted			Seasonally adjusted					
	Jan. 2005	Dec. 2005	Jan. 2006	Jan. 2005	Sept. 2005	Oct. 2005	Nov. 2005	Dec. 2005	Jan. 2006
AGE AND SEX									
Total, 16 years and over	138,682	142,918	141,481	140,234	142,435	142,625	142,611	142,779	143,074
16 to 19 years	5,460	5,934	5,620	5,906	6,030	5,964	6,000	6,061	6,067
16 to 17 years	2,089	2,270	2,099	2,269	2,290	2,290	2,285	2,334	2,280
18 to 19 years	3,371	3,664	3,522	3,636	3,739	3,673	3,694	3,713	3,788
20 years and over	133,221	136,984	135,861	134,328	136,405	136,661	136,610	136,717	137,007
20 to 24 years	13,398	13,799	13,382	13,706	13,841	13,945	13,931	13,840	13,713
25 years and over	119,824	123,185	122,479	120,691	122,601	122,719	122,731	122,906	123,302
25 to 54 years	97,330	99,104	98,514	98,061	98,852	98,834	98,849	98,934	99,216
25 to 34 years	30,345	30,878	30,541	30,667	30,714	30,864	30,920	30,866	30,860
35 to 44 years	34,353	34,681	34,388	34,599	34,821	34,601	34,513	34,581	34,632
45 to 54 years	32,632	33,547	33,585	32,795	33,317	33,369	33,416	33,486	33,724
55 years and over	22,493	24,081	23,965	22,629	23,748	23,885	23,883	23,972	24,086
Men, 16 years and over	73,728	76,287	75,605	74,980	76,257	76,396	76,410	76,529	76,857
16 to 19 years	2,624	2,972	2,741	2,888	2,926	2,896	2,970	3,061	3,013
16 to 17 years	942	1,041	942	1,067	1,053	1,043	1,082	1,090	1,064
18 to 19 years	1,682	1,931	1,799	1,816	1,865	1,848	1,890	1,951	1,943
20 years and over	71,104	73,315	72,864	72,092	73,331	73,500	73,441	73,468	73,844
20 to 24 years	6,966	7,280	7,057	7,188	7,247	7,310	7,330	7,358	7,297
25 years and over	64,139	66,034	65,807	64,930	66,005	66,192	66,142	66,157	66,534
25 to 54 years	52,184	53,239	52,985	52,861	53,324	53,429	53,419	53,375	53,621
25 to 34 years	16,646	17,032	16,855	16,905	17,033	17,107	17,103	17,080	17,106
35 to 44 years	18,556	18,710	18,616	18,773	18,808	18,800	18,745	18,739	18,818
45 to 54 years	16,982	17,497	17,514	17,183	17,483	17,522	17,571	17,558	17,697
55 years and over	11,954	12,795	12,822	12,069	12,711	12,763	12,723	12,782	12,913
Women, 16 years and over	64,953	66,631	65,876	65,254	66,178	66,229	66,200	66,250	66,217
16 to 19 years	2,836	2,962	2,879	3,018	3,104	3,068	3,031	3,000	3,054
16 to 17 years	1,148	1,229	1,157	1,202	1,237	1,247	1,223	1,245	1,216
18 to 19 years	1,688	1,733	1,723	1,820	1,874	1,825	1,804	1,762	1,845
20 years and over	62,117	63,669	62,997	62,236	63,074	63,162	63,170	63,249	63,163
20 to 24 years	6,432	6,519	6,325	6,519	6,594	6,635	6,601	6,484	6,415
25 years and over	55,685	57,150	56,672	55,761	56,568	56,527	56,583	56,749	56,769
25 to 54 years	45,146	45,865	45,529	45,200	45,528	45,405	45,430	45,559	45,596
25 to 34 years	13,699	13,844	13,685	13,762	13,680	13,757	13,817	13,786	13,754
35 to 44 years	15,797	15,971	15,772	15,826	16,013	15,801	15,768	15,843	15,814
45 to 54 years	15,650	16,050	16,071	15,612	15,835	15,847	15,845	15,930	16,027
55 years and over	10,539	11,286	11,143	10,561	11,037	11,122	11,159	11,190	11,173
MARITAL STATUS									
Married men, spouse present	44,853	45,708	45,530	45,195	45,457	45,634	45,480	45,469	45,790
Married women, spouse present	34,880	35,438	35,388	34,696	34,943	34,868	34,910	34,948	35,187
Women who maintain families	8,854	9,026	8,711	([1])	([1])	([1])	([1])	([1])	([1])
FULL- OR PART-TIME STATUS									
Full-time workers [2]	114,181	117,791	116,395	115,839	117,469	117,783	117,860	118,135	118,166
Part-time workers [3]	24,501	25,127	25,086	24,254	25,009	24,898	24,814	24,743	24,931
MULTIPLE JOBHOLDERS									
Total multiple jobholders	7,225	7,665	7,428	7,446	7,816	7,584	7,545	7,473	7,603
Percent of total employed	5.2	5.4	5.3	5.3	5.3	5.3	5.3	5.2	5.3

[1] Data not available.

[2] Employed full-time workers are persons who usually work 35 hours or more per week.

[3] Employed part-time workers are persons who usually work less than 35 hours per week.

NOTE: Detail for the seasonally adjusted data shown in this table will not necessarily add to totals because of the independent seasonal adjustment of the various series. Beginning in January 2006, data reflect revised population controls used in the household survey.

Table A-7. Selected unemployment indicators, seasonally adjusted

Characteristic	Number of unemployed persons (in thousands)			Unemployment rates [1]					
	Jan. 2005	Dec. 2005	Jan. 2006	Jan. 2005	Sept. 2005	Oct. 2005	Nov. 2005	Dec. 2005	Jan. 2006
AGE AND SEX									
Total, 16 years and over	7,723	7,375	7,040	5.2	5.1	4.9	5.0	4.9	4.7
16 to 19 years	1,140	1,091	1,097	16.2	15.8	15.9	17.1	15.2	15.3
16 to 17 years	542	507	451	19.3	18.8	18.7	21.4	17.8	16.5
18 to 19 years	611	580	635	14.4	13.9	14.2	14.2	13.5	14.4
20 years and over	6,582	6,284	5,943	4.7	4.6	4.4	4.4	4.4	4.2
20 to 24 years	1,433	1,283	1,224	9.5	8.7	8.5	8.4	8.5	8.2
25 years and over	5,155	5,010	4,737	4.1	4.1	3.9	3.9	3.9	3.7
25 to 54 years	4,323	4,227	3,924	4.2	4.2	4.1	4.1	4.1	3.8
25 to 34 years	1,639	1,625	1,482	5.1	5.4	4.8	5.0	5.0	4.6
35 to 44 years	1,477	1,381	1,317	4.1	3.7	3.9	3.9	3.8	3.7
45 to 54 years	1,207	1,221	1,125	3.5	3.5	3.6	3.5	3.5	3.2
55 years and over	826	808	791	3.5	3.6	3.2	3.1	3.3	3.2
Men, 16 years and over	4,197	3,902	3,668	5.3	5.1	4.8	5.0	4.9	4.6
16 to 19 years	639	584	584	18.1	17.4	16.5	19.1	16.0	16.2
16 to 17 years	305	269	218	22.2	21.3	18.1	23.6	19.8	17.0
18 to 19 years	345	312	355	15.9	15.1	15.5	15.6	13.8	15.4
20 years and over	3,558	3,318	3,084	4.7	4.5	4.3	4.3	4.3	4.0
20 to 24 years	818	743	711	10.2	9.8	9.4	9.1	9.2	8.9
25 years and over	2,731	2,583	2,386	4.0	3.9	3.7	3.7	3.8	3.5
25 to 54 years	2,246	2,154	1,960	4.1	4.0	3.8	3.8	3.9	3.5
25 to 34 years	840	785	748	4.7	5.0	4.4	4.5	4.4	4.2
35 to 44 years	749	725	625	3.8	3.5	3.5	3.6	3.7	3.2
45 to 54 years	658	643	588	3.7	3.5	3.5	3.3	3.5	3.2
55 years and over	485	430	426	3.9	3.3	3.2	3.1	3.3	3.2
Women, 16 years and over	3,525	3,473	3,372	5.1	5.1	5.1	5.1	5.0	4.8
16 to 19 years	501	507	513	14.2	14.3	15.2	15.0	14.4	14.4
16 to 17 years	237	238	233	16.5	16.6	19.1	19.5	16.1	16.1
18 to 19 years	267	268	281	12.8	12.6	12.8	12.7	13.2	13.2
20 years and over	3,024	2,966	2,859	4.6	4.6	4.6	4.6	4.5	4.3
20 to 24 years	615	540	514	8.6	7.4	7.5	7.5	7.7	7.4
25 years and over	2,424	2,427	2,351	4.2	4.3	4.2	4.3	4.1	4.0
25 to 54 years	2,076	2,073	1,963	4.4	4.4	4.4	4.5	4.4	4.1
25 to 34 years	799	840	734	5.5	5.8	5.3	5.7	5.7	5.1
35 to 44 years	728	656	692	4.4	4.0	4.4	4.2	4.0	4.2
45 to 54 years	549	577	537	3.4	3.6	3.7	3.7	3.5	3.2
55 years and over [2]	350	340	381	3.3	3.9	3.1	3.1	2.9	3.3
MARITAL STATUS									
Married men, spouse present	1,405	1,219	1,136	3.0	2.7	2.6	2.6	2.6	2.4
Married women, spouse present	1,160	1,151	1,102	3.2	3.4	3.3	3.3	3.2	3.0
Women who maintain families [2]	788	671	778	8.2	7.6	7.3	7.2	6.9	8.2
FULL- OR PART-TIME STATUS									
Full-time workers [3]	6,397	5,920	5,782	5.2	5.0	4.9	4.9	4.8	4.7
Part-time workers [4]	1,336	1,454	1,261	5.2	5.3	5.4	5.7	5.5	4.8

[1] Unemployment as a percent of the civilian labor force.

[2] Not seasonally adjusted.

[3] Full-time workers are unemployed persons who have expressed a desire to work full time (35 hours or more per week) or are on layoff from full-time jobs.

[4] Part-time workers are unemployed persons who have expressed a desire to work part time (less than 35 hours per week) or are on layoff from part-time jobs.

NOTE: Detail shown in this table will not necessarily add to totals because of the independent seasonal adjustment of the various series. Beginning in January 2006, data reflect revised population controls used in the household survey.

Table A-8. Unemployed persons by reason for unemployment

(Numbers in thousands)

Reason	Not seasonally adjusted			Seasonally adjusted					
	Jan. 2005	Dec. 2005	Jan. 2006	Jan. 2005	Sept. 2005	Oct. 2005	Nov. 2005	Dec. 2005	Jan. 2006
NUMBER OF UNEMPLOYED									
Job losers and persons who completed temporary jobs	4,771	3,622	3,990	3,982	3,697	3,508	3,455	3,486	3,336
On temporary layoff	1,473	1,013	1,319	962	970	944	899	935	873
Not on temporary layoff	3,299	2,609	2,671	3,020	2,726	2,564	2,556	2,552	2,462
Permanent job losers	2,360	1,866	1,861	(1)	(1)	(1)	(1)	(1)	(1)
Persons who completed temporary jobs	938	743	810	(1)	(1)	(1)	(1)	(1)	(1)
Job leavers	820	752	831	815	874	889	900	841	839
Reentrants	2,310	2,083	2,252	2,336	2,423	2,349	2,538	2,430	2,314
New entrants	542	499	535	621	626	654	679	644	622
PERCENT DISTRIBUTION									
Total unemployed	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Job losers and persons who completed temporary jobs	56.5	52.1	52.4	51.4	48.5	47.4	45.6	47.1	46.9
On temporary layoff	17.4	14.6	17.3	12.4	12.7	12.8	11.9	12.6	12.3
Not on temporary layoff	39.1	37.5	35.1	39.0	35.8	34.7	33.8	34.5	34.6
Job leavers	9.7	10.8	10.9	10.5	11.5	12.0	11.9	11.4	11.8
Reentrants	27.4	30.0	29.6	30.1	31.8	31.7	33.5	32.8	32.5
New entrants	6.4	7.2	7.0	8.0	8.2	8.8	9.0	8.7	8.7
UNEMPLOYED AS A PERCENT OF THE CIVILIAN LABOR FORCE									
Job losers and persons who completed temporary jobs	3.2	2.4	2.7	2.7	2.5	2.3	2.3	2.3	2.2
Job leavers	.6	.5	.6	.6	.6	.6	.6	.6	.6
Reentrants	1.6	1.4	1.5	1.6	1.6	1.6	1.7	1.6	1.5
New entrants	.4	.3	.4	.4	.4	.4	.5	.4	.4

[1] Data not available.

NOTE: Beginning in January 2006, data reflect revised population controls used in the household survey.

Table A-9. Unemployed persons by duration of unemployment

(Numbers in thousands)

Duration	Not seasonally adjusted			Seasonally adjusted					
	Jan. 2005	Dec. 2005	Jan. 2006	Jan. 2005	Sept. 2005	Oct. 2005	Nov. 2005	Dec. 2005	Jan. 2006
NUMBER OF UNEMPLOYED									
Less than 5 weeks	2,948	2,443	2,833	2,597	2,751	2,708	2,779	2,764	2,556
5 to 14 weeks	2,527	2,189	2,433	2,348	2,253	2,263	2,268	2,240	2,263
15 weeks and over	2,969	2,324	2,343	2,821	2,584	2,477	2,492	2,417	2,241
15 to 26 weeks	1,269	1,014	1,143	1,191	1,120	1,045	1,108	1,068	1,090
27 weeks and over	1,700	1,310	1,200	1,630	1,464	1,432	1,383	1,350	1,151
Average (mean) duration, in weeks	18.5	17.5	16.0	19.2	18.2	18.0	17.6	17.3	16.8
Median duration, in weeks	9.2	8.6	8.3	9.3	8.5	8.6	8.5	8.5	8.4
PERCENT DISTRIBUTION									
Total unemployed	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Less than 5 weeks	34.9	35.1	37.2	33.4	36.3	36.4	36.9	37.2	36.2
5 to 14 weeks	29.9	31.5	32.0	30.2	29.7	30.4	30.1	30.2	32.1
15 weeks and over	35.2	33.4	30.8	36.3	34.1	33.3	33.0	32.6	31.7
15 to 26 weeks	15.0	14.6	15.0	15.3	14.8	14.0	14.7	14.4	15.4
27 weeks and over	20.1	18.8	15.8	21.0	19.3	19.2	18.3	18.2	16.3

NOTE: Beginning in January 2006, data reflect revised population controls used in the household survey.

Table A-10. Employed and unemployed persons by occupation, not seasonally adjusted

(Numbers in thousands)

Occupation	Employed		Unemployed		Unemployment rates	
	Jan. 2005	Jan. 2006	Jan. 2005	Jan. 2006	Jan. 2005	Jan. 2006
Total, 16 years and over [1]	138,682	141,481	8,444	7,608	5.7	5.1
Management, professional, and related occupations	48,878	50,131	1,215	1,078	2.4	2.1
Management, business, and financial operations occupations	20,063	21,074	482	424	2.3	2.0
Professional and related occupations	28,815	29,056	733	654	2.5	2.2
Service occupations	22,276	22,550	1,763	1,549	7.3	6.4
Sales and office occupations	35,284	35,799	1,982	1,761	5.3	4.7
Sales and related occupations	15,936	16,315	950	949	5.6	5.5
Office and administrative support occupations	19,348	19,484	1,031	812	5.1	4.0
Natural resources, construction, and maintenance occupations	14,327	15,088	1,487	1,275	9.4	7.8
Farming, fishing, and forestry occupations	798	851	166	161	17.2	15.9
Construction and extraction occupations	8,376	9,102	1,082	915	11.4	9.1
Installation, maintenance, and repair occupations	5,154	5,135	240	199	4.4	3.7
Production, transportation, and material moving occupations	17,916	17,914	1,414	1,365	7.3	7.1
Production occupations	9,372	9,450	721	665	7.1	6.6
Transportation and material moving occupations	8,544	8,464	693	700	7.5	7.6

[1] Persons with no previous work experience and persons whose last job was in the Armed Forces are included in the unemployed total.
NOTE: Beginning in January 2006, data reflect revised population controls used in the household survey.

Table A-11. Unemployed persons by industry and class of worker, not seasonally adjusted

Industry and class of worker	Number of unemployed persons (in thousands)		Unemployment rates	
	Jan. 2005	Jan. 2006	Jan. 2005	Jan. 2006
Total, 16 years and over [1]	8,444	7,608	5.7	5.1
Nonagricultural private wage and salary workers	6,849	6,135	6.0	5.3
Mining	29	26	4.9	3.9
Construction	1,079	868	11.8	9.0
Manufacturing	889	778	5.3	4.6
Durable goods	547	450	5.1	4.1
Nondurable goods	341	328	5.7	5.4
Wholesale and retail trade	1,302	1,203	6.3	5.7
Transportation and utilities	276	287	5.0	5.0
Information	168	105	5.4	3.3
Financial activities	252	233	2.7	2.4
Professional and business services	958	825	7.6	6.5
Education and health services	613	593	3.4	3.2
Leisure and hospitality	993	910	8.7	8.1
Other services	290	308	4.7	4.9
Agriculture and related private wage and salary workers	153	140	13.2	11.5
Government workers	555	457	2.6	2.2
Self employed and unpaid family workers	346	341	3.2	3.2

[1] Persons with no previous work experience are included in the unemployed total.
NOTE: Beginning in January 2006, data reflect revised population controls used in the household survey.

Table A-12. Alternative measures of labor underutilization

(Percent)

Measure	Not seasonally adjusted			Seasonally adjusted					
	Jan. 2005	Dec. 2005	Jan. 2006	Jan. 2005	Sept. 2005	Oct. 2005	Nov. 2005	Dec. 2005	Jan. 2006
U-1 Persons unemployed 15 weeks or longer, as a percent of the civilian labor force	2.0	1.6	1.6	1.9	1.7	1.7	1.7	1.6	1.5
U-2 Job losers and persons who completed temporary jobs, as a percent of the civilian labor force	3.2	2.4	2.7	2.7	2.5	2.3	2.3	2.3	2.2
U-3 Total unemployed, as a percent of the civilian labor force (official unemployment rate)	5.7	4.6	5.1	5.2	5.1	4.9	5.0	4.9	4.7
U-4 Total unemployed plus discouraged workers, as a percent of the civilian labor force plus discouraged workers	6.1	4.9	5.4	5.5	5.3	5.2	5.3	5.2	4.9
U-5 Total unemployed, plus discouraged workers, plus all other marginally attached workers, as a percent of the civilian labor force plus all marginally attached workers	6.9	5.6	6.1	6.4	6.0	5.8	5.9	5.9	5.7
U-6 Total unemployed, plus all marginally attached workers, plus total employed part time for economic reasons, as a percent of the civilian labor force plus all marginally attached workers	10.2	8.4	9.2	9.3	9.0	8.6	8.7	8.6	8.4

NOTE: Marginally attached workers are persons who currently are neither working nor looking for work but indicate that they want and are available for a job and have looked for work sometime in the recent past. Discouraged workers, a subset of the marginally attached, have given a job-market related reason for not currently looking for a job. Persons employed part time for economic reasons are those who want and are available for full-time work but have had to settle for a part-time schedule. For further information, see "BLS introduces new range of alternative unemployment measures," in the October 1995 issue of the *Monthly Labor Review*. Beginning in January 2006, data reflect revised population controls used in the household survey.

Table A-13. Persons not in the labor force and multiple jobholders by sex, not seasonally adjusted

(Numbers in thousands)

Category	Total		Men		Women	
	Jan. 2005	Jan. 2006	Jan. 2005	Jan. 2006	Jan. 2005	Jan. 2006
NOT IN THE LABOR FORCE						
Total not in the labor force	77,712	78,463	29,914	30,122	47,798	48,341
Persons who currently want a job	5,136	5,095	2,433	2,293	2,703	2,802
Searched for work and available to work now [1]	1,804	1,644	981	828	823	815
Reason not currently looking:						
Discouragement over job prospects [2]	515	396	338	216	177	180
Reasons other than discouragement [3]	1,289	1,248	643	613	645	636
MULTIPLE JOBHOLDERS						
Total multiple jobholders [4]	7,225	7,428	3,674	3,803	3,551	3,626
Percent of total employed	5.2	5.3	5.0	5.0	5.5	5.5
Primary job full time, secondary job part time	3,782	3,953	2,117	2,211	1,665	1,743
Primary and secondary jobs both part time	1,612	1,682	548	574	1,064	1,108
Primary and secondary jobs both full time	284	289	179	191	104	99
Hours vary on primary or secondary job	1,497	1,488	809	806	688	682

[1] Data refer to persons who have searched for work during the prior 12 months and were available to take a job during the reference week.

[2] Includes thinks no work available, could not find work, lacks schooling or training, employer thinks too young or old, and other types of discrimination.

[3] Includes those who did not actively look for work in the prior 4 weeks for such reasons as school or family responsibilities, ill health, and transportation problems, as well as a small number for which reason for nonparticipation was not determined.

[4] Includes persons who work part time on their primary job and full time on their secondary job(s), not shown separately.

NOTE: Beginning in January 2006, data reflect revised population controls used in the household survey.

Table B-1. Employees on nonfarm payrolls by industry sector and selected industry detail

(In thousands)

Industry	Not seasonally adjusted				Seasonally adjusted						
	Jan. 2005	Nov. 2005	Dec. 2005p	Jan. 2006p	Jan. 2005	Sept. 2005	Oct. 2005	Nov. 2005	Dec. 2005p	Jan. 2006p	Change from: Dec. 2005-Jan. 2006p
Total nonfarm	130,368	135,316	135,044	132,419	132,471	133,840	133,877	134,231	134,371	134,564	193
Total private	108,741	112,985	112,825	110,644	110,756	111,985	112,025	112,351	112,496	112,690	194
Goods-producing	21,414	22,402	22,157	21,758	21,988	22,143	22,179	22,264	22,273	22,331	58
Natural resources and mining	591	645	644	637	605	631	636	641	646	651	5
Logging	65.3	64.2	62.8	60.9	66.9	62.7	62.1	62.1	62.2	62.3	.1
Mining	525.4	581.1	581.1	576.4	537.7	567.9	573.8	579.3	583.3	589.0	5.7
Oil and gas extraction	123.0	128.5	128.2	127.5	124.0	126.5	127.4	128.9	128.3	128.6	.3
Mining, except oil and gas[1]	199.0	216.8	212.3	207.1	207.8	212.7	214.5	215.0	215.3	216.3	1.0
Coal mining	72.1	75.2	75.8	76.0	72.3	74.5	75.1	75.1	75.5	76.2	.7
Support activities for mining	203.4	235.8	240.6	241.8	205.9	228.7	231.9	235.4	239.7	244.1	4.4
Construction	6,682	7,524	7,286	7,016	7,115	7,325	7,347	7,409	7,414	7,460	46
Construction of buildings	1,615.2	1,738.6	1,722.1	1,681.5	1,675.6	1,697.6	1,702.4	1,722.4	1,728.4	1,738.6	10.2
Residential building	900.4	969.1	965.3	945.2	934.1	952.5	952.8	963.6	969.8	977.4	7.6
Nonresidential building	714.8	769.7	756.8	736.3	741.5	745.1	749.6	758.8	758.6	761.2	2.6
Heavy and civil engineering construction	809.9	1,005.3	932.2	869.2	922.3	963.9	965.3	977.1	973.9	982.1	8.2
Specialty trade contractors	4,258.5	4,779.7	4,631.3	4,464.9	4,517.5	4,663.3	4,679.2	4,709.4	4,711.9	4,739.5	27.6
Residential specialty trade contractors	2,069.0	2,370.9	2,316.8	2,232.3	2,192.8	2,308.6	2,326.0	2,339.4	2,348.6	2,369.1	20.5
Nonresidential specialty trade contractors	2,187.5	2,408.8	2,314.5	2,232.6	2,324.7	2,354.5	2,353.2	2,370.0	2,363.3	2,370.4	7.1
Manufacturing	14,141	14,233	14,227	14,105	14,268	14,187	14,196	14,214	14,213	14,220	7
Production workers	9,946	10,131	10,131	10,042	10,054	10,048	10,069	10,103	10,117	10,138	21
Durable goods	8,882	8,970	8,984	8,918	8,943	8,933	8,952	8,960	8,966	8,973	7
Production workers	6,116	6,287	6,317	6,269	6,169	6,218	6,249	6,274	6,298	6,315	17
Wood products	546.0	556.6	556.6	552.2	556.8	552.2	550.7	556.7	559.5	562.3	2.8
Nonmetallic mineral products	486.6	505.6	497.3	490.2	505.5	501.1	500.6	502.0	501.8	508.0	6.2
Primary metals	467.0	470.7	471.6	472.8	467.4	469.7	470.5	471.5	470.0	473.3	3.3
Fabricated metal products	1,505.9	1,525.7	1,527.8	1,522.9	1,512.3	1,521.7	1,520.8	1,524.1	1,526.7	1,529.4	2.7
Machinery	1,149.4	1,163.6	1,169.9	1,159.8	1,150.1	1,163.4	1,174.5	1,164.4	1,163.9	1,160.0	-3.9
Computer and electronic products[1]	1,315.2	1,322.2	1,323.7	1,312.8	1,317.5	1,322.8	1,323.5	1,322.0	1,320.5	1,314.8	-5.7
Computer and peripheral equipment	205.4	206.0	206.1	203.1	204.6	207.4	207.9	206.3	205.5	202.6	-2.9
Communications equipment	149.8	148.4	148.9	146.9	149.2	147.9	148.2	148.0	148.5	146.1	-2.4
Semiconductors and electronic components	448.6	450.2	450.9	447.6	450.9	451.8	450.7	450.6	450.3	449.6	-.7
Electronic instruments	434.3	442.3	442.8	440.9	435.4	440.6	441.6	442.0	441.5	441.9	.4
Electrical equipment and appliances	440.3	434.3	435.6	436.4	440.7	431.8	431.1	434.3	434.9	436.1	1.2
Transportation equipment[1]	1,754.7	1,776.3	1,785.9	1,764.8	1,766.6	1,753.7	1,765.5	1,771.8	1,775.9	1,775.6	-.3
Motor vehicles and parts[2]	1,094.8	1,095.7	1,099.6	1,085.6	1,103.7	1,098.4	1,088.4	1,092.4	1,091.6	1,093.4	1.8
Furniture and related products	568.0	557.8	559.0	553.7	571.7	561.3	560.5	558.4	558.2	557.1	-1.1
Miscellaneous manufacturing	649.3	656.7	656.8	651.9	654.2	655.0	653.6	654.7	654.9	656.6	1.7
Nondurable goods	5,259	5,263	5,243	5,187	5,325	5,254	5,244	5,254	5,247	5,247	0
Production workers	3,830	3,844	3,814	3,773	3,885	3,830	3,820	3,829	3,819	3,823	4
Food manufacturing	1,459.8	1,474.1	1,471.1	1,442.8	1,484.7	1,481.4	1,458.5	1,465.0	1,466.5	1,465.3	-1.2
Beverages and tobacco products	188.1	193.2	192.0	190.3	193.0	191.0	192.4	193.4	192.5	194.6	2.1
Textile mills	224.0	210.0	206.9	206.3	227.4	214.7	213.2	210.9	209.0	209.5	.5
Textile product mills	169.9	172.9	172.2	174.9	172.8	173.0	173.8	174.5	174.5	177.1	2.6
Apparel	263.9	253.7	249.8	245.9	271.6	255.1	251.8	253.7	252.6	252.4	-.2
Leather and allied products	39.3	39.5	39.9	38.7	40.1	39.5	39.6	39.5	39.8	39.4	-.4
Paper and paper products	488.7	479.4	477.5	475.2	490.2	480.5	478.5	478.5	477.2	476.7	-.5
Printing and related support activities	648.1	647.4	644.8	635.3	653.0	646.4	645.1	644.8	641.9	640.3	-1.6
Petroleum and coal products	108.3	112.3	109.4	107.2	111.8	113.0	113.1	112.3	111.9	111.0	-.9
Chemicals	872.9	879.7	881.9	878.4	878.0	880.3	879.3	881.5	882.6	882.7	.1
Plastics and rubber products	796.4	801.1	797.9	791.5	802.0	799.5	799.1	799.4	798.8	797.5	-1.3

See footnotes at end of table.

ESTABLISHMENT DATA

Table B-1. Employees on nonfarm payrolls by industry sector and selected industry detail—Continued

(In thousands)

Industry	Not seasonally adjusted				Seasonally adjusted						
	Jan. 2005	Nov. 2005	Dec. 2005p	Jan. 2006p	Jan. 2005	Sept. 2005	Oct. 2005	Nov. 2005	Dec. 2005p	Jan. 2006p	Change from: Dec. 2005-Jan. 2006p
Service-providing	108,954	112,914	112,887	110,661	110,483	111,697	111,698	111,967	112,098	112,233	135
Private service-providing	87,327	90,583	90,688	88,886	88,768	89,842	89,846	90,087	90,223	90,359	136
Trade, transportation, and utilities	25,534	26,445	26,629	25,835	25,724	25,944	25,945	26,006	26,018	26,037	19
Wholesale trade	5,655.4	5,790.7	5,796.2	5,754.5	5,701.7	5,762.3	5,767.8	5,782.7	5,786.6	5,801.7	15.1
Durable goods	2,954.0	3,011.7	3,024.2	3,008.3	2,969.7	2,997.8	3,002.3	3,010.5	3,017.9	3,024.5	6.6
Nondurable goods	1,986.8	2,035.6	2,026.7	2,000.6	2,012.1	2,022.1	2,021.7	2,028.9	2,024.6	2,026.2	1.6
Electronic markets and agents and brokers	714.6	743.4	745.3	745.6	719.9	742.4	743.8	743.3	744.1	751.0	6.9
Retail trade	15,046.7	15,684.5	15,871.7	15,183.7	15,156.7	15,267.0	15,259.6	15,292.9	15,302.3	15,300.8	-1.5
Motor vehicle and parts dealers[1]	1,884.1	1,914.4	1,903.7	1,883.5	1,910.4	1,929.4	1,921.5	1,914.3	1,914.0	1,912.3	-1.7
Automobile dealers	1,245.5	1,254.5	1,249.1	1,238.0	1,256.2	1,268.9	1,260.5	1,254.5	1,253.2	1,250.9	-2.3
Furniture and home furnishings stores	573.9	600.0	604.8	591.4	570.9	580.9	581.5	583.3	582.2	587.7	5.5
Electronics and appliance stores	528.6	564.5	570.4	548.0	521.4	539.9	540.5	541.2	541.5	540.7	-.8
Building material and garden supply stores	1,190.9	1,267.2	1,261.7	1,232.0	1,251.9	1,272.3	1,273.1	1,281.6	1,288.4	1,293.5	5.1
Food and beverage stores	2,800.6	2,832.0	2,843.9	2,791.6	2,813.8	2,803.0	2,809.5	2,806.6	2,807.6	2,806.2	-1.4
Health and personal care stores	943.5	972.5	983.4	969.7	943.7	953.8	959.3	964.7	969.7	969.4	-.3
Gasoline stations	859.5	868.2	865.2	852.3	868.8	873.9	874.6	869.1	867.5	862.9	-4.6
Clothing and clothing accessories stores	1,386.6	1,500.3	1,574.9	1,437.4	1,383.5	1,414.2	1,413.5	1,434.5	1,448.0	1,434.6	-13.4
Sporting goods, hobby, book, and music stores	651.9	675.1	704.5	651.5	645.5	631.3	638.7	641.5	641.3	643.4	2.1
General merchandise stores[1]	2,906.0	3,111.5	3,160.2	2,905.1	2,909.4	2,927.4	2,910.6	2,920.4	2,905.4	2,913.0	7.6
Department stores	1,615.0	1,743.0	1,788.7	1,591.5	1,602.4	1,610.9	1,590.6	1,595.2	1,591.8	1,582.8	-9.0
Miscellaneous store retailers	890.3	912.2	925.6	882.3	906.2	902.2	899.1	897.3	897.5	897.8	.3
Nonstore retailers	430.8	466.6	473.4	438.9	431.2	438.7	437.7	438.4	439.2	439.3	.1
Transportation and warehousing	4,276.5	4,410.5	4,403.7	4,339.2	4,308.5	4,355.4	4,358.4	4,370.2	4,368.8	4,375.1	6.3
Air transportation	505.2	488.7	487.3	483.3	509.8	495.1	493.7	488.9	487.6	488.6	1.0
Rail transportation	225.9	228.6	227.7	225.1	228.0	228.2	228.1	227.8	227.4	227.4	.0
Water transportation	55.5	62.1	62.8	61.4	57.8	61.8	62.6	63.6	64.0	63.9	-.1
Truck transportation	1,348.1	1,412.3	1,403.4	1,377.8	1,375.3	1,397.4	1,402.0	1,403.7	1,404.2	1,405.8	1.6
Transit and ground passenger transportation	400.7	411.5	409.3	402.9	389.8	388.0	388.5	394.9	391.2	391.3	.1
Pipeline transportation	38.1	37.1	37.0	37.4	38.0	37.6	37.2	37.2	37.0	37.3	.3
Scenic and sightseeing transportation	19.6	26.7	26.5	23.8	24.3	31.8	31.5	31.4	32.3	32.6	.3
Support activities for transportation	543.3	554.2	557.8	554.2	547.2	551.9	549.8	553.9	554.6	557.4	2.8
Couriers and messengers	567.0	586.2	590.0	576.9	563.2	573.8	576.3	576.8	576.4	573.3	-3.1
Warehousing and storage	573.1	603.1	601.9	596.4	575.1	589.8	588.7	592.0	594.1	597.5	3.4
Utilities	555.7	559.0	557.5	557.8	557.2	558.9	559.4	560.1	559.8	559.6	-.2
Information	3,052	3,071	3,079	3,048	3,068	3,071	3,058	3,064	3,066	3,064	-2
Publishing industries, except Internet	899.4	906.3	907.6	898.6	902.0	904.4	903.7	902.8	902.9	901.6	-1.3
Motion picture and sound recording industries	359.8	385.9	392.9	379.2	370.1	390.6	379.3	383.5	387.5	388.3	.8
Broadcasting, except Internet	326.9	327.2	327.0	321.5	326.8	326.7	327.6	325.7	324.2	322.5	-1.7
Internet publishing and broadcasting	30.8	30.3	30.2	29.3	30.9	30.4	30.1	30.1	30.3	29.4	-.9
Telecommunications	1,007.1	993.9	993.1	992.2	1,009.7	993.4	991.2	995.1	993.3	994.6	1.3
ISPs, search portals, and data processing	376.9	377.7	379.3	378.5	377.7	376.1	376.9	376.7	378.3	377.4	-.9
Other information services	50.7	49.4	49.3	50.4	50.9	49.7	49.4	49.9	49.7	50.5	.8
Financial activities	8,035	8,208	8,219	8,191	8,091	8,172	8,201	8,217	8,224	8,245	21
Finance and insurance	5,967.6	6,063.6	6,074.8	6,071.1	5,984.4	6,029.1	6,053.3	6,066.7	6,071.0	6,086.7	15.7
Monetary authorities - central bank	20.9	20.9	21.0	21.2	20.8	20.7	20.7	20.9	21.1	21.2	.1
Credit intermediation and related activities[1]	2,832.4	2,891.2	2,894.6	2,900.8	2,841.0	2,880.9	2,892.9	2,895.8	2,898.7	2,909.7	11.0
Depository credit intermediation[1]	1,757.6	1,788.6	1,793.7	1,800.0	1,757.9	1,783.5	1,790.8	1,793.3	1,796.9	1,800.0	3.1
Commercial banking	1,288.3	1,305.2	1,307.2	1,310.3	1,288.1	1,302.8	1,306.9	1,309.0	1,309.6	1,310.1	.5
Securities, commodity contracts, investments	777.9	790.9	791.7	791.3	779.6	786.2	790.5	790.7	790.9	793.2	2.3
Insurance carriers and related activities	2,248.5	2,273.5	2,279.8	2,270.6	2,254.7	2,255.1	2,262.1	2,271.8	2,272.7	2,275.2	2.5
Funds, trusts, and other financial vehicles	87.9	87.1	87.7	87.2	88.3	88.2	87.1	87.5	87.6	87.4	-.2
Real estate and rental and leasing	2,067.8	2,144.2	2,144.6	2,119.6	2,106.9	2,143.3	2,147.5	2,150.2	2,153.4	2,158.7	5.3
Real estate	1,407.4	1,475.3	1,477.2	1,467.0	1,433.8	1,469.0	1,474.7	1,478.4	1,482.9	1,492.8	9.9
Rental and leasing services	634.9	641.0	639.5	625.2	647.1	648.8	645.1	643.9	642.5	637.9	-4.6
Lessors of nonfinancial intangible assets	25.5	27.9	27.9	27.4	26.0	27.5	27.7	27.9	28.0	28.0	.0

See footnotes at end of table.

Table B-1. Employees on nonfarm payrolls by industry sector and selected industry detail—Continued

(In thousands)

Industry	Not seasonally adjusted				Seasonally adjusted						
	Jan. 2005	Nov. 2005	Dec. 2005p	Jan. 2006p	Jan. 2005	Sept. 2005	Oct. 2005	Nov. 2005	Dec. 2005p	Jan. 2006p	Change from: Dec. 2005-Jan. 2006p
Professional and business services	16,249	17,194	17,131	16,752	16,638	16,997	16,991	17,061	17,129	17,153	24
Professional and technical services[1]	6,931.2	7,068.8	7,124.8	7,141.8	6,911.1	7,062.2	7,074.8	7,087.2	7,119.1	7,123.5	4.4
Legal services	1,155.1	1,160.6	1,164.6	1,155.6	1,164.3	1,159.5	1,159.2	1,160.0	1,161.6	1,164.4	2.8
Accounting and bookkeeping services	920.9	791.9	840.3	935.1	828.9	848.9	851.0	847.5	860.1	842.5	-17.6
Architectural and engineering services	1,256.7	1,342.7	1,339.0	1,319.2	1,277.5	1,324.3	1,326.1	1,335.3	1,338.5	1,341.7	3.2
Computer systems design and related services	1,170.8	1,212.3	1,216.7	1,211.0	1,174.8	1,195.9	1,204.4	1,204.9	1,208.7	1,215.3	6.6
Management and technical consulting services	808.3	863.4	871.3	861.1	818.7	852.9	855.5	861.4	865.7	871.1	5.4
Management of companies and enterprises	1,733.4	1,750.9	1,759.9	1,743.3	1,747.3	1,754.2	1,749.9	1,743.2	1,756.5	1,758.4	1.9
Administrative and waste services	7,584.6	8,373.8	8,246.7	7,866.6	7,979.5	8,180.5	8,165.8	8,230.5	8,253.1	8,270.7	17.6
Administrative and support services[1]	7,257.5	8,042.8	7,914.9	7,538.1	7,644.4	7,846.5	7,835.6	7,897.8	7,919.0	7,934.8	15.8
Employment services[1]	3,273.7	3,791.3	3,752.5	3,483.3	3,482.6	3,628.2	3,617.2	3,663.7	3,682.9	3,698.4	15.5
Temporary help services	2,297.4	2,715.0	2,684.9	2,479.9	2,462.6	2,573.7	2,576.2	2,616.2	2,635.2	2,649.5	14.3
Business support services	753.7	759.5	761.0	749.0	762.7	757.2	752.7	754.7	752.8	757.6	4.8
Services to buildings and dwellings	1,548.7	1,772.4	1,667.7	1,581.0	1,700.0	1,735.4	1,741.1	1,755.4	1,745.6	1,739.1	-6.5
Waste management and remediation services	327.1	331.0	331.8	328.5	335.1	334.0	330.2	332.7	334.1	335.9	1.8
Education and health services	17,063	17,709	17,668	17,425	17,176	17,451	17,440	17,481	17,503	17,542	39
Educational services	2,746.8	3,018.0	2,962.1	2,747.2	2,817.3	2,844.9	2,815.9	2,820.2	2,818.8	2,819.8	1.0
Health care and social assistance	14,316.1	14,692.5	14,706.1	14,677.9	14,358.7	14,605.8	14,624.5	14,661.2	14,684.3	14,721.8	37.5
Health care[3]	12,146.9	12,446.3	12,457.6	12,433.0	12,182.9	12,382.9	12,392.7	12,423.8	12,440.3	12,469.5	29.2
Ambulatory health care services[1]	5,018.9	5,188.1	5,193.2	5,174.3	5,040.8	5,145.1	5,152.9	5,172.7	5,181.6	5,198.2	14.6
Offices of physicians	2,065.4	2,134.4	2,146.7	2,137.5	2,070.0	2,115.3	2,119.6	2,128.4	2,135.8	2,141.0	5.2
Outpatient care centers	481.6	484.0	484.0	481.5	462.7	479.3	480.6	482.4	483.4	482.9	-.5
Home health care services	798.3	828.0	826.5	822.0	804.1	820.5	820.8	824.3	823.5	827.3	3.8
Hospitals	4,300.7	4,383.1	4,386.0	4,387.2	4,305.7	4,366.8	4,371.7	4,379.2	4,385.2	4,392.5	7.3
Nursing and residential care facilities[1]	2,827.3	2,877.1	2,878.4	2,871.5	2,836.4	2,871.0	2,868.1	2,871.9	2,873.5	2,880.8	7.3
Nursing care facilities	1,569.8	1,587.7	1,588.2	1,577.9	1,575.7	1,582.2	1,578.9	1,582.5	1,584.0	1,583.7	-.3
Social assistance[1]	2,169.2	2,246.2	2,248.5	2,244.9	2,175.8	2,222.9	2,231.8	2,237.4	2,244.0	2,252.3	8.3
Child day care services	776.1	803.6	801.1	800.4	773.9	787.8	793.2	792.9	793.6	798.4	4.8
Leisure and hospitality	12,064	12,601	12,575	12,304	12,673	12,826	12,840	12,881	12,896	12,922	26
Arts, entertainment, and recreation	1,640.5	1,764.2	1,742.7	1,677.8	1,859.6	1,895.1	1,897.8	1,907.5	1,904.5	1,905.3	.8
Performing arts and spectator sports	331.2	354.0	347.6	318.9	365.2	372.2	365.0	382.8	359.5	354.9	-4.6
Museums, historical sites, zoos, and parks	108.3	118.1	114.9	110.0	118.4	123.2	121.6	121.0	121.0	121.1	.1
Amusements, gambling, and recreation	1,201.0	1,292.1	1,280.2	1,248.9	1,376.0	1,399.7	1,411.2	1,423.7	1,424.0	1,429.3	5.3
Accommodations and food services	10,423.4	10,836.8	10,832.5	10,625.9	10,813.3	10,931.2	10,942.4	10,973.9	10,991.9	11,016.3	24.4
Accommodations	1,719.2	1,755.5	1,737.7	1,707.1	1,808.8	1,814.5	1,812.9	1,811.1	1,804.3	1,797.7	-6.6
Food services and drinking places	8,704.2	9,081.3	9,094.8	8,918.8	9,004.5	9,116.7	9,129.5	9,162.8	9,187.6	9,218.6	31.0
Other services	5,330	5,355	5,387	5,331	5,398	5,381	5,371	5,377	5,387	5,396	9
Repair and maintenance	1,221.8	1,225.9	1,234.0	1,229.1	1,235.5	1,230.8	1,227.1	1,232.0	1,241.1	1,241.5	.4
Personal and laundry services	1,257.9	1,265.9	1,266.5	1,258.4	1,276.6	1,271.3	1,270.3	1,271.1	1,270.6	1,275.9	5.3
Membership associations and organizations	2,850.5	2,862.9	2,866.5	2,843.3	2,885.8	2,879.2	2,873.2	2,873.6	2,874.8	2,878.3	3.5
Government	21,627	22,331	22,219	21,775	21,715	21,855	21,852	21,880	21,875	21,874	-1
Federal	2,706	2,721	2,714	2,689	2,721	2,725	2,724	2,728	2,713	2,708	-5
Federal, except U.S. Postal Service	1,932.1	1,945.2	1,929.0	1,922.3	1,946.0	1,949.9	1,949.5	1,953.1	1,941.1	1,939.1	-2.0
U.S. Postal Service	773.7	776.2	784.7	767.1	775.0	774.7	774.1	774.9	772.2	768.9	-3.3
State government	4,926	5,185	5,136	4,958	5,013	5,026	5,022	5,032	5,039	5,041	2
State government education	2,179.8	2,422.2	2,375.7	2,196.0	2,247.6	2,255.1	2,248.1	2,256.6	2,261.6	2,262.3	.7
State government, excluding education	2,746.6	2,762.7	2,760.5	2,759.9	2,765.5	2,771.1	2,773.5	2,775.8	2,777.6	2,778.5	.9
Local government	13,995	14,425	14,369	14,130	13,981	14,104	14,106	14,120	14,123	14,125	2
Local government education	7,934.7	8,253.2	8,218.6	8,015.0	7,816.3	7,891.9	7,894.9	7,899.3	7,903.0	7,902.6	-.4
Local government, excluding education	6,060.5	6,172.1	6,149.9	6,114.5	6,164.4	6,212.1	6,211.5	6,220.6	6,219.7	6,221.9	2.2

[1] Includes other industries, not shown separately.

[2] Includes motor vehicles, motor vehicle bodies and trailers, and motor vehicle parts.

[3] Includes ambulatory health care services, hospitals, and nursing and residential care facilities.

p = preliminary.

NOTE: Data have been revised to reflect March 2005 benchmark levels and updated seasonal adjustment factors.

Table B-2. Average weekly hours of production or nonsupervisory workers[1] on private nonfarm payrolls by industry sector and selected industry detail

Industry	Not seasonally adjusted				Seasonally adjusted						
	Jan. 2005	Nov. 2005	Dec. 2005p	Jan. 2006p	Jan. 2005	Sept. 2005	Oct. 2005	Nov. 2005	Dec. 2005p	Jan. 2006p	Change from: Dec. 2005-Jan. 2006p
Total private	33.6	33.8	33.7	33.8	33.7	33.8	33.8	33.8	33.8	33.8	0.0
Goods-producing	39.5	40.6	40.4	40.1	39.8	40.0	40.3	40.4	40.2	40.4	.2
Natural resources and mining	45.1	45.2	45.5	45.7	45.8	45.9	46.0	45.0	45.8	46.2	.4
Construction	36.8	39.2	38.1	38.3	37.8	38.2	38.5	39.2	38.7	39.2	.5
Manufacturing	40.6	41.2	41.4	40.8	40.7	40.7	41.0	40.8	40.8	40.8	.0
Overtime hours	4.4	4.8	4.9	4.3	4.5	4.5	4.6	4.6	4.5	4.5	.0
Durable goods	41.0	41.7	41.9	41.1	41.1	41.2	41.6	41.3	41.2	41.2	.0
Overtime hours	4.5	4.9	5.0	4.4	4.6	4.6	4.8	4.7	4.5	4.5	.0
Wood products	40.2	40.9	40.4	39.7	40.8	39.6	40.8	40.5	40.1	40.2	.1
Nonmetallic mineral products	40.9	44.2	42.6	42.0	42.0	41.9	42.6	43.5	42.7	42.9	.2
Primary metals	43.3	43.7	44.0	43.9	43.0	43.4	43.5	43.5	43.4	43.5	.1
Fabricated metal products	41.0	41.5	41.8	41.4	40.9	40.8	41.6	41.2	41.1	41.3	.2
Machinery	42.2	42.3	42.8	41.7	42.0	42.1	42.2	42.0	41.9	41.6	-.3
Computer and electronic products	39.7	40.9	40.9	39.9	39.9	40.2	40.5	40.3	40.3	40.1	-.2
Electrical equipment and appliances	40.2	41.6	41.5	41.2	40.2	41.3	41.4	41.0	41.0	41.1	.1
Transportation equipment	42.3	42.9	43.6	42.5	42.3	42.7	43.0	42.7	42.6	42.6	.0
Motor vehicles and parts[2]	42.3	42.6	43.3	42.0	42.2	42.7	42.9	42.4	42.2	42.0	-.2
Furniture and related products	39.4	38.7	39.2	37.8	39.5	39.3	39.2	38.5	38.2	38.0	-.2
Miscellaneous manufacturing	38.6	38.8	38.9	38.6	38.6	38.8	39.0	38.6	38.6	38.6	.0
Nondurable goods	39.9	40.4	40.7	40.2	40.0	39.9	40.1	40.0	40.1	40.2	.1
Overtime hours	4.2	4.6	4.8	4.3	4.4	4.4	4.4	4.4	4.6	4.5	-.1
Food manufacturing	38.7	39.5	39.9	39.5	38.9	38.8	38.9	39.0	39.3	39.6	.3
Beverages and tobacco products	39.9	40.4	39.7	38.8	40.4	39.5	40.8	40.1	40.0	39.7	-.3
Textile mills	40.4	41.0	41.4	40.5	40.3	39.9	40.2	40.6	41.0	40.4	-.6
Textile product mills	39.4	39.9	40.6	40.2	39.5	38.7	38.8	39.6	39.9	40.1	.2
Apparel	35.7	36.1	36.4	35.7	35.9	35.8	36.1	35.9	35.9	35.9	.0
Leather and allied products	37.0	39.8	39.8	39.0	37.2	38.5	38.7	39.5	39.4	39.2	-.2
Paper and paper products	42.7	42.9	43.4	42.8	42.5	42.8	42.9	42.5	42.5	42.4	-.1
Printing and related support activities	38.5	38.7	38.8	38.5	38.6	38.6	38.5	38.3	38.3	38.5	.2
Petroleum and coal products	44.3	46.6	44.5	44.6	44.6	47.4	47.3	45.8	44.6	45.2	.6
Chemicals	42.8	42.6	43.0	43.1	42.8	42.0	42.9	42.3	42.5	42.8	.3
Plastics and rubber products	40.0	40.4	41.1	40.2	40.0	40.0	40.0	40.1	40.4	40.2	-.2
Private service-providing	32.4	32.3	32.3	32.4	32.4	32.4	32.4	32.4	32.4	32.4	.0
Trade, transportation, and utilities	33.2	33.2	33.4	33.0	33.5	33.3	33.3	33.4	33.4	33.3	-.1
Wholesale trade	37.8	37.8	37.8	38.0	37.7	37.7	37.8	37.8	37.9	37.9	.0
Retail trade	30.2	30.3	30.7	30.0	30.7	30.5	30.4	30.6	30.5	30.5	.0
Transportation and warehousing	37.4	37.0	37.0	36.1	37.5	36.6	36.7	36.8	36.7	36.4	-.3
Utilities	40.8	41.7	41.3	40.8	41.0	41.2	41.3	41.2	41.4	41.0	-.4
Information	36.6	36.6	36.6	36.8	36.4	36.6	36.7	36.5	36.7	36.6	-.1
Financial activities	36.4	35.7	35.7	36.5	35.9	36.0	36.1	35.9	35.9	36.0	.1
Professional and business services	34.1	34.3	34.2	34.5	34.2	34.3	34.3	34.3	34.3	34.5	.2
Education and health services	32.9	32.5	32.5	32.9	32.6	32.7	32.7	32.5	32.6	32.6	.0
Leisure and hospitality	25.3	25.4	25.2	25.3	25.7	25.8	25.7	25.7	25.6	25.7	.1
Other services	30.9	30.8	30.8	31.0	30.9	30.9	30.9	30.9	30.9	31.0	.1

[1] Data relate to production workers in natural resources and mining and manufacturing, construction workers in construction, and nonsupervisory workers in the service-providing industries. These groups account for approximately four-fifths of the total employment on private nonfarm payrolls.

[2] Includes motor vehicles, motor vehicle bodies and trailers, and motor vehicle parts.

p = preliminary.

NOTE: Data have been revised to reflect March 2005 benchmark levels and updated seasonal adjustment factors.

Table B-3. Average hourly and weekly earnings of production or nonsupervisory workers[1] on private nonfarm payrolls by industry sector and selected industry detail

Industry	Average hourly earnings				Average weekly earnings			
	Jan. 2005	Nov. 2005	Dec. 2005^p	Jan. 2006^p	Jan. 2005	Nov. 2005	Dec. 2005^p	Jan. 2006^p
Total private	$15.99	$16.30	$16.36	$16.52	$537.26	$550.94	$551.33	$558.38
Seasonally adjusted	15.88	16.28	16.34	16.41	535.16	550.26	552.29	554.66
Goods-producing	17.31	17.76	17.81	17.73	683.75	721.06	719.52	710.97
Natural resources and mining	18.52	18.90	18.90	19.24	835.25	854.28	859.95	879.27
Construction	19.10	19.61	19.67	19.51	702.88	768.71	749.43	747.23
Manufacturing	16.42	16.70	16.81	16.77	666.65	688.04	695.93	684.22
Durable goods	17.14	17.54	17.67	17.58	702.74	731.42	740.37	722.54
Wood products	13.14	13.32	13.20	13.17	528.23	544.79	533.28	522.85
Nonmetallic mineral products	16.29	16.55	16.51	16.44	686.26	731.51	703.33	690.48
Primary metals	18.84	19.21	19.17	19.38	815.77	839.48	843.48	849.90
Fabricated metal products	15.55	16.01	16.18	16.08	637.55	664.42	676.32	665.71
Machinery	17.03	17.01	17.12	17.23	718.67	719.52	732.74	718.49
Computer and electronic products	18.01	18.60	18.76	18.80	715.00	760.74	767.28	750.12
Electrical equipment and appliances	15.08	15.42	15.52	15.42	606.22	641.47	644.08	635.30
Transportation equipment	21.88	22.55	22.73	22.39	925.52	967.40	991.03	951.58
Furniture and related products	13.40	13.45	13.52	13.47	527.96	520.52	529.98	509.17
Miscellaneous manufacturing	14.06	14.12	14.19	14.07	542.72	547.86	551.99	543.10
Nondurable goods	15.24	15.28	15.35	15.40	608.08	617.31	624.75	619.08
Food manufacturing	13.06	13.06	13.11	13.14	505.42	515.87	523.09	519.03
Beverages and tobacco products	18.48	18.76	18.50	18.47	737.35	757.90	734.45	716.64
Textile mills	12.33	12.48	12.46	12.61	498.13	511.68	515.84	510.71
Textile product mills	11.32	11.78	11.89	11.90	446.01	470.02	482.73	478.38
Apparel	10.16	10.41	10.43	10.56	362.71	375.80	379.65	376.99
Leather and allied products	11.61	11.57	11.36	11.61	429.57	460.49	452.13	452.79
Paper and paper products	18.03	17.87	17.95	17.88	769.88	766.62	779.03	761.69
Printing and related support activities	15.75	15.73	15.98	16.02	606.38	608.75	620.02	616.77
Petroleum and coal products	24.77	24.64	24.62	24.85	1,097.31	1,148.22	1,095.59	1,108.31
Chemicals	19.53	19.68	19.83	19.85	835.88	838.37	852.69	855.54
Plastics and rubber products	14.81	14.78	14.84	14.95	592.40	597.11	609.92	600.99
Private service-providing	15.65	15.90	15.97	16.20	507.06	513.57	515.83	524.88
Trade, transportation, and utilities	14.85	15.00	14.98	15.19	493.02	498.00	499.66	501.27
Wholesale trade	18.00	18.46	18.60	18.67	680.40	697.79	703.08	709.46
Retail trade	12.34	12.28	12.25	12.46	372.67	372.08	376.08	373.80
Transportation and warehousing	16.57	16.88	16.87	16.91	619.72	624.56	624.19	610.45
Utilities	26.13	27.37	27.32	27.08	1,066.10	1,141.33	1,128.32	1,104.86
Information	21.77	22.45	22.68	23.09	796.78	821.67	830.09	849.71
Financial activities	17.81	18.17	18.21	18.42	648.28	648.67	650.10	672.33
Professional and business services	18.11	18.25	18.43	18.88	617.55	625.98	630.31	651.36
Education and health services	16.46	16.94	17.03	17.09	541.53	550.55	553.48	562.26
Leisure and hospitality	9.12	9.29	9.38	9.34	230.74	235.97	236.38	236.30
Other services	14.22	14.46	14.52	14.57	439.40	445.37	447.22	451.67

[1] See footnote 1, table B-2.
p = preliminary.

NOTE: Data have been revised to reflect March 2005 benchmark levels and updated seasonal adjustment factors.

Table B-4. Average hourly earnings of production or nonsupervisory workers[1] on private nonfarm payrolls by industry sector and selected industry detail, seasonally adjusted

Industry	Jan. 2005	Sept. 2005	Oct. 2005	Nov. 2005	Dec. 2005[p]	Jan. 2006[p]	Percent change from: Dec. 2005-Jan. 2006[p]
Total private:							
Current dollars	$15.88	$16.19	$16.28	$16.28	$16.34	$16.41	0.4
Constant (1982) dollars[2]	8.23	8.06	8.10	8.16	8.19	N.A.	(3)
Goods-producing	17.37	17.66	17.74	17.74	17.77	17.81	.2
Natural resources and mining	18.43	19.03	19.04	18.95	18.88	19.12	1.3
Construction	19.23	19.54	19.58	19.59	19.64	19.65	.1
Manufacturing	16.38	16.60	16.71	16.68	16.71	16.74	.2
Excluding overtime[4]	15.52	15.73	15.82	15.79	15.84	15.87	.2
Durable goods	17.11	17.38	17.51	17.50	17.53	17.56	.2
Nondurable goods	15.19	15.30	15.35	15.29	15.32	15.36	.3
Private service-providing	15.49	15.80	15.89	15.89	15.96	16.03	.4
Trade, transportation, and utilities	14.78	14.98	15.05	15.04	15.10	15.11	.1
Wholesale trade	17.88	18.26	18.32	18.45	18.58	18.56	-.1
Retail trade	12.31	12.35	12.43	12.35	12.39	12.42	.2
Transportation and warehousing	16.55	16.82	16.82	16.85	16.85	16.90	.3
Utilities	26.13	26.95	27.17	27.15	27.21	27.18	-.1
Information	21.73	22.32	22.65	22.40	22.65	22.99	1.5
Financial activities	17.69	18.01	18.09	18.20	18.24	18.29	.3
Professional and business services	17.81	18.15	18.30	18.29	18.40	18.55	.8
Education and health services	16.41	16.84	16.90	16.95	16.99	17.05	.4
Leisure and hospitality	9.04	9.22	9.22	9.24	9.26	9.26	.0
Other services	14.17	14.40	14.46	14.46	14.49	14.52	.2

[1] See footnote 1, table B-2.
[2] The Consumer Price Index for Urban Wage Earners and Clerical Workers (CPI-W) is used to deflate this series.
[3] Change was 0.4 percent from Nov. 2005 to Dec. 2005, the latest month available.
[4] Derived by assuming that overtime hours are paid at the rate of time and one-half.
N.A. = not available.
[p] = preliminary.
NOTE: Data have been revised to reflect March 2005 benchmark levels and updated seasonal adjustment factors.

ESTABLISHMENT DATA

Table B-5. Indexes of aggregate weekly hours of production or nonsupervisory workers[1] on private nonfarm payrolls by industry sector and selected industry detail

(2002=100)

Industry	Not seasonally adjusted				Seasonally adjusted						
	Jan. 2005	Nov. 2005	Dec. 2005p	Jan. 2006p	Jan. 2005	Sept. 2005	Oct. 2005	Nov. 2005	Dec. 2005p	Jan. 2006p	Percent change from: Dec. 2005-Jan. 2006p
Total private	98.9	104.2	103.8	101.8	101.3	103.1	103.1	103.5	103.7	103.9	0.2
Goods-producing	93.0	101.9	100.0	97.2	96.9	98.6	99.6	100.5	100.0	101.0	1.0
Natural resources and mining	105.7	117.5	117.8	116.3	110.3	116.3	117.6	118.0	118.8	120.3	1.3
Construction	92.6	113.9	106.3	102.4	102.6	107.2	108.5	111.7	110.0	112.4	2.2
Manufacturing	92.7	95.8	96.3	94.0	93.9	93.9	94.7	94.6	94.7	94.9	.2
Durable goods	94.2	98.5	99.4	96.8	95.3	96.3	97.7	97.4	97.5	97.8	.3
Wood products	98.9	103.4	102.3	99.6	102.6	99.5	102.4	102.4	102.1	102.9	.8
Nonmetallic mineral products	90.9	102.1	96.4	93.4	97.5	95.7	97.2	99.5	97.7	99.5	1.8
Primary metals	93.7	95.5	96.8	96.5	93.2	94.5	95.0	95.2	95.0	95.7	.7
Fabricated metal products	98.0	101.1	102.1	100.8	98.5	98.8	100.5	100.3	100.4	101.3	.9
Machinery	97.3	99.7	101.5	98.5	96.8	99.1	100.3	99.0	99.0	98.2	-.8
Computer and electronic products	89.7	102.3	103.1	99.4	90.2	97.9	99.8	100.3	100.8	99.7	-1.1
Electrical equipment and appliances	87.0	89.0	89.6	89.4	87.0	87.8	88.1	87.7	88.1	89.0	1.0
Transportation equipment	95.2	99.5	102.4	98.6	96.1	96.7	98.8	98.8	99.3	99.5	.2
Motor vehicles and parts[2]	94.8	96.2	98.6	94.2	95.6	98.7	96.4	95.4	95.1	94.8	-.3
Furniture and related products	92.7	89.7	91.1	87.2	93.5	91.3	91.0	89.2	88.6	88.2	-.5
Miscellaneous manufacturing	90.5	91.7	92.0	90.5	91.3	91.0	91.5	90.7	90.7	91.2	.6
Nondurable goods	90.0	91.5	91.4	89.3	91.5	90.0	90.2	90.2	90.2	90.5	.3
Food manufacturing	93.7	97.4	97.6	94.9	96.0	94.5	94.5	95.2	95.9	96.8	.9
Beverages and tobacco products	88.1	99.5	97.0	93.9	91.9	94.9	100.3	98.9	98.2	98.8	.6
Textile mills	74.2	69.6	68.8	67.9	75.1	69.4	69.3	69.2	69.1	68.8	-.4
Textile product mills	88.9	93.8	94.4	96.6	90.4	91.2	92.2	94.2	94.3	97.7	3.6
Apparel	67.5	65.1	64.0	62.2	70.3	64.8	64.0	64.5	64.1	64.6	.8
Leather and allied products	75.8	82.1	82.6	77.8	77.7	79.6	79.6	81.0	81.5	79.8	-2.1
Paper and paper products	89.0	88.1	88.8	86.4	88.8	88.1	87.9	87.1	86.8	86.3	-.6
Printing and related support activities	91.6	92.0	91.8	89.0	92.6	91.2	90.8	90.5	90.0	89.7	-.3
Petroleum and coal products	98.5	102.7	94.3	92.2	103.2	105.3	105.3	100.6	97.2	97.4	.2
Chemicals	97.6	97.5	98.6	98.1	98.2	96.4	97.9	96.9	97.4	98.0	.6
Plastics and rubber products	91.9	93.1	94.0	91.3	92.7	91.9	91.9	92.1	92.6	92.1	-.5
Private service-providing	100.8	104.8	104.9	102.9	102.6	104.1	104.1	104.5	104.6	104.8	.2
Trade, transportation, and utilities	99.0	103.4	104.9	100.1	100.8	101.3	101.3	102.0	102.1	101.9	-.2
Wholesale trade	99.4	102.9	103.1	102.8	100.1	102.0	102.3	102.8	103.2	103.5	.3
Retail trade	97.9	103.0	105.9	98.4	100.3	100.4	100.0	101.1	100.8	100.9	.1
Transportation and warehousing	103.8	106.8	106.5	102.2	105.2	103.9	104.3	105.0	104.6	104.1	-.5
Utilities	92.2	96.0	94.8	93.2	93.1	94.5	94.9	95.1	95.3	94.1	-1.3
Information	98.6	100.6	101.1	100.6	98.6	100.5	100.5	100.3	100.8	100.6	-.2
Financial activities	104.5	104.8	105.2	107.1	103.8	105.1	105.8	105.6	105.8	106.4	.6
Professional and business services	100.7	108.5	107.8	106.0	103.8	106.9	106.9	107.6	108.0	108.9	.8
Education and health services	105.6	108.0	107.7	107.6	105.2	107.2	107.0	106.6	107.0	107.3	.3
Leisure and hospitality	97.8	103.0	102.0	100.0	104.9	106.6	106.2	106.7	106.5	107.2	.7
Other services	94.9	95.1	95.3	95.2	96.2	96.0	95.8	95.8	95.9	96.4	.5

[1] See footnote 1, table B-2.
[2] Includes motor vehicles, motor vehicle bodies and trailers, and motor vehicle parts.
p = preliminary.
NOTE: The indexes of aggregate weekly hours are calculated by dividing the current month's estimates of aggregate hours by the corresponding 2002 annual average levels. Aggregate hours estimates are the product of estimates of average weekly hours and production or nonsupervisory worker employment. Data have been revised to reflect March 2005 benchmark levels and updated seasonal adjustment factors.

Table B-6. Indexes of aggregate weekly payrolls of production or nonsupervisory workers[1] on private nonfarm payrolls by industry sector and selected industry detail

(2002=100)

Industry	Not seasonally adjusted				Seasonally adjusted						
	Jan. 2005	Nov. 2005	Dec. 2005[p]	Jan. 2006[p]	Jan. 2005	Sept. 2005	Oct. 2005	Nov. 2005	Dec. 2005[p]	Jan. 2006[p]	Percent change from: Dec. 2005-Jan. 2006[p]
Total private	105.9	113.7	113.6	112.6	107.7	111.6	112.3	112.8	113.3	114.1	0.7
Goods-producing	98.6	110.8	109.0	105.5	103.0	108.6	108.2	109.2	108.8	110.1	1.2
Natural resources and mining	113.8	129.1	129.4	130.2	118.2	128.8	130.2	127.8	130.4	133.8	2.6
Construction	95.5	120.6	112.9	107.8	106.6	113.1	114.7	118.1	116.6	119.2	2.2
Manufacturing	99.5	104.6	105.8	103.1	100.6	101.9	103.5	103.2	103.5	103.9	.4
Durable goods	100.8	107.9	109.7	106.2	101.8	104.4	106.8	106.4	106.7	107.2	.5
Nondurable goods	96.9	98.8	99.2	97.2	98.2	97.3	97.9	97.5	97.6	98.2	.6
Private service-providing	108.3	114.4	115.1	114.6	109.2	113.0	113.6	114.0	114.7	115.5	.7
Trade, transportation, and utilities	104.9	110.6	111.9	108.5	106.3	108.3	108.8	109.4	109.9	109.8	-.1
Wholesale trade	105.4	111.9	113.0	113.0	105.4	109.7	110.4	111.7	112.9	113.1	.2
Retail trade	103.5	108.4	111.1	105.1	105.8	106.3	106.6	107.0	107.1	107.4	.3
Transportation and warehousing	109.1	114.4	114.0	109.6	110.5	110.9	111.3	112.3	111.9	111.6	-.3
Utilities	100.6	109.7	108.1	105.4	101.5	106.3	107.6	107.7	108.2	106.7	-1.4
Information	106.3	111.8	113.5	115.0	106.1	111.0	112.7	111.2	113.1	114.5	1.2
Financial activities	115.1	117.8	118.4	122.0	113.5	117.0	118.4	118.9	119.3	120.3	.8
Professional and business services	108.5	117.6	118.2	119.0	110.0	115.4	116.4	117.1	118.2	120.2	1.7
Education and health services	114.2	120.3	120.6	120.9	113.5	116.6	118.8	118.8	119.5	120.2	.6
Leisure and hospitality	104.0	111.5	111.6	108.9	110.5	114.6	114.2	114.9	114.9	115.7	.7
Other services	98.3	100.2	100.8	101.0	99.3	100.7	100.9	100.9	101.3	102.0	.7

[1] See footnote 1, table B-2.

[p] = preliminary.

NOTE: The indexes of aggregate weekly payrolls are calculated by dividing the current month's estimates of aggregate payrolls by the corresponding 2002 annual average levels. Aggregate payroll estimates are the product of estimates of average hourly earnings, average weekly hours, and production or nonsupervisory worker employment. Data have been revised to reflect March 2005 benchmark levels and updated seasonal adjustment factors.

ESTABLISHMENT DATA

Table B-7. Diffusion indexes of employment change

(Percent)

Time span	Jan.	Feb.	Mar.	Apr.	May	June	July	Aug.	Sept.	Oct.	Nov.	Dec.
	Private nonfarm payrolls, 278 industries [1]											
Over 1-month span:												
2002	40.8	36.5	38.3	38.7	40.1	46.0	43.7	43.3	41.7	41.9	41.5	36.0
2003	44.1	37.9	34.9	38.3	42.8	38.8	37.6	39.7	50.7	49.8	52.0	51.3
2004	51.6	49.5	62.4	65.5	62.4	57.7	52.7	52.0	57.0	54.3	55.0	54.1
2005	50.7	57.7	56.7	54.7	54.5	56.7	59.2	54.1	51.4	53.4	61.7	p 57.6
2006	p 60.6											
Over 3-month span:												
2002	34.5	36.2	35.6	35.8	34.9	38.8	38.5	44.8	37.6	39.7	37.2	39.6
2003	40.6	34.2	34.7	32.7	35.3	41.7	38.5	33.8	42.6	47.8	49.8	50.5
2004	54.3	53.4	57.6	63.1	69.4	68.3	58.8	55.6	57.4	58.5	59.9	55.2
2005	52.9	56.7	59.2	60.4	56.8	60.8	60.4	59.7	57.9	52.2	57.0	p 63.3
2006	p 67.6											
Over 6-month span:												
2002	30.2	30.6	31.5	30.9	32.0	36.3	35.8	37.6	34.5	36.0	36.7	35.3
2003	34.4	31.8	31.8	34.0	32.7	36.2	33.3	32.4	40.5	45.3	46.4	47.7
2004	49.8	52.3	54.7	60.8	63.3	63.8	63.1	63.5	59.0	61.3	55.9	55.6
2005	55.4	57.7	57.4	58.8	55.2	58.6	60.8	59.5	60.6	57.7	58.5	p 57.0
2006	p 57.9											
Over 12-month span:												
2002	33.6	31.7	30.2	30.4	30.2	29.1	32.0	31.3	30.0	29.5	32.9	34.7
2003	34.5	31.5	32.9	33.5	34.2	35.1	32.7	33.1	37.1	36.7	37.2	39.2
2004	40.3	42.1	44.8	48.4	50.7	57.7	57.0	55.2	56.7	58.3	60.1	60.3
2005	60.1	61.0	59.5	58.6	58.6	59.4	60.8	61.0	60.8	58.3	58.8	p 59.9
2006	p 61.7											
	Manufacturing payrolls, 84 industries [1]											
Over 1-month span:												
2002	19.6	21.4	18.5	29.2	25.0	30.4	36.9	25.6	28.6	17.9	17.9	19.6
2003	32.7	19.6	19.6	10.7	23.2	19.0	19.6	29.2	28.6	36.3	42.3	40.5
2004	44.0	47.6	44.6	64.9	53.6	45.8	56.5	52.4	41.7	42.3	39.9	39.3
2005	39.3	38.7	38.7	42.3	44.6	34.5	47.6	35.7	45.2	43.5	50.0	p 47.6
2006	p 52.4											
Over 3-month span:												
2002	9.5	9.5	11.3	17.9	14.9	17.9	22.6	25.6	22.6	17.3	9.5	11.9
2003	18.5	11.3	12.5	8.3	7.7	11.3	14.9	15.5	16.7	27.4	32.1	35.7
2004	43.5	42.3	43.5	53.6	57.7	58.9	53.6	48.8	48.2	40.5	38.1	31.0
2005	35.7	39.9	42.9	39.9	37.5	41.1	39.3	35.7	39.9	38.3	36.9	p 46.4
2006	p 56.5											
Over 6-month span:												
2002	7.1	8.3	7.7	8.3	8.3	11.9	12.5	11.9	13.7	8.9	7.1	7.7
2003	11.3	11.3	8.3	9.5	10.7	9.5	6.0	8.9	13.7	18.5	24.4	23.8
2004	28.6	33.3	33.3	45.8	47.6	51.2	56.0	51.8	48.2	49.4	39.3	35.7
2005	36.9	36.9	35.1	33.3	33.3	32.7	36.9	36.9	41.1	41.7	39.3	p 41.1
2006	p 35.7											
Over 12-month span:												
2002	7.1	6.0	6.0	6.5	7.1	3.6	4.8	6.0	4.8	7.1	4.8	8.3
2003	10.7	6.0	6.5	6.0	8.3	7.1	7.1	8.3	10.7	10.7	9.5	10.7
2004	13.1	14.3	13.1	20.2	23.2	35.7	36.9	38.1	36.3	44.0	44.6	44.6
2005	44.6	44.6	41.7	40.5	39.9	33.3	32.7	31.0	32.1	39.3	35.7	p 38.1
2006	p 40.5											

[1] Based on seasonally adjusted data for 1-, 3-, and 6-month spans and unadjusted data for the 12-month span.

p = preliminary.

NOTE: Figures are the percent of industries with employment increasing plus one-half of the industries with unchanged employment, where 50 percent indicates an equal balance between industries with increasing and decreasing employment. Data have been revised to reflect March 2005 benchmark levels and updated seasonal adjustment factors.

JUL 21 2006

The Honorable Jim Saxton
U.S. House of Representatives
Washington, D.C. 20515

Dear Congressman Saxton:

Please accept my apologies for not responding promptly to the question you raised during the Joint Economic Committee hearing on February 3, 2006, regarding the employment situation for January 2006. The net employment gain in manufacturing was 7,000 with strength concentrated primarily in the durable goods industries.

You specifically asked about the distribution of manufacturing employment held by industries that added jobs over the month. Industries that added at least 1,000 positions--wood products (4.0 percent), nonmetallic mineral products (3.6 percent), primary metals (3.3 percent), fabricated metal products (10.8 percent), electrical equipment (3.1 percent), miscellaneous manufacturing (4.6 percent), and textile product mills (1.2 percent)--represented 30.6 percent of all jobs in the sector. The enclosed table shows more details on the distribution of employment in the manufacturing sector, along with each industry's employment change for January (as released on February 3, 2006).

Current data for the first half of 2006 show manufacturing employment up by 29,000. A 62,000 gain in the durable goods industry is offset by 33,000 jobs lost in the nondurable goods industries. The durable goods gains are widespread, and four industries stand out with increases over 10,000 year to date: fabricated metals, machinery, electrical equipment, and transportation equipment. Textile mills accounted for about one-third of the job loss in nondurable goods.

If you have any further comments or questions, please contact John M. Galvin, Associate Commissioner for the Office of Employment and Unemployment Statistics, on 202-691-6400. Thank you for the opportunity to add this information for the record.

Sincerely yours,

KATHLEEN P. UTGOFF
Commissioner

Enclosure

DOL/BLS/OEUS/DCES
Getz/ch: 7/20/06
Cc: Utgoff, Galvin, Kerr, Nardone, Getz, Clinton, RF, DF, SF

ESTABLISHMENT DATA Released February 3, 2006

Employees on nonfarm payrolls for manufacturing, seasonally adjusted

(In thousands) Industry	Jan. 2006p Level	Percent of Manufacturing Employment		Over-the- month Change	Statistically Significant*
Manufacturing..............................	**14,220**	**100.0**		**7**	
Durable goods..............................	**8,973**	**63.1**		**7**	
Wood products............................	562.3	4.0		2.8	
Nonmetallic mineral products.............	508.0	3.6		6.2	Yes
Primary metals...........................	473.3	3.3		3.3	Yes
Fabricated metal products................	1529.4	10.8		2.7	
Machinery................................	1160.0	8.2		-3.9	
Computer and electronic products(1).......	1314.8	9.2		-5.7	Yes
Electrical equipment and appliances.......	436.1	3.1		1.2	
Transportation equipment(1)..............	1775.6	12.5		-0.3	
Furniture and related products...........	557.1	3.9		-1.1	
Miscellaneous manufacturing..............	656.6	4.6		1.7	
Nondurable goods..........................	**5,247**	**36.9**		**0**	
Food manufacturing.......................	1465.3	10.3		-1.2	
Beverages and tobacco products...........	194.6	1.4		2.1	Yes
Textile mills............................	209.5	1.5		0.5	
Textile product mills....................	177.1	1.2		2.6	Yes
Apparel..................................	252.4	1.8		-0.2	
Leather and allied products..............	39.4	0.3		-0.4	
Paper and paper products.................	476.7	3.4		-0.5	
Printing and related support activities...	640.3	4.5		-1.6	
Petroleum and coal products..............	111.0	0.8		-0.9	
Chemicals................................	882.7	6.2		0.1	
Plastics and rubber products.............	797.5	5.6		-1.3	

*NOTE: Significant over-the-month changes are calculated at a 90 percent confidence level. The standard error is used for a 1-month change.

The New York Times

February 2, 2006

The Nation of the Future

By DAVID BROOKS (NYT); Editorial Desk
Late Edition - Final, Section A, Page 23, Column 5, 768 words

Everywhere I go people tell me China and India are going to blow by us in the coming decades. They've got the hunger. They've got the people. They've got the future. We're a tired old power, destined to fade back to the second tier of nations, like Britain did in the 20th century.

This sentiment is everywhere -- except in the evidence. The facts and figures tell a different story.

Has the United States lost its vitality? No. Americans remain the hardest working people on the face of the earth and the most productive. As William W. Lewis, the founding director of the McKinsey Global Institute, wrote, "The United States is the productivity leader in virtually every industry." And productivity rates are surging faster now than they did even in the 1990's.

Has the United States stopped investing in the future? No. The U.S. accounts for roughly 40 percent of the world's R. & D. spending. More money was invested in research and development in this country than in the other G-7 nations combined.

Is the United States becoming a less important player in the world economy? Not yet. In 1971, the U.S. economy accounted for 30.52 percent of the world's G.D.P. Since then, we've seen the rise of Japan, China, India and the Asian tigers. The U.S. now accounts for 30.74 percent of world G.D.P., a slightly higher figure.

What about the shortage of scientists and engineers? Vastly overblown. According to Duke School of Engineering researchers, the U.S. produces more engineers per capita than China or India. According to The Wall Street Journal, firms with engineering openings find themselves flooded with resumes. Unemployment rates for scientists and engineers are no lower than for other professions, and in some specialties, such as electrical engineering, they are notably higher.

Michael Teitelbaum of the Alfred P. Sloan Foundation told The Wall Street Journal last November, "No one I know who has looked at the data with an open mind has been able to find any sign of a current shortage." The G.A.O., the RAND Corporation and many other researchers have picked apart the quickie studies that warn of a science and engineering gap. "We did not find evidence that such shortages have existed at least since 1990, nor that they are on the horizon," the RAND report concluded.

What about America's lamentable education system? Well, it's true we do a mediocre job of educating people from age 0 to 18, even though we spend by far more per pupil than any other nation on earth. But we do an outstanding job of training people from ages 18 to 65.

At least 22 out of the top 30 universities in the world are American. More foreign students come to American universities now than before 9/11.

More important, the American workplace is so competitive, companies are compelled to promote lifelong learning. A U.N. report this year ranked the U.S. third in the world in ease of doing business, after New Zealand and Singapore. The U.S. has the second most competitive economy on earth, after Finland, according the latest Global Competitiveness Report. As Michael Porter of Harvard told The National Journal, "The U.S. is second to none in terms of innovation and an innovative environment."

What about partisan gridlock and our dysfunctional political system? Well, entitlement debt remains the biggest threat to the country's well-being, but in one area vital to the country's future posterity, we have reached a beneficent consensus. American liberals have given up on industrial policy, and American conservatives now embrace an aggressive federal role for basic research.

Ford and G.M. totter and almost nobody suggests using public money to prop them up. On the other hand, President Bush, reputed to be hostile to science, has increased the federal scientific research budget by 50 percent since taking office, to $137 billion annually. Senators Lamar Alexander and Jeff Bingaman have proposed excellent legislation that would double the R. & D. tax credit and create a Darpa-style lab in the Department of Energy, devoting $9 billion for scientific research and education. That bill has 60 co-sponsors, 30 Democrats and 30 Republicans.

Recent polling suggests that people in Afghanistan and Iraq are more optimistic about their nations' futures than people in the United States. That's just crazy, even given our problems with health care, growing inequality and such. America's problem over the next 50 years will not be wrestling with decline. It will be helping the frustrated individuals and nations left so far behind.

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S. Hrg. 107-426

THE EMPLOYMENT SITUATION: FEBRUARY 2002

HEARING

before the

JOINT ECONOMIC COMMITTEE
CONGRESS OF THE UNITED STATES

ONE HUNDRED SEVENTH CONGRESS

SECOND SESSION

March 8, 2002

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JOINT ECONOMIC COMMITTEE

[Created pursuant to Sec. 5(a) of Public Law 304, 79th Congress]

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WITNESS

SUBMISSIONS FOR THE RECORD

THE EMPLOYMENT SITUATION: FEBRUARY 2002

Friday, March 8, 2002

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

The Committee met, pursuant to notice, at 9:30 a.m., in Room 311, Cannon House Office Building, the Honorable Jim Saxton, Chairman of the Committee, presiding.

Present: Representatives Saxton and English; Senator Reed.

Staff Present: Christopher Frenze, Robert Keleher, Colleen J. Healy, Brian Higginbotham, Patricia Ruggles, and Matthew Salomon.

OPENING STATEMENT OF REPRESENTATIVE JIM SAXTON, CHAIRMAN

Representative Saxton. Good morning. I am pleased to welcome Acting Commissioner Orr once again before the Joint Economic Committee (JEC) to testify on the February employment situation.

The employment data reported today appear to reflect the end of the recession also shown in other recent economic data. Payroll employment stopped its long decline, actually rising 66,000 in February, although partially under the influence of some special factors. The decline of the unemployment rate in January was sustained in February, leaving its level at 5-1/2 percent.

Last month, I noted the preliminary signs that indicated the economy may have bottomed out. Since this time, additional data have been released suggesting that the economic rebound appears to be underway. A resumption of economic growth would be very welcome news for all Americans, although it remains to be seen how strong and sustained the rebound will be.

Nonetheless, the recent data have been generally quite positive. GDP growth in the fourth quarter of 2001 was sharply revised upward, with consumption growth reaching six percent for the period. The Institute for Supply Management data suggest that manufacturing as well as service industry output is now increasing. Personal income and consumption have both increased, according to the most recent monthly data. The leading economic indicators have risen for the fourth month in a row.

The bottoming out in manufacturing output is encouraging since its problems signaled the outset of the slowdown in 2000. Housing and auto sales remain strong, and other official statistics also register improvement.

Over the last month, the evidence has continued to mount that the recession has ended. However, the fragility of the economy, particularly investment, remains a concern that justifies enactment of the economic stimulus package in Congress. Moreover, the economy remains vulnerable to the risks of adverse international economic developments, high debt levels, security costs and other factors.

Given the recession and the events of September 11, the prospect of economic recovery in the near future is especially impressive and reflects the remarkable resilience of the American economy and the American people.

In conclusion, what had been preliminary signs of economic recovery last month have now been confirmed in other more recent data. However, we must be on guard against complacency. Congressional enactment of an economic stimulus package would be a prudent insurance policy against the potential for another slowdown in economic activity.

And I will turn to Senator Reed for his opening statement.

[The prepared statement of Representative Saxton appears in the Submissions for the Record on page 13.]

OPENING STATEMENT OF SENATOR JACK REED, VICE CHAIRMAN

Senator Reed. Thank you very much, Mr. Chairman. I want to thank Commissioner Orr and her colleagues once again for joining us. And as you indicate, there are encouraging signs that the recession is over. Chairman Greenspan last week indicated as much in his testimony. But there is a concern that this might be a jobless recovery. And so these employment numbers today – and those in the future – are particularly critical to measuring the full effect of our returning and reviving the American economy.

Today there are nearly eight million unemployed Americans and more than four million additional workers who want a job but are not counted among those who are unemployed. And more than two million Americans have exhausted their benefits since the start of this recession. In fact, we are approaching a record number of people who have exhausted their benefits and are not eligible for additional benefits.

So it is particularly pleasing to me that this week the House moved to extend unemployment benefits after considering a series of proposals.

I think we finally arrived at a proposal which recognizes the need to assist the unemployed while also providing some prudent and effective, limited steps to further stimulate the economy. Hopefully, this provision will be adopted very quickly by my colleagues in the Senate.

And our task today is to ensure that we put this country on a strong and sustainable growth path; that we do, in fact, follow through and extend unemployment benefits to workers; that we continue to boost the economy, and we do so in a way that will not only revive our GDP, but give back meaningful employment to millions of Americans.

Thank you, Mr. Chairman.

[The prepared statement of Senator Reed appears in the Submissions for the Record on page 15.]

Representative Saxton. I thank the gentleman. Commissioner, welcome, we are pleased to have you here today, and we are prepared for your statement.

OPENING STATEMENT OF LOIS ORR, ACTING COMMISSIONER, BUREAU OF LABOR STATISTICS: ACCOMPANIED BY KENNETH V. DALTON, ASSOCIATE COMMISSIONER, OFFICE OF PRICES AND LIVING CONDITIONS; AND PHILIP L. RONES, ASSISTANT COMMISSIONER OF CURRENT EMPLOYMENT ANALYSIS

Ms. Orr. Thank you. Mr. Chairman and Members of the Committee, as always I appreciate the opportunity to comment on the labor market data, and I think especially today. We are reporting today that nonfarm payroll employment was up by 66,000 in February, following losses that averaged 146,000 a month between the beginning of the recession in March 2001 and this past January. The largest increase over the month occurred in retail trade, but we suggest caution in interpreting that figure as a sign of strength for that industry, as I will explain in more detail later in the statement.

Aside from retail trade, nonfarm payroll employment on net was little changed in February. Employment did rise in health services, and a mild winter helped boost the number of jobs in construction. There were employment declines in manufacturing, mining, wholesale trade, and finance. The unemployment rate was essentially unchanged at 5-1/2 percent.

Looking in more detail at the data from our survey of employers for February, job losses continued in manufacturing, a decline of 50,000 workers, although that was about half the average pace of the prior 12 months. Employment in motor vehicle manufacturing increased by 26,000 over the month, reversing a decline of similar magnitude in January. Most of the February increase stemmed from the reopening of automotive plants that had shut down for inventory control in January. Nonetheless, compared to a year ago, employment in auto manufacturing is down 63,000. Elsewhere in transportation equipment, job losses in aircraft manufacturing have totaled 31,000 in the last four months, 8,000 of which came in February. Sizable employment declines continued in printing and publishing, which was down 13,000, and electrical equipment where the decline was 22,000. The February decline of 14,000 jobs in industrial machinery employment was below the 21,000 average of the prior 12 months. Primary metals and fabricated metals also had smaller employment declines in February than in recent months. The factory workweek edged up a tenth of an hour to 40.7 hours, and factory overtime was steady at 3.9 hours.

Mining employment in February declined sharply by 6,000, with most of the losses in oil and gas extraction. Since last September, the oil and gas industry has lost 9,000 jobs.

Job losses in wholesale trade, which numbered 15,000, accelerated in February after two months of smaller declines. Most of that loss was concentrated in durable goods distribution.

Employment in finance dropped by 11,000 in February, the first loss in this industry since last July. Within finance, job losses continued at security brokerages, where employment has fallen by 45,000 since the industry's peak last March. On the other hand, employment in mortgage brokerages was up in February, but only slightly. In contrast to the decline in finance, real estate added 5,000 jobs in February, its first substantial increase since last September.

With unusually mild and dry weather in February, we found that construction employment increased by 25,000 after seasonal adjustment. This unusually mild and dry weather may have contributed to the employment growth in heavy construction where the increase was 12,000 and in special trade contractors, 14,000, particularly in the weather-sensitive concrete component of special trade. Within general building contractors, continued gains in residential contractors offset nonresidential losses.

In February, retail trade employment rose by 58,000, seasonally adjusted. And, of course, this is the point I was referring to at the beginning of my remarks, that it is important to understand this employment change we are showing in retail trade. Large seasonal layoffs, as we know, always occur in retail trade in January and February, following the holiday season buildup in the preceding months. If you will recall, holiday hiring in late 2001 was well below normal. And then as a result, there were fewer workers to lay off in January and February. These relatively small layoffs in January and February appear in our data as seasonally adjusted increases, and over the two months they have totaled 99,000. A clearer perspective on the industry's trend requires a longer-term view, which shows that retail employment is down by 142,000 workers since last July.

Employment in services edged up by 40,000 in February. Gains in December, January, and February totaled 132,000, which followed losses in October and November that were almost twice that amount, 245,000. In February, help supply services did not lose jobs for the first time in nearly a year and a half, and we have seen consistent job losses every month in help supplies since September, 2000. This month, there is a very modest increase. Losses during that period of September 2000 through January 2002 in help supply had totaled 669,000, and that is an industry that in September 2000 had employment of approximately 3-1/2 million. Modest gains also were posted in education, engineering, and management services and hotels.

Employment in health services continued its strong growth trend, with an above-average gain of 34,000 jobs in February, with 13,000 of those jobs being in doctors' offices and clinics.

Within transportation, job losses in the passenger component of air transportation have slowed dramatically in the past two months, following a decline of 87,000 in the fourth quarter of 2001.

Average hourly earnings of production or nonsupervisory workers in the private sector rose two cents, to $14.63 in February. This followed a gain of three cents in January, and that is a revision to the January number. Hourly earnings over the year increased by 3.7 percent.

Turning to some of the measures obtained from our Current Population Survey, that is, our survey of households, the unemployment rate was essentially unchanged at 5.5 percent in February, as was the number of unemployed persons, which totaled 7.9 million. The jobless rate for Hispanics declined in February, while the rates for adult men, adult women, teenagers, whites, and blacks were little changed. Looking at another measure of labor underutilization, the number of part-time workers who would have preferred full-time work rose by 255,000 to 4.2 million, following a decline in January.

The labor force increased by 821,000 over the month, reflecting a large increase in employment and reversing a very substantial decline that we saw last month; that is, in January. Both the labor force participation rate, which is at 67.7 percent, and the employment population ratio, at 63 percent, rose over the month, offsetting similar declines in January.

In summary, the jobless change rate was essentially unchanged in February at 5.5 percent, and the number of workers on nonfarm payrolls rose slightly in February after six months of losses that totaled 1.3 million.

My colleagues and I now would be glad to answer any questions.

[The prepared statement of Ms. Orr, together with accompanying press release appear in the Submissions for the Record on page 16.]

Representative Saxton. Thank you very much. Your statement is, as usual, very articulate.

I brought some charts with me here that I would just like to run through for just a moment, just to get your reaction to see if your take on these statistics as depicted on these charts is the same as mine.

The first chart shows the trends in GDP over the last several years. And, of course, beginning in mid-2000, we begin to see diminished economic growth as expressed in GDP. And finally in the third quarter of 2001, we actually saw negative growth. And, of course, the revised GDP growth figures for the last quarter of last year are very encouraging, back in the positive territory for the first time. This would be a positive indicator of economic growth, would it not?

[The chart entitled, "Gross Domestic Product" appears in the Submissions for the Record on page 43.]

Ms. Orr. Yes. Of course, we see the reflection in our productivity measures that we released last week for fourth quarter 2001 reflecting that revision in gross domestic product; because if you recall last month we met, the GDP was up two-tenths, and with the revision that is reflected also.

Representative Saxton. We thought maybe the numbers that we saw beginning in January were some kind of an anomaly, since the unemployment rate slipped back to 5.6 percent. But now in February we see, as you put it, the unemployment rate remained the same. And I know you say that for statistical reasons. But the full number is a tenth of a percentage point lower than it was even in January, isn't that right?

Ms. Orr. Right. The difference is not statistically significant.

Representative Saxton. Right. I agree. And of course, we saw positive numbers in employment data for February. That is another good sign. And we look at something called the Diffusion Index, which is an index that measures growth across the economic sectors in 353 industries, and we saw that last November that only 38 percent of those 353 industries were experiencing growth. And in the February numbers, we see that 48 percent, up from 38 percent just four months ago, are now experiencing growth. So that would tend to lend credence to the fact that things have changed some.

Ms. Orr. We haven't seen with the numbers we are releasing today, substantial growth in very many of the industries, but we have seen something – stabilization, if you will, or substantial reduction in the rate of job loss.

Representative Saxton. We would like to certainly see the percentage of the Diffusion Index above 50 percent. But 38 percent as compared to 48 percent, we seem to be doing a little better.

Personal consumption during the last quarter of the year is also an encouraging sign. We saw six percent growth in personal consumption. The last time we saw that was back in the second quarter of 1998. So not to overstate these numbers, or not to overstate these statistics, but we are seeing a trend here in our chart that would indicate at least a bottoming out in some growth as well, true?

[The chart entitled, "Personal Consumption Expenditures" appears in the Submissions for the Record on page 44.]

We still continue to see problems, so we certainly cannot begin to celebrate too strongly yet. As we see in the next chart, fixed private nonresidential investment continues to be a problem. Can you comment?

[The chart entitled, "Fixed Private Nonresidential Investment" appears in the Submissions for the Record on page 45.]

Ms. Orr. Well, certainly we see in our employment numbers in nonresidential construction and in residential construction some continued strength.

Representative Saxton. The next chart also, on its face, looks like we still have a problem with regard to nonfarm payrolls. However, there is a trend that is fair and impartially unmistakable during the last four months. We see that while nonfarm payrolls showed very strong weakness in each month for the last four, things seemed to have gotten a little less bad. And in February, for the first time, we would have a yellow bar that goes above the line. Of course, the February numbers aren't on this chart, but the February numbers would show the trend that began four months ago in terms of nonfarm payroll becoming less bad. And this time, for the first time, we would see a positive yellow bar going up, again indicating that there is a trend underway.

[The chart entitled, "Employees on Nonfarm Payrolls" appears in the Submissions for the Record on page 46.]

Ms. Orr. Actually with this month, it is the first time in seven months that we have had an increase.

Representative Saxton. How long has it been since payroll employment expanded as much as it did in February?

Ms. Orr. It is over a year ago. We had an employment increase of 167,000 last February. That was followed by an increase of 59,000 in March of 2001, and then an April decline of 165,000. In fact, as I said, this month is our first employment increase in seven months.

Representative Saxton. And you are saying that since we have had a nonfarm payroll employment increase of this level has been since last February?

Ms. Orr. Yes.

Representative Saxton. I spoke about the Diffusion Index a few minutes ago. Do you use the Diffusion Index for purposes in your evaluations?

Ms. Orr. We do look at it. We look at a number of different measures.

Representative Saxton. Do you have other indices that show the trend that appears to be underway?

Ms. Orr. I would note that our measure of hours appears to have stabilized. But were you asking me about internal Bureau-produced data that we use, or are there other outside or external data that we look at? We look at the full range of economic data that is issued.

Representative Saxton. I am trying to determine whether the trend that we have seen from the charts, from your numbers, from the unemployment rate, is evident in other economic data? Do you have other indicators that we haven't talked about here?

Ms. Orr. I don't know that we in the Bureau do, but certainly from a variety of other sources there are measures that seem to be consistent with the data that you have in your charts and the data that we are issuing today. I would say, for example, orders for goods and services, for instance, or evidence that there is decline in inventories.

Representative Saxton. House sales, existing house sales, are almost at a peak in January. Is that a high for January or a high overall in terms of existing housing sales? There was a decline in employment in heavy construction; is that correct?

Ms. Orr. Yes.

Representative Saxton. Is that consistent with the problems in the commercial real estate sector?

Ms. Orr. There was an increase in employment in heavy construction in selected special trades such as concrete, as I mentioned. But among general contractors, there is a decline in employment among general contractors that are engaged in nonresidential construction.

Representative Saxton. Is there a reason that you can point to as to why that has occurred?

Ms. Orr. Because folks aren't building buildings.

Representative Saxton. Obviously. You mentioned weather. How important do you think weather was in this month's—

Ms. Orr. It was our assessment that the mild and dry weather actually for December, January, first half of February period, was significant in helping to account for the increase in employment in February.

Representative Saxton. So, while we have seen a trend here – first of all, these numbers are nowhere near as strong as they could have been. So, while we see a trend, and there are other factors that may be at play, like weather, maybe it is not time quite to pop the cork in the champagne bottle and celebrate that robust growth is here again.

Ms. Orr. We were talking about champagne on the way over, and we weren't ready to pop the cork either.

Representative Saxton. Mr. English?

Representative English. Thank you, Mr. Chairman. I appreciate the opportunity to participate in today's hearing. And I guess while I am appreciative of the fact that some of these trends are very encouraging for the long hall, I am constrained to note that in my part of western Pennsylvania, we are still very much in a recession. And it is based particularly with what is going on in the manufacturing sector, to which point I want to direct all of my questions. Commissioner Orr, what has been the trend in manufacturing employment since July of 2000 and specifically how many jobs in this sector have been lost in this time frame and in what industries do these declines seem to be concentrated?

Representative Saxton. If I may just ask the gentleman to yield for a minute, we have a chart that speaks to this issue. I think it is the next-to-the-last chart.

[The chart entitled, "All Employees: Manufacturing" appears in the Submissions for the Record on page 47.]

Representative English. I am grateful to the gentleman for the visuals.

Ms. Orr. You asked the number of manufacturing jobs that have been lost?

Representative English. General trends in manufacturing employment since July 2000, how many jobs have been lost in this sector in this time frame, and in what industries do these declines seem to be concentrated?

Ms. Orr. Between July and this February, manufacturing employment declined by approximately 1.7 million. I would also note there are many who would say that a number of jobs also in manufacturing, to be found in the help supply industry, you know, declined very substantially between – as I noted earlier, between September 2000 and currently.

With respect to the industries in which we had declines, the manufacturing industries in which there were declines looking at this period, they have really spread across almost all manufacturing industries with, in many instances, the larger industries incurring larger losses. Let me just note a few of those industries in manufacturing that accounted for a large share of the loss: electronic equipment, industrial machinery, printing and publishing, air transportation, primary metals, fabricated metals, textiles.

So the losses were to be found certainly in durable goods manufacturing, but also to a somewhat lesser extent in nondurable goods. Industries such as textiles, for example, have been in a state of declining employment for I think decades , a generation.

Representative English. I can understand that in the case of textiles, we are looking at more of a long-term trend. But I am also concerned that some of the manufacturing sectors which we have managed to retain on shore and in which we are competitive seem to be suffering significant job losses. Do you have any evidence to suggest whether these job losses in manufacturing are temporary or permanent?

Ms. Orr. Well, looking at the long haul as far as manufacturing is concerned, you know, we have continued to see manufacturing as a smaller proportion of total employment in the nation. For example, in our every two years' employment projections, we are projecting 10 years from now employment manufacturing will be similar in size to what it is now. So overall, you know, we have seen declines in manufacturing, and based on our projections, would not expect to see vast kinds of increases in employment.

I would note that during the 1990s, we saw a sizable increase in manufacturing employment in this country, but with the job losses in manufacturing that have occurred since 1998, I would say employment right now in manufacturing is fairly similar in size to what it was at the beginning of the nineties.

Representative English. So actually there have been ebbs and flows within manufacturing employment. Isn't it true that manufacturing is one of the last sectors to recover during a recession normally, given, at least for some areas of manufacturing, the long lead times in manufacturing orders?

Mr. Rones. Historically, what employers tend to do is they start increasing hours in manufacturing and that allows for the flexibility for that period when you are not really certain whether you are going to see a sustained increase in demand. More recently, employers have been less likely to use hours – that is, hours have been less cyclical and employment has been more cyclical.

I would say we have a flattening or maybe even a little increase in manufacturing hours in the last few months, and that would be a positive sign.

Representative English. You go ahead.

Ms. Orr. And we sometimes do see some of these jobs showing up in other industries. People that are employed in manufacturing, in reality, may be in help supply. And to the extent that manufacturers increase the contracting out of a lot of the services or functions they would have performed by themselves, we can see a decline in manufacturing that, if organizations were structured differently, might not see as a large a decline.

Representative English. What has been the recent trend in the Diffusion Index for manufacturing measuring the breadth of monthly employment gains in that sector, and what was its level a year ago relative to today?

Mr. Rones. In manufacturing – and this is the full range of specific industries – it is 136 that we include in our Diffusion Index. Right now we are at 41 percent. That is better than a year ago when we were at 32 percent. But I note that we haven't been above that 50 percent mark that the Chairman described earlier since the middle of 2000. So that, of course, corresponds with this long period of sustained – actually this predates the period of sustained losses in manufacturing.

Representative English. I thank the panelists for their testimony. It is most helpful. And I thank you for the opportunity to inquire, Mr. Chairman.

Representative Saxton. Thank you.

Commissioner, we appreciate you being here again. I have no further questions at this point. I would just like to take this opportunity to say that. A function of the Joint Economic Committee is to look at a variety of functions of the Federal Government, and try to determine how those functions are affecting the economy, or whether they are affecting the economy in any way. And certainly as we hope that we are seeing the beginning of the end of the recession, we need to recognize the role that the Federal Reserve has played in bringing about monetary policy that has set the stage for economic growth, pointing of course to relatively low interest rates.

The Congress, in addition, on a second front, reduced tax rates not long ago, not to everybody's liking, maybe not to anybody's liking, depending on your point of view, but marginal rates today are lower than they were earlier.

We have also seen some restraint in government spending, until the events of September 11 at least, and we hope we can continue along that path.

We also during the last decade or so have seen some very robust increases in investment, in technological developments that have added to productivity, and of course we continue to promote open markets and international trade, which have again played a part in setting the stage for what we hope we see here; that is, the beginning of another period of economic growth.

So we thank you for bringing this news to us today. We look forward to seeing you again next month. Mr. Rones and Mr. Dalton, thank you. And I thank my friend, Mr. English, for his participation.

[Whereupon, at 10:10 a.m., the Committee was adjourned.]

SUBMISSIONS FOR THE RECORD

THE PREPARED STATEMENT OF REPRESENTATIVE JIM SAXTON, CHAIRMAN

I am pleased to welcome Acting Commissioner Orr once again before the Joint Economic Committee (JEC) to testify on the February employment situation.

The employment data reported today appear to reflect the end of the recession also shown in other recent economic data. Payroll employment stopped its long decline, actually rising 66,000 in February, although partially under the influence of special factors. The decline of the unemployment rate in January was sustained in February, leaving its level at 5.5 percent.

Last month I noted the preliminary signs that indicated the economy may have bottomed out. Since this time additional data have been released suggesting that an economic rebound appears to be underway. A resumption of economic growth would be very welcome news for all Americans, although it remains to be seen how strong and sustained the rebound will be.

Nonetheless, the recent data have been generally quite positive. GDP growth in the fourth quarter of 2001 was sharply revised upward, with consumption growth reaching six percent in that period. The Institute for Supply Management data suggest that manufacturing as well as service industry output is now increasing. Personal income and consumption have both increased according to the most recent monthly data. The leading economic indicators have risen for four months in a row.

The bottoming out in manufacturing output is encouraging since its problems signaled the outset of the slowdown in 2000. Housing and auto sales remain strong, and other official statistics also register improvement. Over the last month the evidence has continued to mount that the recession has ended.

However, the fragility of the economy, particularly investment, remains a concern that justifies enactment of economic stimulus legislation by the Congress. Moreover, the economy remains vulnerable to risks from adverse international economic developments, high debt levels, security costs, and other factors.

Given the recession and the events of September 11, the prospect of economic recovery in the near future is especially impressive and reflects the remarkable resilience of the American economy and people.

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In conclusion, what had been preliminary signs of economic recovery last month have now been confirmed in other more recent data. However, we must be on guard against complacency. Congressional enactment of economic stimulus legislation would be a prudent insurance policy against the potential for another slowdown in economic activity.

PREPARED STATEMENT OF SENATOR JACK REED, VICE CHAIRMAN

Thank you very much, Mr. Chairman. I want to thank Commissioner Orr and her colleagues once again for joining us. And as you indicate, there are encouraging signs that the recession is over. Chairman Greenspan last week indicated as much in his testimony. But there is a concern that this might be a jobless recovery. And so these employment numbers today – and those in the future – are particularly critical to measuring the full effect of our returning and reviving American economy.

Today there are nearly eight million unemployed Americans and more than four million additional workers who want a job but are not counted among those who are unemployed. And more than two million Americans have exhausted their benefits since the start of this recession. In fact, we are approaching a record number of people who have exhausted their benefits and are not eligible for additional benefits.

So it is particularly pleasing to me that this week the House moved to extend unemployment benefits after considering a series of proposals. I think we finally arrived at a proposal which recognizes the need to assist the unemployed while also providing some prudent and effective, limited steps to further stimulate the economy. Hopefully, this provision will be adopted very quickly by my colleagues in the Senate.

And our task today is to ensure that we put this country on a strong and sustainable growth path; that we do, in fact, follow through and extend unemployment benefits to workers; that we continue to boost the economy, and we do so in a way that will not only revive our GDP, but give back meaningful employment to millions of Americans.

Thank you, Mr. Chairman.

FOR DELIVERY: 9:30 A.M., E.S.T.
FRIDAY, MARCH 8, 2002

Advance copies of this statement are made available to the press under lock-up conditions with the explicit understanding that the data are embargoed until 8:30 a.m. Eastern Standard Time.

Statement of

Lois Orr
Acting Commissioner
Bureau of Labor Statistics

before the

Joint Economic Committee

UNITED STATES CONGRESS

Friday, March 8, 2002

Mr. Chairman and Members of the Committee:

I appreciate this opportunity to comment on the labor market data that we released this morning.

We are reporting today that nonfarm payroll employment was up by 66,000 in February, following losses that averaged 146,000 a month between the beginning of the recession in March 2001 and January 2002. The largest increase occurred in retail trade, but we suggest caution in interpreting that figure as a sign of strength for that industry, as I will explain in more detail later in this statement. Aside from retail trade, nonfarm payroll employment on net was little changed in February. Employment did rise in health services, and mild weather helped boost the number of jobs in construction. There were employment declines in manufacturing, mining, wholesale trade, and finance. The unemployment rate was essentially unchanged at 5.5 percent.

Looking in more detail at the data from our survey of employers for February, job losses continued in manufacturing (-50,000), although at about half the average pace of the prior 12 months. Employment in motor vehicle manufacturing increased by 26,000 over the month, reversing a decline of similar magnitude in January. Most of the February increase stemmed from the reopening of automobile plants that had shut down for inventory control in January. Still, employment in auto manufacturing is down 63,000 over the year. Elsewhere in transportation equipment, job losses in aircraft manufacturing have totaled 31,000 in the last 4 months, 8,000 of which came in February. Sizable employment declines continued in printing and publishing (-13,000) and in electrical equipment (-22,000). The February decline of 14,000 jobs in industrial machinery employment was below the 21,000 average of the prior 12 months. Primary metals and fabricated metals also had smaller employment declines in February than in recent months. The factory workweek edged up 0.1 hour to 40.7 hours, and factory overtime was steady at 3.9 hours.

Mining employment declined sharply in February (-6,000), with most of the losses in oil and gas extraction. Since last September, the oil and gas industry has lost 9,000 jobs.

Job losses in wholesale trade (-15,000) accelerated in February after 2 months of smaller declines. Most of the loss was concentrated in durable goods distribution.

Employment in finance fell by 11,000 in February, the first loss in this industry since last July. Within finance, job losses continued in security brokerages, where employment has fallen by 45,000 since the industry's peak last March. Employment in mortgage brokerages was up slightly in February. In contrast to the decline in finance, real estate added 5,000 jobs, its first substantial increase since September.

Construction employment increased by 25,000 in February, after seasonal adjustment, partly offsetting a large decline in January. Unusually mild and dry weather may have contributed to employment growth in heavy construction (12,000) and special trade contractors (14,000)--particularly in the weather-sensitive concrete component. Within general building contractors, continued gains in residential contractors offset nonresidential losses.

In February, retail trade employment rose by 58,000 (seasonally adjusted). Large seasonal layoffs always occur in retail trade in January and February, following the holiday-season employment buildup in the preceding months. Holiday hiring in late 2001, however, was well below normal. As a result, there were fewer workers to lay off in January and February. The relatively small layoffs in those 2 months appear in our data as seasonally adjusted increases, totaling 99,000. A clearer perspective on the industry's trend requires a longer-term view, which shows that retail employment is down by 142,000 since last July.

Employment in services edged up by 40,000 in February. Gains in December, January, and February totaled 132,000, following losses in October and November that totaled 245,000. In February, help supply services did not lose jobs for the first time in nearly a year and a half. Losses from September 2000 through January 2002 had totaled 669,000. Modest gains also were posted in education, engineering and management services, and hotels. Employment in health services continued its strong growth trend, with an above-average gain of 34,000 jobs in February, including 13,000 in doctors' offices and clinics.

Within transportation, job losses in the passenger component of air transportation have slowed dramatically in the past 2 months, following a decline of 87,000 in the fourth quarter of 2001.

Average hourly earnings of production or nonsupervisory workers in the private sector rose 2 cents to $14.63 in February. This followed a gain of 3 cents in January (as revised). Hourly earnings increased by 3.7 percent from February 2001.

Turning to some of the measures obtained from the survey of households, the unemployment rate was essentially unchanged at 5.5 percent in February, as was the number of unemployed persons, at 7.9 million. The jobless rate for Hispanics declined in February, while the rates for adult men, adult women, teenagers, whites, and blacks were little changed. Looking at another measure of labor underutilization, the number of part-time workers who would have preferred full-time work rose by 255,000 to 4.2 million, following a decline in January.

The labor force increased by 821,000, reflecting a large increase in employment (851,000) in February and reversing a substantial decline in January. Both the labor force participation rate (66.7 percent) and the employment-population ratio (63.0 percent) rose over the month, offsetting declines in January.

To summarize, the jobless rate was essentially unchanged in February at 5.5 percent. The number of workers on nonfarm payrolls rose slightly in February, after 6 months of losses that totaled 1.3 million.

My colleagues and I now would be glad to answer your questions.

News

United States Department of Labor

Bureau of Labor Statistics Washington, D.C. 20212

Technical information:
Household data: (202) 691-6378 http://www.bls.gov/cps/
Establishment data: 691-6555 http://www.bls.gov/ces/
Media contact: 691-5902

USDL 02-124

Transmission of material in this release is embargoed until 8:30 A.M. (EST), Friday, March 8, 2002.

THE EMPLOYMENT SITUATION: FEBRUARY 2002

The unemployment rate was essentially unchanged at 5.5 percent in February, the Bureau of Labor Statistics of the U.S. Department of Labor reported today. Nonfarm payroll employment was up by 66,000 in February, following several months of large job losses. February gains in several industries, however, can be attributed to special factors. Manufacturing employment continued to decline, although at a slower pace.

Chart 1. Unemployment rate, seasonally adjusted, March 1999 - February 2002

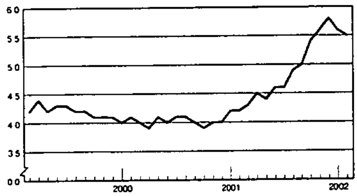
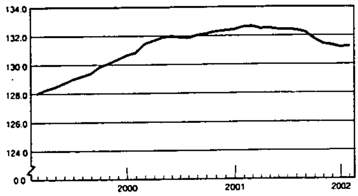


Chart 2. Nonfarm payroll employment, seasonally adjusted, March 1999 - February 2002



Unemployment (Household Survey Data)

The number of unemployed persons (7.9 million) and the unemployment rate (5.5 percent) were essentially unchanged in February, following declines in both measures in January. The unemployment rate for Hispanics fell by a percentage point to 7.1 percent in February. Jobless rates for the other major worker groups—adult men (5.0 percent), adult women (5.0 percent), teenagers (15.6 percent), whites (4.9 percent), and blacks (9.6 percent)—were little changed. (See tables A-1 and A-2.)

Total Employment and the Labor Force (Household Survey Data)

Total employment rose by 851,000 to 134.3 million in February, after seasonal adjustment; this increase more than offset a large decline in January. The employment-population ratio increased by 0.4 percentage point in February, returning to its December level of 63.0 percent. (See table A-1.)

In February, the number of persons working part time despite their preference for full-time work increased by 255,000 to 4.2 million. The number of persons working part time for economic reasons had been at about that level from September through December. (See table A-4.)

Table A. Major indicators of labor market activity, seasonally adjusted
(Numbers in thousands)

Category	Quarterly averages 2001 III	Quarterly averages 2001 IV	Monthly data 2001 Dec.	Monthly data 2002 Jan.	Monthly data 2002 Feb.	Jan.-Feb. change
HOUSEHOLD DATA	Labor force status					
Civilian labor force	141,700	142,291	142,314	141,390	142,211	821
Employment	134,839	134,308	134,055	133,468	134,319	851
Unemployment	6,860	7,983	8,259	7,922	7,891	-31
Not in labor force	70,438	70,467	70,613	71,699	70,995	-704
	Unemployment rates					
All workers	4.8	5.6	5.8	5.6	5.5	-0.1
Adult men	4.3	5.0	5.2	5.2	5.0	-.2
Adult women	4.2	5.0	5.2	4.8	5.0	.2
Teenagers	15.2	15.8	16.2	16.1	15.6	-.5
White	4.2	4.9	5.1	5.0	4.9	-.1
Black	8.7	9.9	10.2	9.8	9.6	-.2
Hispanic origin	6.4	7.5	7.9	8.1	7.1	-1.0
ESTABLISHMENT DATA	Employment					
Nonfarm employment	132,358	131,510	131,321	p131,195	p131,261	p66
Goods-producing[1]	24,991	24,592	24,453	p24,278	p24,247	p-31
Construction	6,866	6,851	6,850	p6,787	p6,812	p25
Manufacturing	17,556	17,174	17,039	p16,929	p16,879	p-50
Service-producing[1]	107,367	106,918	106,868	p106,917	p107,014	p97
Retail trade	23,575	23,404	23,365	p23,406	p23,464	p58
Services	41,103	40,947	40,957	p40,981	p41,021	p40
Government	20,973	21,022	21,061	p21,063	p21,083	p20
	Hours of work[2]					
Total private	34.1	34.1	34.1	p34.1	p34.1	p.0
Manufacturing	40.7	40.5	40.6	p40.6	p40.7	p0.1
Overtime	4.0	3.8	3.8	p3.9	p3.9	p.0
	Indexes of aggregate weekly hours (1982=100)[2]					
Total private	150.3	148.8	148.8	p148.3	p148.5	p0.2
	Earnings[2]					
Average hourly earnings, total private	$14.40	$14.53	$14.58	p$14.61	p$14.63	p$0.02
Average weekly earnings, total private	490.93	494.99	497.18	p498.20	p498.88	p.68

[1] Includes other industries, not shown separately.

[2] Data relate to private production or nonsupervisory workers.

p=preliminary.

Following a decline of 924,000 in January, the civilian labor force increased by 821,000 in February, to 142.2 million. The labor force participation rate—the proportion of the population that is either working or looking for work—increased by 0.3 percentage point, to 66.7 percent. (See table A-1.)

Persons Not in the Labor Force (Household Survey Data)

In February, the number of persons not in the labor force who reported that they currently want a job decreased by 449,000, to 4.4 million (seasonally adjusted); this group accounted for 6.2 percent of all persons not in the labor force. These individuals were not counted as unemployed because they had not searched for work in the 4-week period preceding the survey. Most had not searched for over a year. (See table A-1.)

About 1.4 million persons (not seasonally adjusted) were marginally attached to the labor force in February. These individuals reported that they wanted and were available for work and had looked for a job sometime in the prior 12 months. They were not counted as unemployed, however, because they had not actively searched for work in the 4 weeks preceding the survey. The number of discouraged workers was 371,000 in February, up by 82,000 from a year earlier. Discouraged workers, a subset of the marginally attached, were not currently looking for work specifically because they believed no jobs were available for them. (See table A-10.)

Industry Payroll Employment (Establishment Survey Data)

Nonfarm payroll employment was up by 66,000 in February to 131.3 million, seasonally adjusted. While the over-the-month change was positive for the first time since July 2001, much of the gain was due to special circumstances. Unusual seasonal employment patterns in retail trade, favorable weather for construction, and a return from temporary plant shutdowns in motor vehicle manufacturing were important components of the February change. (See table B-1.)

In the goods-producing sector, manufacturing lost 50,000 jobs in February, compared with average losses of about 111,000 in the prior 12 months. Motor vehicle employment rose by 26,000, as most of the plants that had been temporarily shut down in January to reduce inventories were operating in February. Large employment declines continued in electrical equipment (-22,000) and industrial machinery (-14,000). Aircraft manufacturing lost 8,000 jobs in February; since September, employment in this industry has fallen by 33,000. Employment in printing and publishing fell by 13,000 in February and has declined by 107,000 over the year.

Construction employment increased by 25,000 in February, reflecting unusually warm temperatures and dry weather across the country. The job gains were in heavy construction and, within special trades, concrete work, both of which are particularly sensitive to the weather. Other construction components showed little change.

Mining employment declined by 6,000 in February, with most of the losses in oil and gas extraction (-4,000). Since September, oil and gas employment has decreased by 9,000.

Within the service-producing sector, wholesale trade job losses totaled 15,000 in February, after 2 months of smaller declines. Employment in the insurance industry continued to fall in February; the industry has lost 14,000 jobs since September. Employment in finance declined by 11,000 over the month. Within finance, security brokerages continued to shed jobs, with losses totaling 45,000 since industry employment peaked in March 2001. In contrast, employment continued to increase in mortgage brokerages in February, reflecting low mortgage interest rates.

Retail trade employment rose by 58,000 in February, after seasonal adjustment. This followed a rise of 41,000 in January. Because of light hiring during the holiday season, there were fewer workers to lay off in January and February, resulting in over-the-month gains after seasonal adjustment. On net, since July, employment in retail trade is down by 142,000, seasonally adjusted.

After substantial job losses in October and November 2001, employment in the services industry rose modestly for the third consecutive month. Health services employment rose by 34,000, with offices and clinics of medical doctors showing a large gain (13,000). Employment in help supply services edged up by 14,000; however, employment in this industry is 655,000, or 18.5 percent, below its peak level of September 2000. Engineering and management services added 9,000 jobs.

In transportation, job losses in the passenger component of air transportation have slowed in the past 2 months, following a decline of 87,000 in the fourth quarter. Trucking employment continued on the downward trend that began in April 2001.

Weekly Hours (Establishment Survey Data)

The average workweek for production or nonsupervisory workers on private nonfarm payrolls was unchanged in February at 34.1 hours, seasonally adjusted. The manufacturing workweek edged up by 0.1 hour to 40.7 hours. Manufacturing overtime was unchanged at 3.9 hours. (See table B-2.)

The index of aggregate weekly hours of production or nonsupervisory workers on private nonfarm payrolls increased by 0.1 percent in February to 148.5 (1982=100), seasonally adjusted. The index has fallen by 2.4 percent from its recent peak in January 2001. The manufacturing index edged down by 0.1 percent to 92.6 in February and has fallen by 9.7 percent since January 2001. (See table B-5.)

Hourly and Weekly Earnings (Establishment Survey Data)

Average hourly earnings of production or nonsupervisory workers on private nonfarm payrolls increased by 2 cents in February to $14.63, seasonally adjusted. Average weekly earnings rose by 0.1 percent to $498.88. Over the year, average hourly earnings increased by 3.7 percent and average weekly earnings grew by 3.1 percent. (See table B-3.)

The Employment Situation for March 2002 is scheduled to be released on Friday, April 5, at 8:30 A.M. (EST).

March 2001 National Benchmarks

In accordance with standard practice, BLS will release nonfarm payroll employment benchmark revisions with the May data on June 7, 2002. The March 2001 benchmark level has been finalized and will result in a downward revision of 123,000 to total nonfarm employment for the March 2001 reference month, an adjustment of 0.1 percent.

Also concurrent with the release of the March 2001 benchmark revisions on June 7, BLS will continue the implementation of a new probability-based sample design for the payroll survey. Estimates for the mining, construction, manufacturing, and wholesale trade industries are currently produced using the new sample and methodology. Estimates for the transportation and public utilities; retail trade; and finance, insurance, and real estate industries will incorporate the new sample design with the June 7 release. Further information is available on the Internet (http://www.bls.gov/ces/) or by calling (202) 691-6555.

Explanatory Note

This news release presents statistics from two major surveys, the Current Population Survey (household survey) and the Current Employment Statistics survey (establishment survey). The household survey provides the information on the labor force, employment, and unemployment that appears in the A tables, marked HOUSEHOLD DATA. It is a sample survey of about 60,000 households conducted by the U.S. Census Bureau for the Bureau of Labor Statistics (BLS).

The establishment survey provides the information on the employment, hours, and earnings of workers on nonfarm payrolls that appears in the B tables, marked ESTABLISHMENT DATA. This information is collected from payroll records by BLS in cooperation with State agencies. In June 2001, the sample included about 350,000 establishments employing about 39 million people.

For both surveys, the data for a given month relate to a particular week or pay period. In the household survey, the reference week is generally the calendar week that contains the 12th day of the month. In the establishment survey, the reference period is the pay period including the 12th, which may or may not correspond directly to the calendar week.

Coverage, definitions, and differences between surveys

Household survey. The sample is selected to reflect the entire civilian noninstitutional population. Based on responses to a series of questions on work and job search activities, each person 16 years and over in a sample household is classified as employed, unemployed, or not in the labor force.

People are classified as *employed* if they did any work at all as paid employees during the reference week; worked in their own business, profession, or on their own farm; or worked without pay at least 15 hours in a family business or farm. People are also counted as employed if they were temporarily absent from their jobs because of illness, bad weather, vacation, labor-management disputes, or personal reasons.

People are classified as *unemployed* if they meet all of the following criteria: They had no employment during the reference week; they were available for work at that time; and they made specific efforts to find employment sometime during the 4-week period ending with the reference week. Persons laid off from a job and expecting recall need not be looking for work to be counted as unemployed. The unemployment data derived from the household survey in no way depend upon the eligibility for or receipt of unemployment insurance benefits.

The *civilian labor force* is the sum of employed and unemployed persons. Those not classified as employed or unemployed are *not in the labor force*. The *unemployment rate* is the number unemployed as a percent of the labor force. The *labor force participation rate* is the labor force as a percent of the population, and the *employment-population ratio* is the employed as a percent of the population.

Establishment survey. The sample establishments are drawn from private nonfarm businesses such as factories, offices, and stores, as well as Federal, State, and local government entities. *Employees on nonfarm payrolls* are those who received pay for any part of the reference pay period, including persons on paid leave. Persons are counted in each job they hold. *Hours and earnings* data are for private businesses and relate only to production workers in the goods-producing sector and nonsupervisory workers in the service-producing sector.

Differences in employment estimates. The numerous conceptual and methodological differences between the household and establishment surveys result in important distinctions in the employment estimates derived from the surveys. Among these are:

- The household survey includes agricultural workers, the self-employed, unpaid family workers, and private household workers among the employed. These groups are excluded from the establishment survey.
- The household survey includes people on unpaid leave among the employed. The establishment survey does not.
- The household survey is limited to workers 16 years of age and older. The establishment survey is not limited by age.
- The household survey has no duplication of individuals, because individuals are counted only once, even if they hold more than one job. In the establishment survey, employees working at more than one job and thus appearing on more than one payroll would be counted separately for each appearance.

Other differences between the two surveys are described in "Comparing Employment Estimates from Household and Payroll Surveys," which may be obtained from BLS upon request.

Seasonal adjustment

Over the course of a year, the size of the nation's labor force and the levels of employment and unemployment undergo sharp fluctuations due to such seasonal events as changes in weather, reduced or expanded production, harvests, major holidays, and the opening and closing of schools. The effect of such seasonal variation can be very large; seasonal fluctuations may account for as much as 95 percent of the month-to-month changes in unemployment.

Because these seasonal events follow a more or less regular pattern each year, their influence on statistical trends can be eliminated by adjusting the statistics from month to month. These adjustments make nonseasonal developments, such as declines in economic activity or increases in the participation of women in the labor force, easier to spot. For example, the large number of youth entering the labor force each June is likely to obscure any other changes that have taken place relative to May, making it difficult to determine if the level of economic activity has risen or declined. However, because the effect of students finishing school in previous years is known, the statistics for the current year can be adjusted to allow for a comparable change. Insofar as the seasonal adjustment is made correctly, the adjusted figure provides a more useful tool with which to analyze changes in economic activity.

In both the household and establishment surveys, most seasonally adjusted series are independently adjusted. However, the adjusted series for many major estimates, such as total payroll employment, employment in most major industry divisions, total employment, and

unemployment are computed by aggregating independently adjusted component series. For example, total unemployment is derived by summing the adjusted series for four major age-sex components: this differs from the unemployment estimate that would be obtained by directly adjusting the total or by combining the duration, reasons, or more detailed age categories.

The numerical factors used to make the seasonal adjustments are recalculated twice a year. For the household survey, the factors are calculated for the January-June period and again for the July-December period. For the establishment survey, updated factors for seasonal adjustment are calculated for the May-October period and introduced along with new benchmarks, and again for the November-April period. In both surveys, revisions to historical data are made once a year.

Reliability of the estimates

Statistics based on the household and establishment surveys are subject to both sampling and nonsampling error. When a sample rather than the entire population is surveyed, there is a chance that the sample estimates may differ from the "true" population values they represent. The exact difference, or *sampling error*, varies depending on the particular sample selected, and this variability is measured by the standard error of the estimate. There is about a 90-percent chance, or level of confidence, that an estimate based on a sample will differ by no more than 1.6 standard errors from the "true" population value because of sampling error. BLS analyses are generally conducted at the 90-percent level of confidence.

For example, the confidence interval for the monthly change in total employment from the household survey is on the order of plus or minus 292,000. Suppose the estimate of total employment increases by 100,000 from one month to the next. The 90-percent confidence interval on the monthly change would range from -192,000 to 392,000 (100,000 +/- 292,000). These figures do not mean that the sample results are off by these magnitudes, but rather that there is about a 90-percent chance that the "true" over-the-month change lies within this interval. Since this range includes values of less than zero, we could not say with confidence that employment had, in fact, increased. If, however, the reported employment rise was half a million, then all of the values within the 90-percent confidence interval would be greater than zero. In this case, it is likely (at least a 90-percent chance) that an employment rise had, in fact, occurred. The 90-percent confidence interval for the monthly change in unemployment is +/- 273,000, and for the monthly change in the unemployment rate it is +/- .19 percentage point.

In general, estimates involving many individuals or establishments have lower standard errors (relative to the size of the estimate) than estimates which are based on a small number of observations. The precision of estimates is also improved when the data are cumulated over time such as for quarterly and annual averages. The seasonal adjustment process can also improve the stability of the monthly estimates.

The household and establishment surveys are also affected by *nonsampling error*. Nonsampling errors can occur for many reasons, including the failure to sample a segment of the population, inability to obtain information for all respondents in the sample, inability or unwillingness of respondents to provide correct information on a timely basis, mistakes made by respondents, and errors made in the collection or processing of the data.

For example, in the establishment survey, estimates for the most recent 2 months are based on substantially incomplete returns; for this reason, these estimates are labeled preliminary in the tables. It is only after two successive revisions to a monthly estimate, when nearly all sample reports have been received, that the estimate is considered final.

Another major source of nonsampling error in the establishment survey is the inability to capture, on a timely basis, employment generated by new firms. To correct for this systematic underestimation of employment growth (and other sources of error), a process known as bias adjustment is included in the survey's estimating procedures, whereby a specified number of jobs is added to the monthly sample-based change. The size of the monthly bias adjustment is based largely on past relationships between the sample-based estimates of employment and the total counts of employment described below.

The sample-based estimates from the establishment survey are adjusted once a year (on a lagged basis) to universe counts of payroll employment obtained from administrative records of the unemployment insurance program. The difference between the March sample-based employment estimates and the March universe counts is known as a benchmark revision, and serves as a rough proxy for total survey error. The new benchmarks also incorporate changes in the classification of industries. Over the past decade, the benchmark revision for total nonfarm employment has averaged 0.3 percent, ranging from zero to 0.7 percent.

Additional statistics and other information

More comprehensive statistics are contained in *Employment and Earnings*, published each month by BLS. It is available for $26.00 per issue or $50.00 per year from the U.S. Government Printing Office, Washington, DC 20402. All orders must be prepaid by sending a check or money order payable to the Superintendent of Documents, or by charging to Mastercard or Visa.

Employment and Earnings also provides measures of sampling error for the household survey data published in this release. For unemployment and other labor force categories, these measures appear in tables 1-B through 1-D of its "Explanatory Notes." Measures of the reliability of the data drawn from the establishment survey and the actual amounts of revision due to benchmark adjustments are provided in tables 2-B through 2-H of that publication.

Information in this release will be made available to sensory impaired individuals upon request. Voice phone: 202-691-5200; TDD message referral phone: 1-800-877-8339.

Table A-1. Employment status of the civilian population by sex and age

(Numbers in thousands)

Employment status, sex, and age	Not seasonally adjusted			Seasonally adjusted[1]					
	Feb. 2001	Jan. 2002	Feb. 2002	Feb. 2001	Oct. 2001	Nov. 2001	Dec. 2001	Jan. 2002	Feb. 2002
TOTAL									
Civilian noninstitutional population	211,026	213,089	213,206	211,026	212,581	212,767	212,927	213,089	213,206
Civilian labor force	141,238	141,074	142,057	141,622	142,280	142,279	142,314	141,390	142,211
Participation rate	66.9	66.2	66.6	67.1	66.9	66.9	66.8	66.4	66.7
Employed	134,774	132,139	133,349	135,734	134,615	134,253	134,055	133,468	134,319
Employment-population ratio	63.9	62.0	62.5	64.3	63.3	63.1	63.0	62.6	63.0
Agriculture	2,794	2,896	2,878	3,133	3,203	3,154	3,246	3,273	3,246
Nonagricultural industries	131,980	129,244	130,472	132,601	131,412	131,099	130,809	130,195	131,073
Unemployed	6,464	8,935	8,707	5,888	7,665	8,026	8,259	7,922	7,891
Unemployment rate	4.6	6.3	6.1	4.2	5.4	5.6	5.8	5.6	5.5
Not in labor force	69,788	72,014	71,149	69,404	70,301	70,488	70,613	71,699	70,995
Persons who currently want a job	4,500	4,872	4,436	4,442	4,673	4,698	4,661	4,824	4,375
Men, 16 years and over									
Civilian noninstitutional population	101,428	102,484	102,542	101,428	102,229	102,322	102,402	102,484	102,542
Civilian labor force	75,118	75,208	75,500	75,502	76,027	76,023	75,976	75,469	75,685
Participation rate	74.1	73.4	73.6	74.4	74.4	74.3	74.2	73.6	73.8
Employed	71,430	70,053	70,522	72,348	71,871	71,570	71,577	71,114	71,457
Employment-population ratio	70.4	68.4	68.8	71.3	70.3	69.9	69.9	69.4	69.7
Unemployed	3,687	5,155	4,978	3,154	4,156	4,453	4,399	4,356	4,228
Unemployment rate	4.9	6.9	6.6	4.2	5.5	5.9	5.8	5.8	5.6
Men, 20 years and over									
Civilian noninstitutional population	93,227	94,228	94,262	93,227	94,015	94,077	94,161	94,228	94,262
Civilian labor force	71,139	71,593	71,786	71,289	71,940	71,935	71,988	71,534	71,718
Participation rate	76.3	76.0	76.2	76.5	76.5	76.5	76.5	75.9	76.1
Employed	68,114	67,127	67,510	68,766	68,486	68,204	68,276	67,818	68,157
Employment-population ratio	73.1	71.2	71.6	73.8	72.8	72.5	72.5	72.0	72.3
Agriculture	1,906	1,978	1,933	2,157	2,132	2,082	2,141	2,207	2,185
Nonagricultural industries	66,208	65,152	65,577	66,609	66,354	66,122	66,135	65,611	65,973
Unemployed	3,025	4,466	4,276	2,523	3,454	3,731	3,712	3,716	3,560
Unemployment rate	4.3	6.2	6.0	3.5	4.8	5.2	5.2	5.2	5.0
Women, 16 years and over									
Civilian noninstitutional population	109,598	110,605	110,663	109,598	110,353	110,445	110,525	110,605	110,663
Civilian labor force	66,120	65,867	66,557	66,120	66,253	66,256	66,338	65,920	66,525
Participation rate	60.3	59.6	60.1	60.3	60.0	60.0	60.0	59.6	60.1
Employed	63,344	62,087	62,827	63,386	62,744	62,683	62,478	62,354	62,862
Employment-population ratio	57.8	56.1	56.8	57.8	56.9	56.8	56.5	56.4	56.8
Unemployed	2,777	3,780	3,729	2,734	3,509	3,573	3,860	3,566	3,663
Unemployment rate	4.2	5.7	5.6	4.1	5.3	5.4	5.8	5.4	5.5
Women, 20 years and over									
Civilian noninstitutional population	101,686	102,550	102,651	101,686	102,371	102,438	102,492	102,550	102,651
Civilian labor force	62,335	62,277	62,947	62,130	62,269	62,321	62,481	62,056	62,703
Participation rate	61.3	60.7	61.3	61.1	60.8	60.8	61.0	60.5	61.1
Employed	60,005	59,048	59,738	59,869	59,302	59,288	59,205	59,102	59,588
Employment-population ratio	59.0	57.6	58.2	58.9	57.9	57.9	57.8	57.6	58.0
Agriculture	794	771	803	824	842	852	859	824	829
Nonagricultural industries	59,211	58,277	58,935	59,045	58,460	58,436	58,346	58,277	58,759
Unemployed	2,329	3,229	3,209	2,261	2,967	3,033	3,276	2,954	3,116
Unemployment rate	3.7	5.2	5.1	3.6	4.8	4.9	5.2	4.8	5.0
Both sexes, 16 to 19 years									
Civilian noninstitutional population	16,113	16,310	16,293	16,113	16,195	16,252	16,275	16,310	16,293
Civilian labor force	7,765	7,204	7,323	8,203	8,071	8,023	7,845	7,800	7,790
Participation rate	48.2	44.2	44.9	50.9	49.8	49.4	48.2	47.8	47.8
Employed	6,655	5,964	6,101	7,099	6,827	6,761	6,574	6,548	6,575
Employment-population ratio	41.3	36.6	37.4	44.1	42.2	41.6	40.4	40.1	40.4
Agriculture	94	149	141	152	229	220	246	241	233
Nonagricultural industries	6,561	5,815	5,960	6,947	6,598	6,541	6,328	6,307	6,342
Unemployed	1,110	1,240	1,222	1,104	1,244	1,262	1,271	1,252	1,215
Unemployment rate	14.3	17.2	16.7	13.5	15.4	15.7	16.2	16.1	15.6

[1] The population figures are not adjusted for seasonal variation; therefore, identical numbers appear in the unadjusted and seasonally adjusted columns.

Table A-2. Employment status of the civilian population by race, sex, age, and Hispanic origin

(Numbers in thousands)

Employment status, race, sex, age, and Hispanic origin	Not seasonally adjusted			Seasonally adjusted[1]					
	Feb. 2001	Jan. 2002	Feb. 2002	Feb. 2001	Oct. 2001	Nov. 2001	Dec. 2001	Jan. 2002	Feb. 2002
WHITE									
Civilian noninstitutional population	175,326	176,713	176,783	175,326	176,372	176,500	176,607	176,713	176,783
Civilian labor force	117,883	117,569	118,412	118,143	118,506	118,566	118,403	117,759	118,472
Participation rate	67.2	66.5	67.0	67.4	67.2	67.2	67.0	66.6	67.0
Employed	113,029	110,796	111,880	113,779	112,878	112,652	112,388	111,876	112,632
Employment-population ratio	64.5	62.7	63.3	64.9	64.0	63.8	63.6	63.3	63.7
Unemployed	4,853	6,773	6,532	4,364	5,628	5,914	6,015	5,883	5,840
Unemployment rate	4.1	5.8	5.5	3.7	4.7	5.0	5.1	5.0	4.9
Men, 20 years and over									
Civilian labor force	60,335	60,511	60,788	60,444	60,957	60,900	60,875	60,473	60,714
Participation rate	76.7	76.3	76.6	76.9	77.0	76.9	76.8	76.3	76.5
Employed	57,975	57,024	57,472	58,545	58,287	58,044	58,051	57,658	58,053
Employment-population ratio	73.7	71.9	72.5	74.5	73.7	73.3	73.3	72.7	73.2
Unemployed	2,360	3,487	3,316	1,899	2,670	2,856	2,824	2,815	2,661
Unemployment rate	3.9	5.8	5.5	3.1	4.4	4.7	4.6	4.7	4.4
Women, 20 years and over									
Civilian labor force	51,019	50,941	51,487	50,753	50,762	50,850	50,869	50,696	51,199
Participation rate	60.7	60.2	60.9	60.4	60.1	60.2	60.2	59.9	60.5
Employed	49,303	48,610	49,185	49,069	48,695	48,712	48,591	48,562	48,941
Employment-population ratio	58.7	57.5	58.1	58.4	57.7	57.7	57.5	57.4	57.8
Unemployed	1,716	2,330	2,302	1,684	2,067	2,138	2,278	2,136	2,259
Unemployment rate	3.4	4.6	4.5	3.3	4.1	4.2	4.5	4.2	4.4
Both sexes, 16 to 19 years									
Civilian labor force	6,529	6,117	6,137	6,946	6,787	6,816	6,659	6,588	6,558
Participation rate	51.4	47.5	47.7	54.7	52.9	53.1	51.8	51.2	51.0
Employed	5,752	5,162	5,223	6,165	5,896	5,896	5,746	5,656	5,639
Employment-population ratio	45.3	40.1	40.6	48.5	45.9	45.9	44.7	44.0	43.9
Unemployed	778	955	915	781	891	920	913	932	920
Unemployment rate	11.9	15.6	14.9	11.2	13.1	13.5	13.7	14.2	14.0
Men	14.3	16.8	17.4	12.7	14.7	15.8	14.6	13.7	15.4
Women	9.4	14.5	12.4	9.6	11.5	11.1	12.8	14.6	12.6
BLACK									
Civilian noninstitutional population	25,412	25,785	25,813	25,412	25,686	25,720	25,752	25,785	25,813
Civilian labor force	16,511	16,623	16,637	16,660	16,748	16,687	16,833	16,769	16,747
Participation rate	65.0	64.5	64.5	65.6	65.2	64.9	65.4	65.0	64.9
Employed	15,192	14,906	14,933	15,407	15,144	15,040	15,122	15,119	15,131
Employment-population ratio	59.8	57.8	57.8	60.6	59.0	58.5	58.7	58.8	58.6
Unemployed	1,319	1,717	1,704	1,253	1,604	1,647	1,711	1,650	1,616
Unemployment rate	8.0	10.3	10.2	7.5	9.6	9.9	10.2	9.8	9.6
Men, 20 years and over									
Civilian labor force	7,317	7,520	7,452	7,338	7,354	7,385	7,490	7,548	7,444
Participation rate	71.8	72.7	71.9	72.0	71.4	71.6	72.5	72.9	71.8
Employed	6,770	6,776	6,730	6,847	6,751	6,739	6,811	6,872	6,798
Employment-population ratio	66.4	65.5	65.0	67.2	65.5	65.3	65.9	66.4	65.6
Unemployed	547	745	722	489	603	646	679	674	645
Unemployment rate	7.5	9.9	9.7	6.7	8.2	8.7	9.1	8.9	8.7
Women, 20 years and over									
Civilian labor force	8,305	8,316	8,328	8,348	8,450	8,371	8,456	8,329	8,361
Participation rate	65.1	64.3	64.3	65.4	65.6	64.9	65.4	64.4	64.5
Employed	7,799	7,582	7,599	7,858	7,734	7,669	7,720	7,628	7,653
Employment-population ratio	61.1	58.6	58.7	61.6	60.0	59.4	59.7	58.9	59.1
Unemployed	506	734	728	490	716	702	736	702	708
Unemployment rate	6.1	8.8	8.7	5.9	8.5	8.4	8.7	8.4	8.5
Both sexes, 16 to 19 years									
Civilian labor force	889	787	857	976	944	931	887	894	943
Participation rate	36.1	31.5	34.3	39.7	37.9	37.3	35.5	35.8	37.8
Employed	623	548	603	702	659	632	591	619	680
Employment-population ratio	25.3	22.0	24.2	28.5	26.5	25.3	23.7	24.8	27.2
Unemployed	266	238	254	274	285	299	296	274	263
Unemployment rate	29.9	30.3	29.6	28.1	30.2	32.1	33.4	30.7	27.9
Men	31.3	32.8	29.7	31.1	31.2	31.6	32.0	32.1	30.0
Women	28.6	27.2	29.5	25.1	29.1	32.6	34.8	29.0	25.6

See footnotes at end of table.

Table A-2. Employment status of the civilian population by race, sex, age, and Hispanic origin — Continued

(Numbers in thousands)

Employment status, race, sex, age, and Hispanic origin	Not seasonally adjusted			Seasonally adjusted[1]					
	Feb. 2001	Jan. 2002	Feb. 2002	Feb. 2001	Oct. 2001	Nov. 2001	Dec. 2001	Jan. 2002	Feb. 2002
HISPANIC ORIGIN									
Civilian noninstitutional population	22,830	23,542	23,604	22,830	23,351	23,417	23,478	23,542	23,604
Civilian labor force	15,662	15,926	16,044	15,652	15,956	15,932	16,013	15,988	16,011
Participation rate	68.6	67.6	68.0	68.6	68.3	68.0	68.2	67.9	67.8
Employed	14,629	14,553	14,823	14,682	14,824	14,751	14,753	14,700	14,867
Employment-population ratio	64.1	61.8	62.8	64.3	63.5	63.0	62.8	62.4	63.0
Unemployed	1,034	1,373	1,221	970	1,132	1,181	1,260	1,288	1,143
Unemployment rate	6.6	8.6	7.6	6.2	7.1	7.4	7.9	8.1	7.1

[1] The population figures are not adjusted for seasonal variation; therefore, identical numbers appear in the unadjusted and seasonally adjusted columns.

NOTE: Detail for the above race and Hispanic-origin groups will not sum to totals because data for the "other races" group are not presented and Hispanics are included in both the white and black population groups.

Table A-3. Employment status of the civilian population 25 years and over by educational attainment

(Numbers in thousands)

Educational attainment	Not seasonally adjusted			Seasonally adjusted[1]					
	Feb. 2001	Jan. 2002	Feb. 2002	Feb. 2001	Oct. 2001	Nov. 2001	Dec. 2001	Jan. 2002	Feb. 2002
Less than a high school diploma									
Civilian noninstitutional population	27,191	28,078	27,420	27,191	27,325	27,504	27,815	28,078	27,420
Civilian labor force	11,732	12,201	11,824	12,089	12,076	12,035	12,257	12,112	12,172
Percent of population	43.1	43.5	43.1	44.5	44.2	43.8	44.1	43.1	44.4
Employed	10,706	10,970	10,673	11,189	11,139	11,066	11,173	11,126	11,165
Employment-population ratio	39.4	39.1	38.9	41.1	40.8	40.2	40.2	39.6	40.7
Unemployed	1,026	1,231	1,151	900	937	969	1,084	986	1,008
Unemployment rate	8.7	10.1	9.7	7.4	7.8	8.1	8.8	8.1	8.3
High school graduates, no college[2]									
Civilian noninstitutional population	57,617	57,608	57,362	57,617	57,221	57,400	57,520	57,608	57,362
Civilian labor force	37,238	37,128	37,134	37,224	36,912	36,719	36,856	36,675	37,023
Percent of population	64.6	64.4	64.7	64.6	64.5	64.0	64.1	63.7	64.5
Employed	35,644	34,838	34,903	35,831	35,199	34,882	35,051	34,768	35,078
Employment-population ratio	61.9	60.5	60.8	62.2	61.5	60.8	60.9	60.4	61.2
Unemployed	1,594	2,290	2,231	1,393	1,713	1,837	1,805	1,907	1,945
Unemployment rate	4.3	6.2	6.0	3.7	4.6	5.0	4.9	5.2	5.3
Less than a bachelor's degree[3]									
Civilian noninstitutional population	45,263	45,075	45,350	45,263	45,471	45,353	45,362	45,075	45,350
Civilian labor force	33,414	33,126	33,277	33,063	33,373	33,420	33,521	33,516	32,884
Percent of population	73.8	73.5	73.4	73.0	73.4	73.7	73.9	74.4	72.5
Employed	32,423	31,604	31,780	32,165	32,057	32,018	32,087	32,117	31,527
Employment-population ratio	71.6	70.1	70.1	71.1	70.5	70.6	70.7	71.3	69.5
Unemployed	991	1,523	1,498	898	1,316	1,402	1,434	1,398	1,356
Unemployment rate	3.0	4.6	4.5	2.7	3.9	4.2	4.3	4.2	4.1
College graduates									
Civilian noninstitutional population	46,167	46,965	47,636	46,167	47,371	47,225	46,677	46,965	47,636
Civilian labor force	36,683	37,140	37,949	36,506	37,157	37,324	37,101	37,106	37,773
Percent of population	79.5	79.0	79.7	79.1	78.4	79.0	79.1	79.0	79.3
Employed	36,104	36,013	36,865	35,926	36,153	36,223	35,960	36,013	36,681
Employment-population ratio	78.2	76.6	77.4	77.8	76.3	76.7	76.7	76.6	77.0
Unemployed	579	1,127	1,084	580	1,004	1,101	1,142	1,093	1,092
Unemployment rate	1.6	3.0	2.9	1.6	2.7	2.9	3.1	2.9	2.9

[1] The population figures are not adjusted for seasonal variation, therefore, identical numbers appear in the unadjusted and seasonally adjusted columns.

[2] Includes high school diploma or equivalent.

[3] Includes the categories, some college, no degree; and associate degree.

HOUSEHOLD DATA

Table A-4. Selected employment indicators

(In thousands)

Category	Not seasonally adjusted			Seasonally adjusted					
	Feb. 2001	Jan. 2002	Feb. 2002	Feb. 2001	Oct. 2001	Nov. 2001	Dec. 2001	Jan. 2002	Feb. 2002
CHARACTERISTIC									
Total employed, 16 years and over	134,774	132,139	133,349	135,734	134,615	134,253	134,055	133,468	134,319
Married men, spouse present	43,080	42,566	42,972	43,372	42,983	42,861	42,772	42,823	43,275
Married women, spouse present	34,059	33,440	33,838	33,959	33,227	33,330	33,209	33,174	33,703
Women who maintain families	8,348	8,313	8,375	8,380	8,256	8,331	8,458	8,396	8,417
OCCUPATION									
Managerial and professional specialty	41,701	41,564	41,969	41,708	41,940	41,925	41,890	41,668	41,968
Technical, sales, and administrative support	39,781	38,480	38,616	39,632	38,626	38,546	38,573	38,557	38,424
Service occupations	18,301	18,238	18,650	18,269	18,406	18,456	18,532	18,553	18,612
Precision production, craft, and repair	14,746	14,144	14,091	14,993	14,802	14,637	14,507	14,432	14,335
Operators, fabricators, and laborers	17,439	16,719	17,146	17,956	17,596	17,311	17,179	17,032	17,668
Farming, forestry, and fishing	2,806	2,996	2,877	3,258	3,264	3,267	3,371	3,467	3,334
CLASS OF WORKER									
Agriculture:									
Wage and salary workers	1,587	1,674	1,660	1,843	1,898	1,865	1,879	1,917	1,930
Self-employed workers	1,187	1,186	1,203	1,281	1,290	1,276	1,313	1,311	1,283
Unpaid family workers	20	35	14	29	26	12	27	49	21
Nonagricultural industries:									
Wage and salary workers	123,439	121,022	122,315	123,916	122,710	122,507	122,196	122,145	122,770
Government	19,523	19,238	19,749	19,073	19,223	19,172	19,183	19,047	19,286
Private industries	103,916	101,784	102,567	104,843	103,487	103,335	103,013	103,098	103,485
Private households	830	690	708	833	867	790	736	725	709
Other industries	103,087	101,094	101,858	104,010	102,620	102,545	102,277	102,373	102,775
Self-employed workers	8,393	8,114	8,059	8,608	8,505	8,507	8,524	8,213	8,257
Unpaid family workers	147	107	97	130	95	77	92	97	86
PERSONS AT WORK PART TIME									
All industries:									
Part time for economic reasons	3,424	4,470	4,414	3,277	4,329	4,206	4,267	3,973	4,228
Slack work or business conditions	2,209	3,072	2,968	2,049	2,983	2,796	2,809	2,549	2,755
Could only find part-time work	947	1,047	1,148	925	1,108	1,121	1,161	1,089	1,120
Part time for noneconomic reasons	20,010	18,566	19,407	18,974	18,644	18,587	18,540	18,291	18,395
Nonagricultural industries:									
Part time for economic reasons	3,291	4,249	4,190	3,137	4,222	4,017	4,119	3,781	3,988
Slack work or business conditions	2,129	2,955	2,821	1,970	2,898	2,679	2,717	2,448	2,815
Could only find part-time work	932	1,023	1,124	904	1,082	1,096	1,138	1,068	1,089
Part time for noneconomic reasons	19,583	18,071	18,888	18,560	18,065	18,007	17,960	17,717	17,886

NOTE. Persons at work excludes employed persons who were absent from their jobs during the entire reference week for reasons such as vacation, illness, or industrial dispute. Part time for noneconomic reasons excludes persons who usually work full time but worked only 1 to 34 hours during the reference week for reasons such as holidays, illness, and bad weather.

HOUSEHOLD DATA

Table A-5. Selected unemployment indicators, seasonally adjusted

Category	Number of unemployed persons (in thousands)			Unemployment rates[1]					
	Feb. 2001	Jan. 2002	Feb. 2002	Feb. 2001	Oct. 2001	Nov. 2001	Dec. 2001	Jan. 2002	Feb. 2002
CHARACTERISTIC									
Total, 16 years and over	5,888	7,922	7,891	4.2	5.4	5.6	5.8	5.6	5.5
Men, 20 years and over	2,523	3,716	3,560	3.5	4.8	5.2	5.2	5.2	5.0
Women, 20 years and over	2,261	2,954	3,116	3.6	4.8	4.9	5.2	4.8	5.0
Both sexes, 16 to 19 years	1,104	1,252	1,215	13.5	15.4	15.7	16.2	16.1	15.6
Married men, spouse present	1,017	1,544	1,513	2.3	3.1	3.3	3.4	3.5	3.4
Married women, spouse present	916	1,173	1,330	2.6	3.6	3.6	3.7	3.4	3.8
Women who maintain families	534	719	728	6.0	6.6	8.0	8.0	7.9	8.0
Full-time workers	4,728	6,671	6,738	4.0	5.4	5.6	5.8	5.7	5.7
Part-time workers	1,179	1,240	1,179	4.8	5.5	5.6	5.6	5.2	4.8
OCCUPATION[2]									
Managerial and professional specialty	768	1,244	1,347	1.8	2.7	2.8	2.9	2.9	3.1
Technical, sales, and administrative support	1,453	2,005	2,040	3.5	4.7	5.1	5.2	4.9	5.0
Precision production, craft, and repair	587	965	827	3.8	5.6	5.8	5.8	6.3	5.5
Operators, fabricators, and laborers	1,384	1,790	1,690	7.2	8.5	9.1	9.2	9.5	8.7
Farming, forestry, and fishing	247	298	256	7.0	6.4	6.8	7.3	7.9	7.1
INDUSTRY									
Nonagricultural private wage and salary workers	4,817	6,505	6,553	4.4	5.8	6.0	6.2	5.9	6.0
Goods-producing industries	1,462	2,055	1,952	5.1	6.7	7.1	7.4	7.4	7.1
Mining	26	29	23	4.5	5.8	5.3	6.1	5.9	4.5
Construction	546	790	651	6.8	8.3	8.9	8.9	9.4	7.9
Manufacturing	890	1,236	1,278	4.5	6.0	6.4	6.8	6.6	6.7
Durable goods	500	798	870	4.1	6.5	6.9	7.2	7.0	7.5
Nondurable goods	390	438	408	4.9	5.3	5.5	6.1	5.9	5.5
Service-producing industries	3,355	4,450	4,601	4.1	5.5	5.6	5.8	5.4	5.6
Transportation and public utilities	236	500	471	3.0	6.0	6.1	6.1	6.2	5.8
Wholesale and retail trade	1,401	1,730	1,794	5.1	6.1	6.4	7.1	6.3	6.5
Finance, insurance, and real estate	203	184	234	2.4	2.8	3.5	3.0	2.2	2.8
Services	1,515	2,037	2,103	4.1	5.5	5.4	5.5	5.4	5.5
Government workers	313	440	536	1.6	2.3	2.4	2.4	2.3	2.7
Agricultural wage and salary workers	187	219	202	9.2	9.0	9.3	9.6	10.3	9.5

[1] Unemployment as a percent of the civilian labor force.

[2] Seasonally adjusted unemployment data for service occupations are not available because the seasonal component, which is small relative to the trend-cycle and irregular components, cannot be separated with sufficient precision.

Table A-6. Duration of unemployment

(Numbers in thousands)

Duration	Not seasonally adjusted			Seasonally adjusted					
	Feb. 2001	Jan. 2002	Feb. 2002	Feb. 2001	Oct. 2001	Nov. 2001	Dec. 2001	Jan. 2002	Feb. 2002
NUMBER OF UNEMPLOYED									
Less than 5 weeks	2,732	3,466	2,820	2,749	3,084	3,090	3,024	2,978	2,828
5 to 14 weeks	2,115	2,795	3,060	1,737	2,522	2,573	2,724	2,586	2,515
15 weeks and over	1,617	2,673	2,827	1,466	2,042	2,317	2,410	2,546	2,561
15 to 26 weeks	891	1,430	1,585	778	1,136	1,207	1,295	1,418	1,383
27 weeks and over	726	1,244	1,242	688	906	1,110	1,115	1,127	1,178
Average (mean) duration, in weeks	12.8	14.2	15.1	12.8	13.0	14.4	14.5	14.6	15.0
Median duration, in weeks	6.6	8.1	9.0	6.0	7.4	7.6	8.2	8.8	8.1
PERCENT DISTRIBUTION									
Total unemployed	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Less than 5 weeks	42.3	38.8	32.4	46.2	40.3	38.7	37.1	36.7	35.6
5 to 14 weeks	32.7	31.3	35.1	29.2	33.0	32.2	33.4	31.9	31.8
15 weeks and over	25.0	29.9	32.5	24.6	26.7	29.0	29.5	31.4	32.4
15 to 26 weeks	13.8	16.0	18.2	13.1	14.9	15.1	15.9	17.5	17.5
27 weeks and over	11.2	13.9	14.3	11.6	11.8	13.9	13.7	13.9	14.9

Table A-7. Reason for unemployment

(Numbers in thousands)

Reason	Not seasonally adjusted			Seasonally adjusted					
	Feb. 2001	Jan. 2002	Feb. 2002	Feb. 2001	Oct. 2001	Nov. 2001	Dec. 2001	Jan. 2002	Feb. 2002
NUMBER OF UNEMPLOYED									
Job losers and persons who completed temporary jobs	3,309	5,365	5,014	2,856	4,297	4,501	4,492	4,354	4,326
On temporary layoff	1,286	1,753	1,499	950	1,288	1,157	1,107	1,124	1,106
Not on temporary layoff	2,023	3,611	3,515	1,906	3,009	3,344	3,385	3,231	3,220
Permanent job losers	1,451	2,764	2,677	(1)	(1)	(1)	(1)	(1)	(1)
Persons who completed temporary jobs	572	848	838	(1)	(1)	(1)	(1)	(1)	(1)
Job leavers	830	884	891	815	880	848	908	879	877
Reentrants	1,998	2,270	2,383	1,900	2,113	2,197	2,361	2,191	2,258
New entrants	327	417	420	387	466	497	495	479	485
PERCENT DISTRIBUTION									
Total unemployed	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Job losers and persons who completed temporary jobs	51.2	60.0	57.6	47.9	55.4	56.0	54.4	55.1	54.4
On temporary layoff	19.9	19.6	17.2	15.9	16.6	14.4	13.4	14.2	13.9
Not on temporary layoff	31.3	40.4	40.4	32.0	38.8	41.6	41.0	40.9	40.5
Job leavers	12.8	9.9	10.2	13.7	11.3	10.5	11.0	11.1	11.0
Reentrants	30.9	25.4	27.4	31.9	27.2	27.3	28.6	27.7	28.5
New entrants	5.1	4.7	4.8	6.5	6.0	6.2	6.0	6.1	6.1
UNEMPLOYED AS A PERCENT OF THE CIVILIAN LABOR FORCE									
Job losers and persons who completed temporary jobs	2.3	3.8	3.5	2.0	3.0	3.2	3.2	3.1	3.0
Job leavers	.6	.6	.6	.6	.6	.6	.6	.6	.6
Reentrants	1.4	1.6	1.7	1.3	1.5	1.5	1.7	1.5	1.6
New entrants	.2	.3	.3	.3	.3	.3	.3	.3	.3

1 Not available.

Table A-8. Range of alternative measures of labor underutilization

(Percent)

Measure	Not seasonally adjusted			Seasonally adjusted					
	Feb. 2001	Jan. 2002	Feb. 2002	Feb. 2001	Oct. 2001	Nov. 2001	Dec. 2001	Jan. 2002	Feb. 2002
U-1 Persons unemployed 15 weeks or longer, as a percent of the civilian labor force	1.1	1.9	2.0	1.0	1.4	1.6	1.7	1.8	1.8
U-2 Job losers and persons who completed temporary jobs, as a percent of the civilian labor force	2.3	3.8	3.5	2.0	3.0	3.2	3.2	3.1	3.0
U-3 Total unemployed, as a percent of the civilian labor force (official unemployment rate)	4.6	6.3	6.1	4.2	5.4	5.6	5.8	5.6	5.5
U-4 Total unemployed plus discouraged workers, as a percent of the civilian labor force plus discouraged workers	4.8	6.5	6.4	(1)	(1)	(1)	(1)	(1)	(1)
U-5 Total unemployed, plus discouraged workers, plus all other marginally attached workers, as a percent of the civilian labor force plus all marginally attached workers	5.5	7.3	7.1	(1)	(1)	(1)	(1)	(1)	(1)
U-6 Total unemployed, plus all marginally attached workers, plus total employed part time for economic reasons, as a percent of the civilian labor force plus all marginally attached workers	7.9	10.5	10.1	(1)	(1)	(1)	(1)	(1)	(1)

1 Not available.

NOTE: This range of alternative measures of labor underutilization replaces the U1-U7 range published in table A-7 of this release prior to 1994. Marginally attached workers are persons who currently are neither working nor looking for work but indicate that they want and are available for a job and have looked for work sometime in the recent past. Discouraged workers, a subset of the marginally attached, have given a job-market related reason for not currently looking for a job. Persons employed part time for economic reasons are those who want and are available for full-time work but have had to settle for a part-time schedule. For further information, see "BLS introduces new range of alternative unemployment measures," in the October 1995 issue of the *Monthly Labor Review*.

Table A-9. Unemployed persons by sex and age, seasonally adjusted

Age and sex	Number of unemployed persons (in thousands)			Unemployment rates[1]					
	Feb. 2001	Jan. 2002	Feb. 2002	Feb. 2001	Oct. 2001	Nov. 2001	Dec. 2001	Jan. 2002	Feb. 2002
Total, 16 years and over	5,888	7,922	7,891	4.2	5.4	5.6	5.8	5.6	5.5
16 to 24 years	2,160	2,653	2,602	9.5	11.5	11.7	11.9	11.9	11.6
16 to 19 years	1,104	1,252	1,215	13.5	15.4	15.7	16.2	16.1	15.6
16 to 17 years	543	487	478	16.9	17.4	17.5	18.8	17.0	16.5
18 to 19 years	549	749	718	11.0	14.2	14.8	14.8	15.2	14.7
20 to 24 years	1,056	1,401	1,387	7.3	9.3	9.5	9.6	9.7	9.5
25 years and over	3,788	5,268	5,383	3.2	4.2	4.4	4.5	4.4	4.5
25 to 54 years	3,253	4,655	4,590	3.2	4.4	4.6	4.7	4.7	4.6
55 years and over	517	675	758	2.8	3.4	3.5	4.0	3.5	3.8
Men, 16 years and over	3,154	4,356	4,228	4.2	5.5	5.9	5.8	5.8	5.6
16 to 24 years	1,251	1,439	1,439	10.6	12.4	13.0	12.8	12.5	12.4
16 to 19 years	631	640	668	15.0	17.2	17.7	17.2	16.3	16.8
16 to 17 years	301	249	277	18.4	20.3	20.4	20.0	17.6	19.6
18 to 19 years	338	383	397	12.9	15.1	16.2	15.6	15.1	15.4
20 to 24 years	620	799	771	8.1	9.8	10.5	10.5	10.6	10.2
25 years and over	1,934	2,908	2,837	3.0	4.2	4.5	4.5	4.5	4.4
25 to 54 years	1,642	2,532	2,392	3.1	4.3	4.6	4.5	4.7	4.5
55 years and over	290	408	438	2.8	3.7	4.1	4.2	3.8	4.1
Women, 16 years and over	2,734	3,566	3,663	4.1	5.3	5.4	5.8	5.4	5.5
16 to 24 years	909	1,214	1,163	8.3	10.5	10.3	11.0	11.3	10.7
16 to 19 years	473	612	547	11.9	13.6	13.7	15.1	15.8	14.3
16 to 17 years	242	238	202	15.3	14.5	14.5	17.6	16.4	13.6
18 to 19 years	211	365	321	8.8	13.3	13.3	14.0	15.2	13.9
20 to 24 years	436	601	615	6.3	8.7	8.3	8.7	8.7	8.7
25 years and over	1,854	2,360	2,547	3.4	4.2	4.4	4.6	4.3	4.6
25 to 54 years	1,611	2,123	2,197	3.4	4.4	4.7	4.8	4.6	4.7
55 years and over	227	267	320	2.7	3.2	2.8	3.7	3.0	3.5

[1] Unemployment as a percent of the civilian labor force.

Table A-10. Persons not in the labor force and multiple jobholders by sex, not seasonally adjusted

(Numbers in thousands)

Category	Total		Men		Women	
	Feb. 2001	Feb. 2002	Feb. 2001	Feb. 2002	Feb. 2001	Feb. 2002
NOT IN THE LABOR FORCE						
Total not in the labor force	69,788	71,149	26,310	27,043	43,478	44,106
Persons who currently want a job	4,500	4,436	1,871	1,963	2,629	2,472
Searched for work and available to work now[1]	1,339	1,410	613	720	727	689
Reason not currently looking:						
Discouragement over job prospects[2]	289	371	186	224	103	147
Reasons other than discouragement[3]	1,050	1,039	427	496	623	543
MULTIPLE JOBHOLDERS						
Total multiple jobholders[4]	7,592	7,398	3,989	3,689	3,603	3,708
Percent of total employed	5.6	5.5	5.6	5.2	5.7	5.9
Primary job full time, secondary job part time	4,258	4,070	2,496	2,257	1,762	1,813
Primary and secondary jobs both part time	1,627	1,633	459	493	1,168	1,141
Primary and secondary jobs both full time	304	255	210	166	94	89
Hours vary on primary or secondary job	1,360	1,384	792	747	568	637

[1] Data refer to persons who have searched for work during the prior 12 months and were available to take a job during the reference week.
[2] Includes thinks no work available, could not find work, lacks schooling or training, employer thinks too young or old, and other types of discrimination.
[3] Includes those who did not actively look for work in the prior 4 weeks for such reasons as child-care and transportation problems, as well as a small number for which reason for nonparticipation was not determined.
[4] Includes persons who work part time on their primary job and full time on their secondary job(s), not shown separately.

ESTABLISHMENT DATA

Table B-1. Employees on nonfarm payrolls by industry

(In thousands)

Industry	Not seasonally adjusted				Seasonally adjusted					
	Feb. 2001	Dec. 2001	Jan. 2002p	Feb. 2002p	Feb. 2001	Oct. 2001	Nov 2001	Dec. 2001	Jan. 2002p	Feb. 2002p
Total	131,102	132,143	129,217	129,839	132,595	131,782	131,427	131,321	131,195	131,261
Total private	110,086	110,756	108,239	108,426	111,915	110,784	110,421	110,260	110,132	110,178
Goods-producing	25,034	24,375	23,748	23,672	25,627	24,746	24,577	24,453	24,278	24,247
Mining	542	563	549	543	555	569	567	564	562	556
Metal mining	38.1	32.8	30.5	30 4	39	35	34	33	31	31
Coal mining	75.3	82.9	81.9	80.5	75	81	81	82	82	81
Oil and gas extraction	323 2	337.2	333.1	327.8	328	340	339	336	337	333
Nonmetallic minerals, except fuels	104 9	110 4	103 5	103 8	113	113	113	113	112	111
Construction	6,393	6,739	6,356	6,330	6,880	6,852	6,851	6,850	6,787	6,812
General building contractors	1,478 6	1,549.2	1,479 0	1,470.2	1,555	1,560	1,561	1,559	1,550	1,549
Heavy construction, except building	796 0	895.0	803 6	805 6	930	933	942	944	928	940
Special trade contractors	4,118 8	4,294.4	4,073.2	4,054 2	4,395	4,359	4,348	4,347	4,309	4,323
Manufacturing	18,099	17,073	16,843	16,799	18,192	17,325	17,159	17,039	16,929	16,879
Production workers	12,242	11,428	11,249	11,229	12,323	11,626	11,500	11,405	11,325	11,299
Durable goods	10,962	10,180	10,022	9,997	·10,997	10,363	10,240	10,158	10,053	10,027
Production workers	7,382	6,761	6,636	6,630	7,415	6,897	6,805	6,744	6,670	6,656
Lumber and wood products	783.4	778:5	767.3	766.5	799	789	784	780	781	784
Furniture and fixtures	546 4	499.5	496.1	499.4	549	505	499	499	498	502
Stone, clay, and glass products	562.9	554.8	539.8	536 3	578	566	562	559	554	550
Primary metal industries	681.7	615.5	602.0	600 5	679	633	619	613	601	597
Blast furnaces and basic steel products	216.7	201.1	190.6	189.7	(1)	(1)	(1)	(1)	(1)	(1)
Fabricated metal products	1,511 4	1,433.5	1,414.6	1,411.6	1,514	1,454	1,435	1,428	1,416	1,415
Industrial machinery and equipment	2,108.9	1,895.6	1,874.8	1,861.0	2,105	1,943	1,917	1,892	1,870	1,856
Computer and office equipment	370 5	334.8	330.0	327.2	370	342	339	335	327	326
Electronic and other electrical equipment	1,729.0	1,480.4	1,461.5	1,444 8	1,726	1,529	1,499	1,474	1,459	1,437
Electronic components and accessories	710.1	584.6	574.7	566.5	711	601	591	583	572	563
Transportation equipment	1,781.2	1,705.3	1,656.9	1,670.6	1,786	1,714	1,706	1,696	1,660	1,676
Motor vehicles and equipment	963.7	909 6	877.6	900.4	967	903	903	901	878	904
Aircraft and parts	463 4	453.7	440 0	431.8	464	463	456	452	440	432
Instruments and related products	869.9	837.7	835.1	831.0	871	849	843	839	836	832
Miscellaneous manufacturing	386 8	378 7	373.9	375.2	390	381	376	378	378	378
Nondurable goods	7,137	6,893	6,821	6,802	7,195	6,962	6,919	6,881	6,876	6,852
Production workers	4,860	4,667	4,613	4,599	4,908	4,729	4,695	4,661	4,655	4,643
Food and kindred products	1,653 6	1,679.7	1,658.8	1,655.8	1,686	1,689	1,691	1,682	1,685	1,686
Tobacco products	32.3	34.2	34.0	33.6	31	33	33	32	33	33
Textile mill products	490.7	443.2	436.5	435.7	496	454	446	442	440	439
Apparel and other textile products	588.4	529.3	523.9	525.7	595	542	533	531	535	531
Paper and allied products	642.1	626.3	623.6	620.7	645	628	627	624	624	623
Printing and publishing	1,524.6	1,453.9	1,431.7	1,419.3	1,529	1,465	1,452	1,444	1,435	1,422
Chemicals and allied products	1,037.4	1,020.0	1,015.1	1,016.5	1,039	1,027	1,024	1,021	1,018	1,018
Petroleum and coal products	122.9	125.8	122.9	122.8	127	128	127	127	128	127
Rubber and misc. plastics products	977 4	922.7	917.3	914 0	979	935	927	920	919	915
Leather and leather products	67.4	58.0	57.6	57.9	68	61	59	58	59	58
Service-producing	106,068	107,768	105,469	106,167	106,968	107,036	106,850	106,868	106,917	107,014
Transportation and public utilities	7,045	6,973	6,840	6,831	7,123	7,016	6,952	6,915	6,897	6,901
Transportation	4,520	4,444	4,325	4,321	4,591	4,472	4,414	4,387	4,376	4,384
Railroad transportation	227.7	226.2	223.1	223.2	231	225	224	227	226	226
Local and interurban passenger transit	490 6	500 0	494.6	499.3	480	479	480	485	486	489
Trucking and warehousing	1,828 0	1,834.5	1,795.1	1,785.2	1,870	1,832	1,830	1,832	1,829	1,824
Water transportation	189.7	199.7	192 4	195.4	200	206	204	206	203	206
Transportation by air	1,296 4	1,235.7	1,177.4	1,173.3	1,318	1,264	1,221	1,189	1,187	1,192
Pipelines, except natural gas	13.5	14.2	13.8	13.8	14	14	14	14	14	14
Transportation services	474 4	434.1	428.1	430.7	478	452	441	434	431	433
Communications and public utilities	2,525	2,529	2,515	2,510	2,532	2,544	2,538	2,528	2,521	2,517
Communications	1,682.0	1,684.5	1,669.1	1,668.4	1,685	1,695	1,689	1,683	1,673	1,671
Electric, gas, and sanitary services	843 4	844.9	845.6	842.0	847	849	849	845	848	846
Wholesale trade	7,015	6,951	6,882	6,872	7,064	6,971	6,941	6,938	6,934	6,919
Durable goods	4,181	4,090	4,057	4,051	4,198	4,114	4,087	4,086	4,077	4,067
Nondurable goods	2,834	2,861	2,825	2,821	2,866	2,857	2,854	2,852	2,857	2,852

See footnotes at end of table.

Table B-1. Employees on nonfarm payrolls by industry—Continued

(In thousands)

Industry	Not seasonally adjusted				Seasonally adjusted					
	Feb 2001	Dec. 2001	Jan. 2002p	Feb. 2002p	Feb. 2001	Oct. 2001	Nov. 2001	Dec. 2001	Jan. 2002p	Feb. 2002p
Retail trade	22,941	24,029	23,048	22,925	23,472	23,422	23,424	23,365	23,406	23,464
Building materials and garden supplies	951.1	998.8	969.0	970.6	1,007	1,012	1,010	1,013	1,021	1,028
General merchandise stores	2,710.9	3,058.1	2,760.9	2,692.2	2,807	2,764	2,778	2,755	2,720	2,797
Department stores	2,378.9	2,674.8	2,410.9	2,350.1	2,462	2,422	2,420	2,410	2,378	2,437
Food stores	3,513.2	3,585.1	3,504.0	3,476.1	3,548	3,542	3,539	3,525	3,522	3,508
Automotive dealers and service stations	2,393.3	2,416.8	2,400.8	2,400.3	2,424	2,429	2,430	2,428	2,432	2,430
New and used car dealers	1,117.8	1,137.0	1,136.8	1,141.3	1,124	1,134	1,137	1,141	1,145	1,148
Apparel and accessory stores	1,184.1	1,296.1	1,226.4	1,175.6	1,227	1,208	1,203	1,192	1,222	1,216
Furniture and home furnishings stores	1,136.3	1,191.4	1,147.4	1,132.7	1,146	1,136	1,136	1,143	1,139	1,141
Eating and drinking places	7,939.1	8,170.8	7,892.6	7,958.6	8,171	8,187	8,198	8,209	8,211	8,198
Miscellaneous retail establishments	3,112.8	3,311.4	3,147.1	3,118.5	3,142	3,144	3,130	3,100	3,139	3,146
Finance, insurance, and real estate	7,552	7,614	7,582	7,574	7,609	7,634	7,638	7,632	7,636	7,626
Finance	3,737	3,775	3,766	3,757	3,748	3,761	3,772	3,774	3,777	3,766
Depository institutions	2,019.7	2,045.1	2,043.3	2,038.6	2,025	2,041	2,045	2,044	2,046	2,044
Commercial banks	1,413.4	1,428.9	1,426.5	1,422.6	1,417	1,427	1,428	1,427	1,429	1,428
Savings institutions	253.2	259.6	261.3	260.7	254	257	259	260	262	261
Nondepository institutions	681.8	728.7	727.8	728.8	683	712	717	728	731	730
Mortgage bankers and brokers	302.3	341.6	344.0	348.3	304	326	333	342	346	348
Security and commodity brokers	776.4	743.5	738.1	733.1	781	750	751	744	741	736
Holding and other investment offices	258.6	258.0	256.5	256.4	259	258	259	258	259	256
Insurance	2,345	2,353	2,346	2,343	2,351	2,361	2,356	2,352	2,352	2,348
Insurance carriers	1,588.9	1,594.1	1,590.9	1,586.9	1,592	1,602	1,597	1,594	1,595	1,590
Insurance agents, brokers, and service	758.4	759.0	755.2	755.6	759	759	759	758	757	758
Real estate	1,470	1,486	1,470	1,474	1,510	1,512	1,510	1,506	1,507	1,512
Services[2]	40,499	40,814	40,139	40,552	41,020	40,995	40,889	40,957	40,981	41,021
Agricultural services	700.3	779.9	721.2	716.8	821	841	840	846	843	841
Hotels and other lodging places	1,848.3	1,766.4	1,742.4	1,758.0	1,957	1,862	1,852	1,845	1,849	1,855
Personal services	1,338.4	1,278.4	1,344.1	1,357.3	1,261	1,281	1,271	1,294	1,294	1,281
Business services	9,843.2	9,426.7	9,118.0	9,135.5	9,851	9,467	9,356	9,346	9,316	9,307
Services to buildings	997.2	985.4	972.4	968.3	1,007	995	996	992	984	978
Personnel supply services	3,555.5	3,325.7	3,076.0	3,085.8	3,731	3,378	3,282	3,252	3,234	3,238
Help supply services	3,160.3	2,959.2	2,736.5	2,749.7	3,339	3,005	2,913	2,894	2,878	2,892
Computer and data processing services	2,188.7	2,191.9	2,187.3	2,196.7	2,186	2,201	2,189	2,189	2,188	2,193
Auto repair, services, and parking	1,286.4	1,296.8	1,296.7	1,305.8	1,291	1,298	1,305	1,304	1,308	1,310
Miscellaneous repair services	360.0	358.8	354.7	357.5	365	362	360	359	359	362
Motion pictures	596.4	581.7	581.7	580.6	600	582	584	580	589	583
Amusement and recreation services	1,554.3	1,590.0	1,528.8	1,560.6	1,772	1,781	1,762	1,777	1,771	1,775
Health services	10,213.5	10,496.3	10,478.0	10,512.0	10,236	10,431	10,458	10,483	10,501	10,535
Offices and clinics of medical doctors	1,953.2	2,006.0	2,004.3	2,014.3	1,958	1,993	2,000	2,002	2,007	2,020
Nursing and personal care facilities	1,803.8	1,844.8	1,841.2	1,839.7	1,808	1,834	1,837	1,842	1,846	1,844
Hospitals	4,040.6	4,161.2	4,163.2	4,172.3	4,045	4,135	4,149	4,158	4,166	4,176
Home health care services	640.9	661.5	654.4	658.0	645	655	657	659	661	662
Legal services	1,014.0	1,031.5	1,024.9	1,025.1	1,020	1,030	1,030	1,031	1,030	1,031
Educational services	2,502.6	2,585.7	2,392.1	2,615.3	2,375	2,436	2,439	2,457	2,471	2,484
Social services	3,001.2	3,119.3	3,103.0	3,123.9	2,997	3,096	3,100	3,105	3,121	3,121
Child day care services	750.2	771.1	762.2	767.6	734	757	755	757	755	753
Residential care	826.2	853.3	855.0	858.4	829	854	855	853	860	862
Museums and botanical and zoological gardens	100.5	107.6	101.0	101.4	110	112	110	110	110	110
Membership organizations	2,466.7	2,495.3	2,468.9	2,482.0	2,487	2,505	2,505	2,506	2,504	2,502
Engineering and management services	3,500.7	3,527.5	3,514.6	3,548.5	3,504	3,538	3,543	3,541	3,543	3,552
Engineering and architectural services	1,038.0	1,058.7	1,053.8	1,051.4	1,050	1,069	1,065	1,063	1,064	1,063
Management and public relations	1,114.6	1,125.3	1,120.9	1,122.5	1,123	1,124	1,127	1,125	1,134	1,130
Services, nec	50.6	50.5	49.7	49.8	(1)	(1)	(1)	(1)	(1)	(1)
Government	21,016	21,387	20,978	21,413	20,680	20,998	21,006	21,061	21,063	21,083
Federal	2,605	2,600	2,589	2,591	2,615	2,625	2,607	2,615	2,608	2,602
Federal, except Postal Service	1,747.9	1,757.7	1,758.0	1,767.0	1,756	1,779	1,777	1,775	1,776	1,776
State	4,928	5,022	4,836	5,039	4,825	4,919	4,916	4,928	4,928	4,937
Education	2,171.7	2,232.9	2,051.2	2,244.8	2,048	2,107	2,109	2,112	2,115	2,121
Other State government	2,756.2	2,789.4	2,784.3	2,793.8	2,777	2,812	2,807	2,816	2,813	2,816
Local	13,483	13,765	13,553	13,783	13,240	13,454	13,483	13,518	13,527	13,544
Education	7,847.5	7,987.8	7,804.9	8,020.9	7,479	7,607	7,630	7,642	7,641	7,653
Other local government	5,635.5	5,777.6	5,748.0	5,762.3	5,761	5,847	5,853	5,876	5,886	5,891

[1] These series are not published seasonally adjusted because the seasonal component, which is small relative to the trend-cycle and irregular components, cannot be separated with sufficient precision.

[2] Includes other industries, not shown separately.

p = preliminary.

Table B-2. Average weekly hours of production or nonsupervisory workers[1] on private nonfarm payrolls by industry

Industry	Not seasonally adjusted				Seasonally adjusted					
	Feb. 2001	Dec. 2001	Jan. 2002p	Feb. 2002p	Feb. 2001	Oct. 2001	Nov. 2001	Dec. 2001	Jan. 2002p	Feb. 2002p
Total private	34.0	34.4	33.6	33.9	34.3	34.0	34.1	34.1	34.1	34.1
Goods-producing	39.8	40.4	39.9	39.9	40.3	40.0	40.0	40.1	40.4	40.4
Mining	42.7	43.3	42.3	43.0	43.2	43.1	43.2	43.3	43.0	43.6
Construction	37.6	38.3	38.6	38.5	38.7	38.7	39.2	38.8	39.8	39.6
Manufacturing	40.5	41.3	40.4	40.3	40.9	40.5	40.3	40.6	40.6	40.7
Overtime hours	3.8	4.1	3.7	3.7	3.9	3.6	3.7	3.8	3.9	3.9
Durable goods	40.8	41.6	40.8	40.7	41.1	40.7	40.4	40.8	40.9	41.0
Overtime hours	3.8	4.1	3.7	3.7	3.9	3.7	3.6	3.8	3.9	3.9
Lumber and wood products	39.2	40.7	39.8	39.5	40.1	40.6	40.5	40.8	40.3	40.4
Furniture and fixtures	38.4	39.8	39.8	39.6	39.1	38.3	38.4	38.8	40.0	40.4
Stone, clay, and glass products	41.6	43.5	43.2	43.1	42.8	43.9	43.8	43.5	44.3	44.5
Primary metal industries	43.2	44.4	43.3	43.2	43.2	43.2	42.6	43.8	43.2	43.4
Blast furnaces and basic steel products	44.0	43.8	43.2	43.1	44.4	44.0	43.3	43.8	43.1	43.5
Fabricated metal products	41.4	42.1	41.1	41.3	41.7	41.0	40.7	41.2	41.2	41.6
Industrial machinery and equipment	41.2	41.1	40.4	40.3	41.0	40.4	39.9	40.2	40.2	40.0
Electronic and other electrical equipment	40.0	40.2	38.6	38.7	40.3	39.0	38.8	39.3	38.6	38.9
Transportation equipment	41.5	42.7	42.4	42.2	42.0	41.3	41.3	41.7	42.8	42.5
Motor vehicles and equipment	41.6	44.0	43.7	43.6	42.0	41.9	42.2	43.0	44.5	43.9
Instruments and related products	41.5	41.2	40.5	40.5	41.1	40.7	40.3	40.5	40.4	40.2
Miscellaneous manufacturing	37.9	38.1	37.1	37.7	38.2	37.5	37.1	37.7	37.5	38.0
Nondurable goods	40.1	40.8	39.9	39.8	40.4	40.2	40.0	40.2	40.1	40.1
Overtime hours	3.8	4.2	3.8	3.8	4.0	4.1	3.9	4.0	4.0	4.0
Food and kindred products	40.3	41.5	40.7	39.8	41.1	41.1	40.8	40.8	41.0	40.6
Tobacco products	38.7	41.3	40.2	40.3	39.8	40.2	39.8	40.6	41.6	41.5
Textile mill products	39.9	40.5	39.7	40.4	40.4	39.7	39.5	40.0	39.7	40.9
Apparel and other textile products	37.7	37.8	36.4	37.2	37.6	36.8	36.9	37.4	36.8	37.1
Paper and allied products	41.3	42.3	41.4	41.0	41.7	41.5	41.3	41.5	41.2	41.4
Printing and publishing	38.1	38.3	37.4	37.4	38.4	38.0	37.8	37.8	37.6	37.6
Chemicals and allied products	42.3	42.4	41.9	41.6	42.3	42.3	42.1	41.8	42.0	41.7
Petroleum and coal products	43.1	41.5	41.4	40.1	(2)	(2)	(2)	(2)	(2)	(2)
Rubber and misc. plastics products	40.8	42.0	40.8	40.9	40.9	40.5	40.7	41.2	40.8	41.1
Leather and leather products	36.1	37.5	37.2	37.6	36.4	36.0	36.6	37.4	37.6	38.0
Service-producing	32.6	33.0	32.2	32.5	32.8	32.6	32.6	32.7	32.6	32.7
Transportation and public utilities	38.2	38.3	37.4	37.5	38.5	37.8	37.8	38.0	37.8	37.7
Wholesale trade	37.8	38.6	37.9	38.1	38.1	38.1	38.2	38.3	38.2	38.4
Retail trade	28.4	29.2	28.0	28.5	28.9	28.7	28.8	28.9	28.8	29.0
Finance, insurance, and real estate	36.3	36.7	35.9	36.3	36.3	36.0	36.2	36.1	36.1	36.3
Services	32.6	32.9	32.2	32.4	32.7	32.5	32.6	32.7	32.5	32.5

[1] Data relate to production workers in mining and manufacturing; construction workers in construction; and nonsupervisory workers in transportation and public utilities; wholesale and retail trade; finance, insurance, and real estate; and services. These groups account for approximately four-fifths of the total employees on private nonfarm payrolls.

[2] This series is not published seasonally adjusted because the seasonal component, which is small relative to the trend-cycle and irregular components, cannot be separated with sufficient precision.

p = preliminary.

ESTABLISHMENT DATA

Table B-3. Average hourly and weekly earnings of production or nonsupervisory workers[1] on private nonfarm payrolls by industry

Industry	Average hourly earnings				Average weekly earnings			
	Feb. 2001	Dec. 2001	Jan. 2002p	Feb. 2002p	Feb. 2001	Dec. 2001	Jan. 2002p	Feb. 2002p
Total private	$14.16	$14.63	$14.68	$14.68	$481.44	$503.27	$493.25	$497.65
Seasonally adjusted	14.11	14.58	14.61	14.63	483.97	497.18	498.20	498.88
Goods-producing	15.62	16.25	16.17	16.16	621.68	656.50	645.18	644.78
Mining	17.61	17.93	17.93	17.85	751.95	776.37	758.44	767.55
Construction	18.16	18.64	18.48	18.47	682.82	713.91	713.33	711.10
Manufacturing	14.61	15.18	15.16	15.15	591.71	626.93	612.46	610.55
Durable goods	15.03	15.68	15.64	15.62	613.22	652.29	638.11	635.73
Lumber and wood products	12.08	12.40	12.38	12.26	473.54	504.68	492.72	484.27
Furniture and fixtures	12.03	12.57	12.60	12.57	461.95	500.29	501.48	497.77
Stone, clay, and glass products	14.68	15.22	15.30	15.29	610.69	662.07	660.96	659.00
Primary metal industries	16.58	17.30	17.25	17.29	716.26	768.12	746.93	746.93
Blast furnaces and basic steel products	20.05	20.63	20.60	20.69	882.20	903.59	889.92	891.74
Fabricated metal products	14.03	14.60	14.56	14.51	580.84	614.66	598.42	599.26
Industrial machinery and equipment	15.74	16.33	16.33	16.25	648.49	671.16	659.73	654.88
Electronic and other electrical equipment	14.16	14.98	14.90	14.89	566.40	602.20	575.14	576.24
Transportation equipment	18.68	19.66	19.56	19.62	775.22	839.48	829.34	827.96
Motor vehicles and equipment	18.91	20.20	20.05	20.03	786.66	888.80	876.19	873.31
Instruments and related products	14.60	15.14	15.18	15.15	605.90	623.77	614.79	613.58
Miscellaneous manufacturing	11.98	12.64	12.62	12.45	454.04	481.58	468.20	469.37
Nondurable goods	13.97	14.45	14.46	14.46	560.20	589.56	576.95	575.51
Food and kindred products	12.65	13.22	13.14	13.09	509.80	548.63	534.80	520.98
Tobacco products	21.49	22.26	21.84	22.13	831.66	919.34	877.97	891.84
Textile mill products	11.27	11.50	11.64	11.63	449.67	465.75	462.11	469.85
Apparel and other textile products	9.36	9.67	9.77	9.78	352.87	365.53	355.63	363.82
Paper and allied products	16.54	17.16	17.11	17.04	683.10	725.87	708.35	698.64
Printing and publishing	14.64	15.02	15.04	15.11	557.78	575.27	562.50	565.11
Chemicals and allied products	18.41	18.80	18.85	18.99	778.74	797.12	789.82	789.98
Petroleum and coal products	22.21	21.98	22.12	22.63	957.25	912.17	915.77	907.46
Rubber and misc. plastics products	13.31	13.66	13.65	13.60	543.05	573.72	556.92	558.24
Leather and leather products	10.35	10.26	10.29	10.30	373.64	384.75	382.79	387.28
Service-producing	13.73	14.18	14.25	14.27	447.60	467.94	458.85	463.78
Transportation and public utilities	16.68	17.26	17.34	17.42	637.18	661.06	648.52	653.25
Wholesale trade	15.62	16.17	16.07	16.14	590.44	624.16	609.05	614.93
Retail trade	9.72	9.99	10.06	10.04	276.05	291.71	281.68	286.14
Finance, insurance, and real estate	15.63	16.19	16.18	16.23	567.37	594.17	580.86	589.15
Services	14.47	15.08	15.09	15.10	471.72	496.13	485.90	489.24

[1] See footnote 1, table B-2

p = preliminary

Table B-4. Average hourly earnings of production or nonsupervisory workers[1] on private nonfarm payrolls by industry, seasonally adjusted

Industry	Feb. 2001	Oct. 2001	Nov. 2001	Dec. 2001	Jan. 2002p	Feb 2002p	Percent change from: Jan. 2002-Feb. 2002
Total private:							
Current dollars	$14 11	$14 47	$14 54	$14 58	$14 61	$14.63	0.1
Constant (1982) dollars[2]	7 92	8.06	8.11	8.15	8.15	N.A	(3)
Goods-producing	15 74	16.05	16.15	16 20	16 23	16.25	1
Mining	17.52	17.73	17.85	17 83	17.74	17.74	.0
Construction	18 30	18.38	18 46	18 57	18 55	18.54	-.1
Manufacturing	14 63	14 97	15.05	15.09	15 12	15 17	.3
Excluding overtime[4]	13.94	14.31	14 38	14 41	14.43	14 46	.2
Service-producing	13 62	14 01	14 07	14 12	14.14	14.16	1
Transportation and public utilities	16 64	17.09	17.23	17.23	17.30	17.39	.5
Wholesale trade	15.60	15.89	15 91	16 05	16.05	16.13	.5
Retail trade	9 69	9.91	9 98	9.99	10.00	10 01	.1
Finance, insurance, and real estate	15 55	16 05	16 07	16.14	16.16	16.16	.0
Services	14 34	14.81	14.87	14.93	14 94	14 97	.2

[1] See footnote 1, table B-2.

[2] The Consumer Price Index for Urban Wage Earners and Clerical Workers (CPI-W) is used to deflate this series. Data have been revised to reflect updated seasonal adjustment factors used in the CPI-W.

[3] Change was .0 percent from December 2001 to January 2002, the latest month available.

[4] Derived by assuming that overtime hours are paid at the rate of time and one-half.

N.A. = not available.

p = preliminary.

 ESTABLISHMENT DATA

Table B-5. Indexes of aggregate weekly hours of production or nonsupervisory workers[1] on private nonfarm payrolls by industry

(1982=100)

Industry	Not seasonally adjusted				Seasonally adjusted					
	Feb 2001	Dec 2001	Jan 2002p	Feb 2002p	Feb 2001	Oct 2001	Nov 2001	Dec 2001	Jan 2002p	Feb 2002p
Total private	147.6	150.6	143.4	144.7	151.7	148.9	148.7	148.8	148.3	148.5
Goods-producing	108.7	107.3	102.6	102.2	113.6	108.3	107.5	107.1	107.0	106.6
Mining	51.1	54.4	50.9	52.5	53.2	54.8	54.8	54.3	53.2	54.8
Construction	166.4	179.1	168.1	167.0	186.9	185.5	187.9	185.8	188.6	185.8
Manufacturing	100.0	95.1	91.7	91.3	101.5	94.9	93.4	93.3	92.7	92.6
Durable goods	105.1	98.0	94.4	94.2	106.4	97.9	96.0	96.1	95.3	95.3
Lumber and wood products	131.3	134.8	129.5	128.3	137.4	136.1	135.1	135.5	133.8	134.4
Furniture and fixtures	130.7	123.3	121.8	122.5	133.7	119.5	118.3	119.8	122.9	125.7
Stone, clay, and glass products	110.0	113.3	108.9	108.2	117.2	117.0	116.0	114.4	115.4	115.1
Primary metal industries	87.4	79.4	75.5	75.2	87.0	79.9	76.5	78.0	75.0	75.0
Blast furnaces and basic steel products	66.6	61.0	56.8	56.5	67.0	63.2	60.6	60.5	56.9	57.0
Fabricated metal products	115.9	111.1	106.8	107.0	117.1	109.7	107.4	108.1	107.2	108.2
Industrial machinery and equipment	98.6	86.4	83.8	82.9	98.3	87.5	85.1	84.4	83.3	82.2
Electronic and other electrical equipment	104.7	87.4	82.9	81.9	105.2	87.9	85.5	85.1	82.7	81.7
Transportation equipment	112.0	108.6	104.2	105.5	113.5	105.9	105.4	105.3	106.0	106.5
Motor vehicles and equipment	145.1	143.1	135.7	140.4	146.4	135.3	136.5	137.8	139.4	142.0
Instruments and related products	76.5	71.6	70.3	70.0	75.7	71.9	70.5	70.5	70.0	69.3
Miscellaneous manufacturing	93.5	90.3	86.4	88.4	94.9	89.6	87.3	89.1	88.6	89.8
Nondurable goods	93.0	91.0	88.0	87.4	94.8	90.8	89.8	89.5	89.1	89.0
Food and kindred products	110.6	115.4	111.5	108.8	115.4	115.5	114.5	113.6	114.3	113.4
Tobacco products	45.5	51.5	50.5	49.7	43.4	47.8	47.3	46.3	49.4	49.3
Textile mill products	68.0	61.9	59.7	60.5	69.7	62.8	61.4	61.2	59.9	62.0
Apparel and other textile products	50.5	44.7	42.9	44.0	50.9	44.9	44.1	44.5	44.4	44.3
Paper and allied products	98.2	98.2	95.4	94.1	99.8	96.5	96.2	95.9	95.2	95.5
Printing and publishing	117.5	112.5	107.5	106.5	119.0	112.5	110.7	109.9	108.6	107.4
Chemicals and allied products	99.0	96.3	94.8	94.5	99.0	96.8	96.2	95.0	94.9	94.4
Petroleum and coal products	67.4	70.2	67.8	65.7	70.0	71.6	71.7	71.4	70.8	68.1
Rubber and misc. plastics products	139.7	135.6	131.1	131.1	140.6	132.6	131.8	132.9	131.4	132.0
Leather and leather products	28.6	24.7	24.3	24.4	29.1	24.9	24.7	24.7	24.8	24.5
Service-producing	165.1	170.1	161.7	163.8	168.9	167.1	167.1	167.5	166.9	167.4
Transportation and public utilities	137.7	137.3	131.3	131.8	140.3	136.3	135.0	135.0	134.4	134.0
Wholesale trade	129.2	131.2	127.4	127.7	131.4	129.7	129.3	129.8	129.6	130.0
Retail trade	140.4	152.0	138.9	140.5	146.8	144.8	145.3	145.5	145.3	146.6
Finance, insurance, and real estate	138.5	141.3	137.5	138.5	139.8	139.3	140.2	139.6	139.5	139.9
Services	209.1	212.4	204.0	207.8	212.5	211.1	211.1	211.8	210.7	210.9

[1] See footnote 1, table B-2

p = preliminary.

Table B-6. Diffusion indexes of employment change, seasonally adjusted

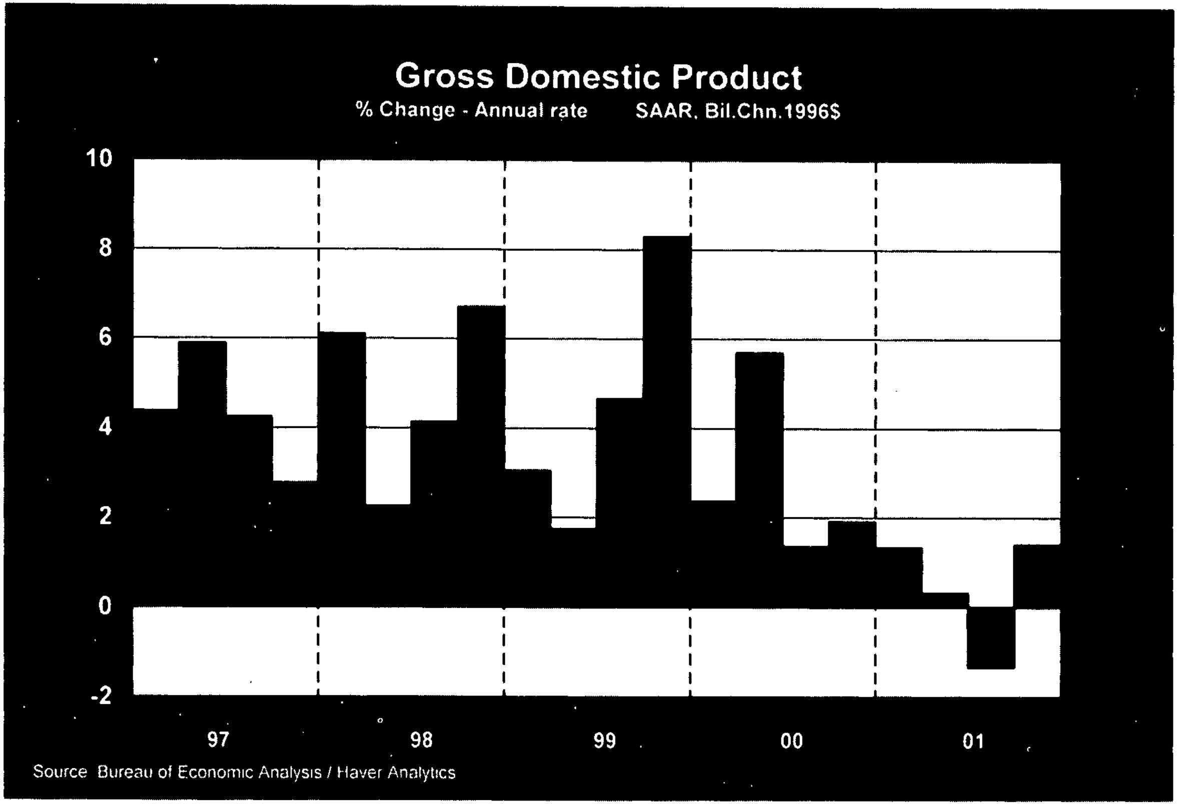
(Percent)

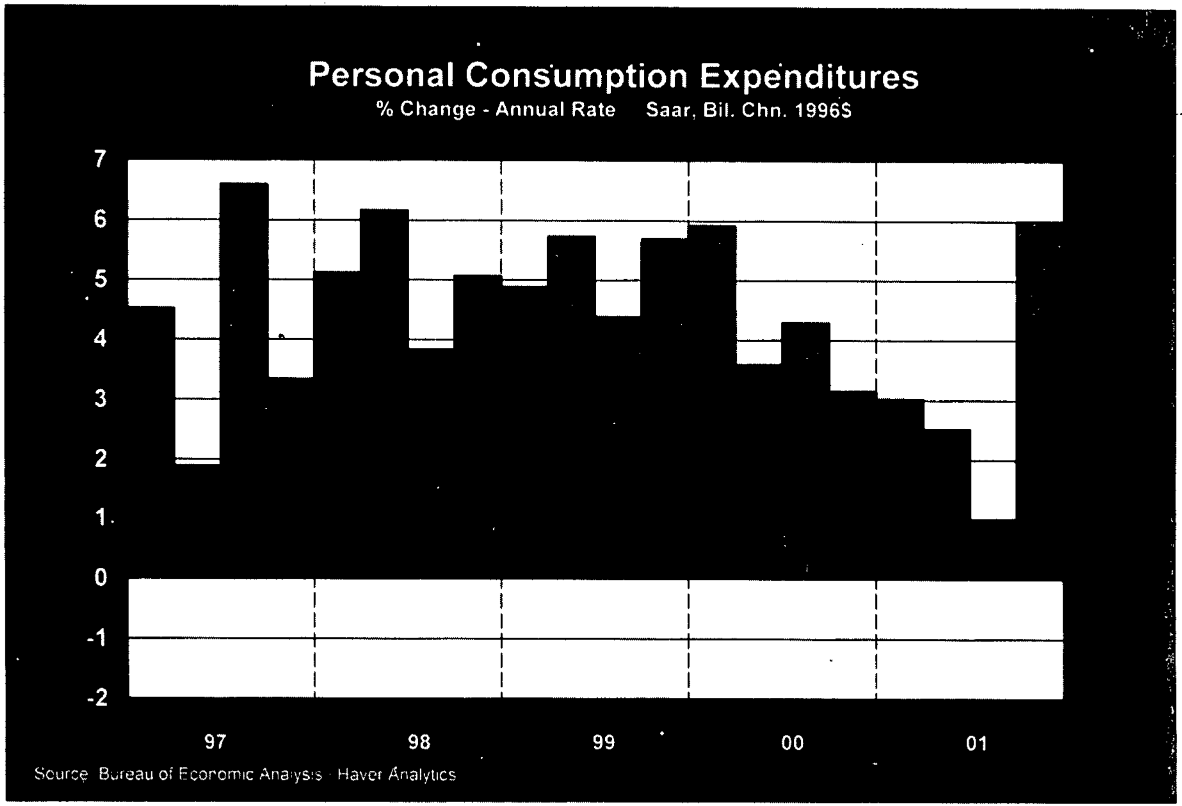
Time span	Jan.	Feb.	Mar.	Apr.	May	June	July	Aug.	Sept.	Oct.	Nov.	Dec.
	Private nonfarm payrolls, 353 industries[1]											
Over 1-month span:												
1998	63.2	56.2	59.3	60.2	58.9	57.1	55.4	58.4	54.8	55.0	58.2	56.4
1999	55.1	59.6	52.8	57.2	58.2	54.2	57.1	54.4	55.2	57.9	59.9	56.8
2000	55.7	59.3	61.0	54.2	47.7	60.5	57.8	55.1	52.0	54.8	55.1	54.2
2001	53.7	50.4	55.8	45.0	46.6	44.3	45.5	43.9	44.1	38.7	38.7	41.8
2002	p47.2	p48.2										
Over 3-month span:												
1998	65.3	66.1	64.6	65.7	62.2	57.9	57.5	58.4	59.1	59.2	59.3	59.2
1999	60.8	57.8	58.5	55.8	58.1	57.9	57.2	59.2	59.8	59.1	61.0	60.6
2000	61.6	63.3	61.9	56.2	55.1	57.9	61.5	56.4	54.1	53.3	55.7	53.3
2001	51.7	54.1	48.6	49.2	42.5	42.4	40.5	39.9	38.8	35.8	35.6	p37.5
2002	p43.8											
Over 6-month span:												
1998	70.4	67.4	65.0	62.5	63.6	60.5	59.2	58.6	57.9	59.6	60.6	59.9
1999	59.8	59.8	58.2	60.3	56.7	59.2	61.8	60.8	62.2	61.2	62.3	64.9
2000	63.5	60.6	62.6	63.7	61.5	55.5	56.1	58.6	54.2	54.8	51.8	54.2
2001	52.0	50.6	48.6	45.3	44.1	38.5	37.1	35.6	35.1	p35.4	p35.8	
2002												
Over 12-month span:												
1998	69.7	67.6	67.4	66.0	64.0	62.7	61.9	62.0	60.9	59.3	60.8	58.8
1999	61.2	60.2	58.2	60.8	60.8	61.6	62.2	61.3	63.9	63.0	61.3	60.9
2000	62.5	63.0	61.8	59.5	58.4	56.8	55.7	56.5	54.2	53.4	53.0	51.7
2001	49.6	47.7	45.0	43.1	40.5	39.8	p39.5	p38.0				
2002												
	Manufacturing payrolls, 136 industries[1]											
Over 1-month span:												
1998	57.4	51.5	53.7	53.3	43.8	48.2	38.2	51.5	41.9	41.5	41.2	43.4
1999	46.0	44.5	43.0	42.3	50.4	39.3	51.5	39.3	45.2	46.3	53.3	46.7
2000	44.9	56.6	55.5	46.7	41.2	54.8	53.7	38.6	34.6	41.5	43.8	44.1
2001	37.9	32.4	41.5	31.3	29.4	33.1	39.0	27.6	36.0	29.4	25.7	29.4
2002	p39.7	p40.8										
Over 3-month span:												
1998	59.6	59.6	55.9	50.4	46.7	37.9	41.5	41.5	41.9	38.2	36.8	40.8
1999	41.2	39.0	38.2	41.5	40.8	45.2	39.0	45.2	40.8	44.9	46.3	46.0
2000	50.0	54.0	52.9	42.3	43.0	48.5	48.2	33.8	28.7	30.5	39.0	35.7
2001	28.3	29.4	24.6	26.5	22.4	24.6	21.0	19.9	19.9	21.0	17.6	p20.6
2002	p30.1											
Over 6-month span:												
1998	63.2	54.4	50.4	40.4	44.5	40.1	37.5	36.4	34.9	40.1	37.1	34.2
1999	36.0	38.2	37.5	41.2	36.8	39.7	43.0	41.5	46.0	40.4	46.3	51.5
2000	51.5	44.5	48.5	55.1	43.8	34.9	33.5	34.6	30.1	29.4	25.0	27.9
2001	26.8	25.4	19.9	20.6	20.2	15.1	13.2	14.0	11.8	p14.7	p18.8	
2002												
Over 12-month span:												
1998	54.8	52.2	51.8	46.7	40.4	40.1	38.2	37.5	36.4	34.6	35.7	34.2
1999	38.6	34.6	32.4	36.0	37.9	39.0	40.1	40.4	44.5	46.0	44.9	44.5
2000	46.3	45.2	41.2	37.9	33.8	31.3	31.3	31.3	27.6	25.4	24.3	21.0
2001	19.1	16.5	14.7	16.2	15.1	12.1	p14.0	p12.9				
2002												

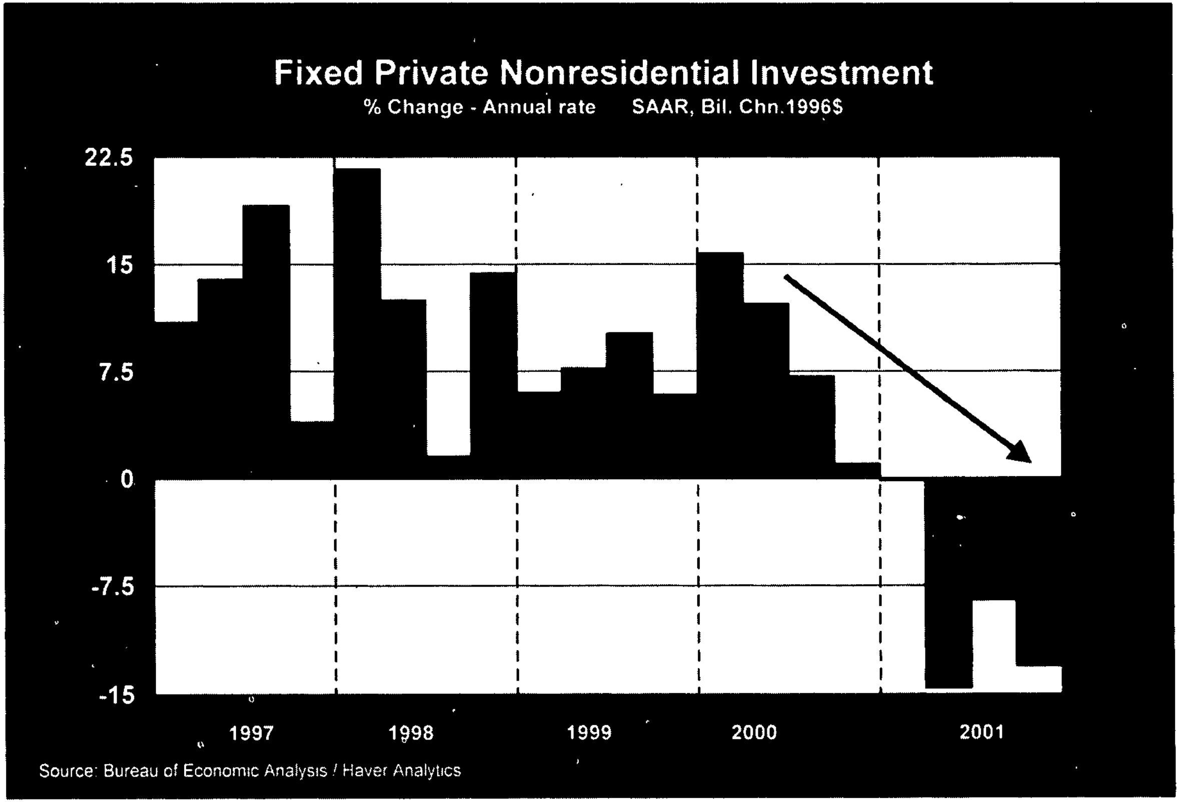
[1] Based on seasonally adjusted data for 1-, 3-, and 6-month spans and unadjusted data for the 12-month span. Data are centered within the span.

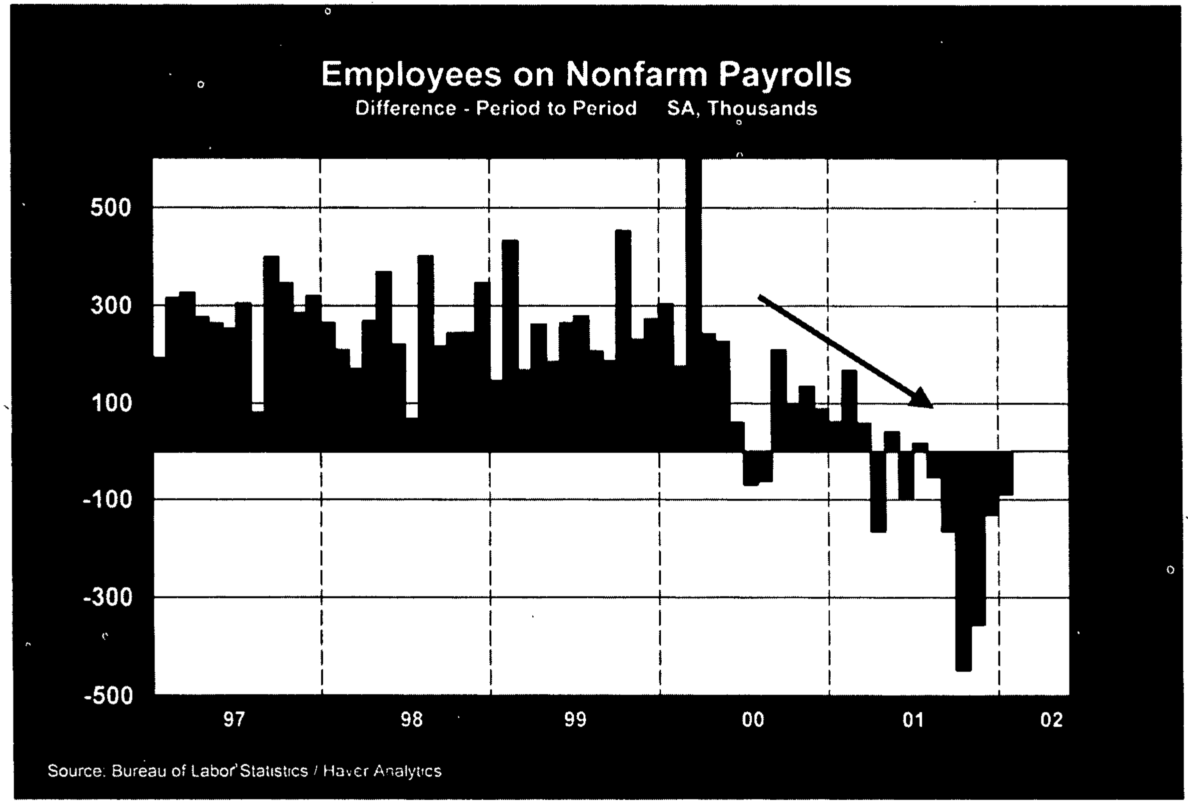
p = preliminary.

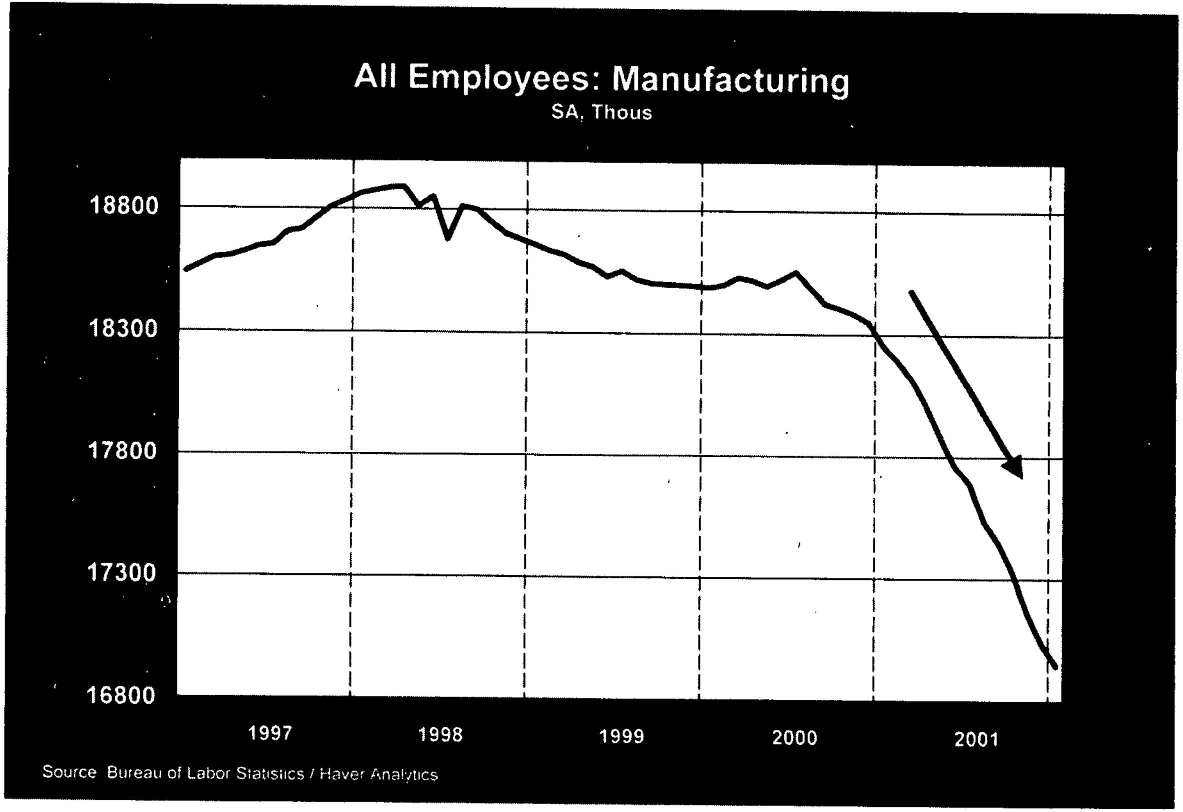
NOTE: Figures are the percent of industries with employment increasing plus one-half of the industries with unchanged employment, where 50 percent indicates an equal balance between industries with increasing and decreasing employment.


Gross Domestic Product
% Change - Annual rate
SAAR, Bil.Chn.1996$
10
8
6
4
2
0
-2
97
98
99
00
01
Source Bureau of Economic Analysis / Haver Analytics


Personal Consumption Expenditures
% Change - Annual Rate
Saar, Bil. Chn. 1996$
7
6
5
4
3
2
1
0
-1
-2
97
98
99
00
01
Source Bureau of Economic Analysis Haver Analytics


Fixed Private Nonresidential Investment
% Change - Annual rate SAAR, Bil. Chn.1996$
22.5
15
7.5
0
-7.5
-15
1997
1998
1999
2000
2001
Source: Bureau of Economic Analysis / Haver Analytics


Employees on Nonfarm Payrolls
Difference - Period to Period SA, Thousands
500
300
100
-100
-300
-500
97
98
99
00
01
02
Source: Bureau of Labor Statistics / Haver Analytics


All Employees: Manufacturing
SA, Thous
18800
18300
17800
17300
16800
1997
1998
1999
2000
2001
Source Bureau of Labor Statistics / Haver Analytics

1749

S. Hrg. 107-478

REFORM OF THE IMF AND WORLD BANK

HEARING

before the

JOINT ECONOMIC COMMITTEE CONGRESS OF THE UNITED STATES

ONE HUNDRED SEVENTH CONGRESS

SECOND SESSION

March 6, 2002

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JOINT ECONOMIC COMMITTEE

[Created pursuant to Sec. 5(a) of Public Law 304, 79th Congress]

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WITNESSES

SUBMISSIONS FOR THE RECORD

REFORM OF THE IMF AND WORLD BANK

Wednesday, March 6, 2002

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

The Committee met, pursuant to notice, at 10 a.m., in Room 311, Cannon House Office Building, the Honorable Jim Saxton, Chairman of the Committee, presiding.

Present: Representatives Saxton and English; Senator Crapo.

Staff Present: Chris Frenze, Robert Keleher, Colleen J. Healy, Darryl Evans, Brian Higginbotham, Donald Marron, Patricia Ruggles, Diane Rogers, Nan Gibson, and James Barrett.

OPENING STATEMENT OF REPRESENTATIVE JIM SAXTON, CHAIRMAN

Representative Saxton. I am pleased to welcome the panel of witnesses before us today. The members of the panel are all associated with the Meltzer Commission, and I would like to thank them specifically for their service and assure each of you that your Commission's influence on international economic policy has been very positive and far-reaching.

In recent years a number of issues have been identified related to proposals for reform of the International Monetary Fund (IMF). The evidence shows that the IMF was not financially transparent, it provided below-market subsidized interest rates and promoted moral hazard.

In addition, IMF's mission creep was reflected in its drift into lending for development and structural reform often involving longer loan maturities and rollovers of existing loans. Moreover, there was a lack of IMF accounting controls and lending safeguards that could result in misuse of taxpayer money. A number of other findings involved the IMF's heavy reliance on the G-10 for resources and a lack of meaningful financial support for the IMF by most of its members.

In the last few years the IMF has made some limited progress in the area of financial transparency. However, a former IMF research director has also noted, "the need to improve the financial structure of the Fund in terms of transparency, efficiency and equity."

The basic problem here is that the IMF is saddled with an archaic accounting framework rooted in an economic and institutional environment that no longer exists. For example, the IMF financial statements still present IMF loans as, "currency purchases" instead of loans. Furthermore, the workings of the SDR department remain as murky as ever. In addition the minutes of the Executive Board meetings are still classified for 20 years.

I would also like to note the President's Council on Economic Advisors (CEA) statements endorsing reform of the International Monetary Fund. According to the recent CEA report, IMF liquidity loan "programs, would appropriately involve short-term lending at penalty interest rates, to encourage and facilitate the borrower's quick return to private capital markets." This is very consistent with the findings of the Meltzer Commission as well as the Congressional mandates for IMF reform that are currently in law.

The administration's support for substantial grant financing of some World Bank activities is also very significant. This reform would offer the best approach to improving living standards and reducing poverty in the world's poorest nations. The traditional World Bank-IMF approach to saddling poorer countries with loans they cannot repay has failed. Moreover, the high failure rate of the World Bank projects reflects a waste of resources that could have been better used to alleviate poverty.

Unfortunately, the defenders of the World Bank status quo are resisting the administration's grants proposal. Ever since the idea of grants was first proposed, the World Bank's own evaluations of its performance have shown sudden improvement. However, we all realize that without truly independent review, performance can be misrepresented. An independent review of World Bank performance is urgently needed. Let me underscore that last thought. An independent review of World Bank performance is urgently needed.

The Bush administration has shown that it is serious about needed reform of the IMF and the World Bank. The work of the Meltzer Commission has been essential to this improvement of international economic policy. The recommendations of the Commission have led to U.S. Government proposals to limit moral hazards, curb international financial instability and reduce the waste of resources to the benefit of many millions of people around the world.

I would like to welcome all of you here this morning. Dr. Meltzer and Dr. Lerrick, Mr. Levinson, Dr. Bergsten, thank you for taking your time to come and share your thoughts with us this morning.

Dr. Meltzer, why don't we begin with you. And we are anxious to hear your interesting testimony, so why don't you go ahead and begin, and at the conclusions of all four statements, we will have some questions.

[The prepared statement of Representative Saxton appears in the Submissions for the Record on page 34.]

OPENING STATEMENT OF ALLAN H. MELTZER, CHAIRMAN, INTERNATIONAL FINANCIAL INSTITUTION ADVISORY COMMISSION (IFIAC); PROFESSOR, CARNEGIE MELLON UNIVERSITY

Dr. Meltzer. Thank you, Mr. Chairman. Thank you for holding this hearing. You, your colleagues and staff have played a major role in reforming and improving the operations of the International Monetary Fund and the development banks by insisting on greater transparency, increased accountability and improved performance.

You have rendered a great service to the American public and the people in the developing countries. Your efforts have not only saved taxpayers money, they have raised standards of accountability for performance. I am pleased to have been part of that effort, an effort that is continuing and has the support of the Bush administration, Treasury Secretary O'Neill and his principal staff.

Today we recognize the second anniversary of the Commission report. My colleague Adam Lerrick and I have divided the review of the past two years and prospects of the future into two parts. I will discuss the IMF, and he will discuss the development banks, particularly the World Bank.

The Commission proposed four kinds of changes at the IMF. First, it proposed improved transparency and information to permit outside observers to better understand what the IMF had done, what it recommended, and what resources it had available. Before this Committee took an interest, even a trained accountant would have difficulty interpreting the IMF's financial statement. The Commission developed a balance sheet that the IMF adopted.

Its accounting statements became less opaque. Reports of IMF surveillance of a majority of member countries, so-called Article 4 consultations, are now routinely posted on the IMF's website, along with a lesser but still substantial number of staff reports.

Improved quality and increased quantity of information helps markets to operate more efficiently and reduces risk. However, the IMF has not restructured accounting in the SDR department, and many countries have not improved the quality of their data. The IMF should do much more to get countries to improve data quality and to release it.

Second, the Commission found considerable overlap between the programs of the Fund and the development banks. It criticized the overlap and the large number of conditions that the IMF negotiated with borrowers, particularly borrowers in crisis. The IMF reduced the number of programs and the number of conditions attached to loans. It now limits conditions to matters directly related to the country's problem.

The Meltzer Commission proposed that troubled crisis countries should not look to the IMF to provide a reform program. Reform has a much better chance if the country adopts and implements its own choices of policy reforms. Management of the economy should remain in local hands. The IMF should confine its role to seeing that the promises are kept and that its loans are used effectively, not squandered on wasteful expenditures, paid to creditors or used to support the exchange rate.

The IMF has now moved in this direction. A senior IMF official recently said, quote, the main aim is to have a minimum amount of conditionality that enables countries to meet these goals. How can these goals be achieved? The IMF needs to be more flexible, not dictating to a country what policies are needed. The country should be allowed to present a program to the IMF. There has to be broad participation in the discussion of policies in the country, and the IMF needs to be selective, patiently waiting for the country to be ready. Already there are promising signs. The streamlining process is under way, and collaboration with the Bank, that is the World Bank, has been strengthened, end quote.

The IMF did not eliminate all duplication. The Poverty Reduction and Growth Facility continues. IMF management is sensitive to criticisms about the effect of disinflations on the poorest citizens of the disinflating countries. It does not want to give up poverty relief so that it can temper its macropolicies with policies to help the poor during a transition or recession. I believe it does not have enough confidence in the development banks to relinquish poverty fund programs to them where they belong.

Increased effectiveness of development banks would help to make the case for closing the IMF's poverty relief program and restricting the IMF to its principal functions, providing information; creating incentives that reduce the number, frequency, depth and virulence of financial crises; assisting governments to resolve crises; and preventing the spread of crises that occur.

Third, the Commission urged the IMF to phase in over five years an incentive system that induces countries to adopt prudent policies that reduce the risk of financial crises. We proposed a small list of observable prudent policies, preconditions, that if adopted and maintained would obligate the IMF to assist the country when it faced a financial crisis.

The great advantage for the country of adopting preconditions is that the IMF's commitment to assist in a crisis and its monitoring increased lenders' confidence that the country maintains prudent policies. Preconditions in place would act like a good conduct badge. The country would get more capital from the market at lower cost. This would foster development and reduce debt burdens.

IMF senior officials accepted this idea. They have proposed a contingent credit line to implement the proposal. Unfortunately no country has agreed to join. I believe there are two principal reasons. First, the IMF bureaucracy will not offer automatic assistance to countries that join. Second, until very recently all countries received assistance whether they adopted preconditions or not, so there was not much reason for private lenders to favor countries with more prudent policies over countries that were riskier.

The market does not lend to the poorest countries with little prospect of repaying its loans, but as Argentina, Ecuador, Russia and Indonesia have shown, the market has provided large loans to risky borrowers. Now that the IMF has not bailed out creditors of Argentina and others, I expect more discrimination by private lenders and more caution. Lenders who made moral hazard loans expecting to be rescued by the IMF and the G-7 will improve their monitoring and demand better policies by borrowing governments. If this proves to be correct, borrower incentives for prudent policies will be strengthened. More countries would willingly adopt more prudent policies and join an improved Contingent Credit Line (CCL).

A critical condition is that incentives work both ways. Countries with imprudent policies should not get IMF assistance in a crisis, once a five-year phase-in is completed.

Fourth, the Commission urged the IMF to improve crisis management by making different responses to prudent and imprudent lenders. The majority proposed that the IMF restrict its aid to two kinds of countries, those with prudent policies and those countries threatened by policies and practices of imprudent neighbors and trading partners.

As Argentina moved toward crisis, the IMF approved a standby loan to Brazil, a country currently with responsible monetary and fiscal policies, that seemed to be injured by Argentina's decline. After mistakes in December of 2000 and August of 2001, the IMF stopped lending to Argentina. Instead of offering Argentina a large loan with many conditions based on empty promises, the new IMF insisted on a coherent, consistent plan developed, adopted, and implemented by the Argentine Government. It has refused to finance Argentina's budget deficit or the bailout of international and domestic creditors. I should say it has so far refused to finance Argentina's budget deficit. It has not provided additional billions to support an overvalued exchange rate or to finance capital flight.

If the IMF withstands the pressure to throw in more money, moral hazard will be reduced. Lenders will expect to bear losses if they make risky loans. Countries that want to borrow to grow will have much greater incentive to adopt prudent policies, to rely more on foreign direct investment and less on short-term borrowing. They will invite foreign banks into the country and strengthen domestic financial institutions. The risk of crises will decline.

In the last decade the global economy experienced severe crises in 1994, 1995, 1997, 1998 and 2001. This alone suggests that the system was not working well. Tens of billions in emergency loans attempted to stem the crises. In many of the crisis countries, the banking and financial system collapsed, the exchange rate went into free fall, and unemployment rose as output fell.

Argentina, the latest crisis country, has one of the most severe crises. Unemployment rates will reach 30 percent of the labor force or more. That is worse than the worst year of the Great Depression in the United States. Mistaken policies have paralyzed economic transactions and bankrupted financial institutions.

The main problem with bailouts is that they cover over today's problem, but encourage a larger problem somewhere else. Twenty years of bailouts and conditional lending have failed. The crises have become larger. The promises to meet conditions are kept infrequently. This should not come as a surprise. The system of conditional bailouts and conditional lending relied on command and control. Countries had good reason to promise reforms, but few incentives to carry them through once the recovery was under way. Lenders came to expect that the IMF and other international financial institutions would not just bail them out, they would reward them with higher interest rates and fees for renegotiating and extending the maturity of their debt.

We have started to replace command and control with incentives for lenders and borrowers. If we continue on this path with patience and conviction in the face of pressures, we will achieve a better system. Lenders will have incentives to use the improved information that the IMF now provides, study the risks they have undertaken or are about to take.

Borrowers must have heightened incentives to adopt and maintain prudent policies. Rapid support for countries that meet preconditions provides the incentives. Some critics of the new policies assert that markets have failed, that openness, privatization and market incentives have been tried and have failed. This is a peculiar claim. It ignores such successes as Chile, China, Korea, Mexico, Poland, Taiwan and many others. It fails to mention that Argentina's problems are not novel. Their economy is barely open to trade. Their markets continue to suffer from the rigidities adopted by Juan Peron's governments.

There can be little budget discipline until there is a financial responsibility law that restricts provincial spending. Argentina's exchange rate was overvalued, its budget in deficit. The current government has no plan as yet to restore economic activity without inflation.

Argentine journalists ask me repeatedly, what does Argentina have to do to get IMF assistance? President Bush, Secretary O'Neill, Mr. Kohler, the Managing Director of the IMF, and many others have answered that question repeatedly. Argentina must come forward with a coherent, consistent plan that restores growth without inflation, increases productivity and settles its defaulted debt.

Policy toward Argentina is an abrupt change from past policies. Having embarked on a new and better course, the IMF and the G-7 must not go back to the old ways.

We are in the early phase of a transition to a safer, sounder international financial system based upon proposals for reform that this Committee and our Commission brought to public attention. Lenders now have reason to recognize the risks of lending to developing countries and, therefore, to be more prudent. Borrowers now have reason to recognize that excessive borrowing or imprudent behavior is costly to their country, because they may be dismissed from office suddenly. Recognition of the true risks and costs on both sides will do much more than so-called Basel standards to reduce moral hazard, promote more orderly development lending, save the taxpayers money and reduce the frequency of crises and tragedies in developing countries.

With your support and continued support of the new administration at the IMF and at the U.S. Treasury, we will achieve that safer, sounder system. Thank you, Mr. Chairman.

[The prepared statement of Dr. Meltzer appears in the Submissions for the Record on page 37.]

Representative Saxton. Thank you, Dr. Meltzer.

Dr. Lerrick.

OPENING STATEMENT OF ADAM LERRICK, SENIOR ADVISOR, INTERNATIONAL FINANCIAL INSTITUTION ADVISORY COMMISSION; DIRECTOR, GAILLIOT CENTER FOR PUBLIC POLICY

Dr. Lerrick. It is a privilege to address the Joint Economic Committee. First, Mr. Chairman, I would like to thank you and Majority Leader Armey for the strong support you provided when violent attack came from almost all sides. Two years ago Minority Leader Gephardt greeted the publication of the Meltzer Commission report with the following appraisal, "an extreme neoisolationist attitude that will undermine development efforts in the world's poorest countries and the stability of the world financial system."

Then Secretary of the Treasury Summers made a rare personal appearance on the pages of the *Financial Times* to claim that one of the Commission's key proposals, a shift in the format of aid from loans to grants, would, "require an unworkable system for delivering assistance."

World Bank President Wolfensohn deemed grants unrealistic.

One year ago my fellow witness Mr. Bergsten stated that the Joint Economic Committee hearing on the first anniversary of the report's publication was appropriate as a burial service because none of the Commission's recommendations had been or would be adopted. What a difference a year makes. Once branded ivory tower by some and radical by many, the Report was recently termed the blueprint for international reform efforts by *The Economist* magazine. Today we have a new administration that supports international reform, and a new International Monetary Fund with a disciplined approach to assistance. Many of the major recommendations of the Commission are on the way to becoming global public policy.

My remarks will focus on developments at the World Bank, particularly those current issues that would benefit from the intervention of the Congress.

A critical look at the Bank is doubly important as the institution assumes the leadership role in the United Nations campaign to double development aid flows to more than $100 billion each year. When leaders from both the industrialized and developing world meet in Monterrey, Mexico, on March 18th at the United Nations Conference for Financing for Development, two topics that originate in the Meltzer report will be high on the agenda: First, a change from loans to grants for the delivery of aid to the poorest countries; second, a move to rigorous measures to increase the effectiveness of development assistance.

President Bush launched these proposals at the Group of 7 meeting in Genoa last summer, and the Secretary of the Treasury continues to speak out forcefully in support of the administration's commitment to these policies. Grants were proposed by the Commission to address the shortcomings endemic to the tradition of open-handed lending by the multilateral institutions. The poorest countries had accumulated debt they were clearly unable to repay. Funds had been diverted to unproductive ends. Donor contributions ended in write-offs instead of real improvements in the standard of living of the impoverished.

This grant format is new because it is performance-based. Counter to the trend of lending blanket sums for indeterminate government plans, grants will be project-linked and executed under competitive bid by private sector contractors and nongovernmental organizations. For the easily quantified basic needs that improve the quality of life, and are the preconditions for economic growth, health, primary education, water and sanitation, the grants system would count by independent audit and pay for output. Numbers of babies vaccinated, children that can read, water and sewer services delivered to villages. No results, no funds expended, no funds diverted to offshore bank accounts, vanity projects or private jets.

Opposition to the use of grants has been orchestrated by the World Bank around the faulty argument that grants will deplete its resources together with its ability to help the poor unless they are partnered with an immense infusion of new funding, $800 million more each year from the U.S. alone. It is worth taking the time to explode this false argument.

It would seem logical that if money is given away instead of being lent, the stockpile of funds will eventually vanish. Not so. Grants will not cost more than loans. They deliver the same amount of aid without diminishing the funding pool and without asking for more taxpayer moneys from the industrialized world. The funding requirement is the same when the level of aid is the same. The arithmetic is straightforward. The International Development Association (IDA), the arm of the Bank dedicated to 72 of the globe's neediest nations, extends 40-year loans at virtually zero interest. The interest-free use of the money translates into a gift component equal to $73 out of every $100 loan. Although ultimately $100 will be repaid, the real cost to the recipient is $27. A simple way to verify the mathematics is that if the recipient were to take $27 out of the $100 received and invest it in the capital markets, the proceeds would be sufficient to repay the entire $100 loan at maturity, and he would get to keep the $73 out of the original $100 as a free gift. The loan is therefore identical to an outright grant that pays $73 out of $100 of program outlays, with the remaining $27 paid by the recipient. In both cases the cost to the country is $27.

Again, if the level of assistance is the same, grants cannot cost more than loans. The grant format can produce the same reflows into the IDA pool of financial resources as traditional loans at the same level of aid. For each $100 of donor funds, $73 would be disbursed as grants and $27 invested in the capital markets. The proceeds of the investment will match the $100 of loan reflows over the life of a traditional 40-year IDA loan.

The effectiveness of World Bank performance has been another highly contested but not unrelated debate. Although the Bank claims 75 to 80 percent success rates, when the Meltzer Commission reviewed the Bank's own data, it found that more than half of World Bank programs overall and more than two-thirds of projects in the poorest countries, failed to achieve both satisfactory and sustainable results.

Debate over the numbers is irrelevant, because the Bank's auditors are captive, because the judgments are made too early, at the time of final loan disbursements, but long before an operating history is established, because sustainability, the sine qua non of development, is given little consideration in the evaluation.

After the publication of the Meltzer Commission Report in 1999, World Bank sustainability ratings that had stagnated at 50 percent for years jumped to 72 percent in 2000. Was there such swift improvement, or was the bar simply lowered? Thinking has continued long after the official life of the Meltzer Commission. After 50 years and $500 billion of aid, we have no evaluation of World Bank performance except the one it chooses to promote. If the wrong people are applying the wrong criteria at the wrong time, how credible are the conclusions?

Why not establish a bona fide external audit by private sector firms on site to determine the lasting contribution of IDA projects after a credible operating history, and to provide a continuing benchmark for Bank efforts in the poorest countries. The World Bank is now seeking $13 billion in IDA replenishment funding. The U.S. share alone is $2.5 to $2.8 billion; five to seven million dollars, or just one-quarter of one percent of this commitment, would cover the cost of an audit. The condition of an external performance review of IDA programs, together with provision for its financing, should be written into the upcoming appropriation and to all funding going forward. Thank you, Mr. Chairman.

[The prepared statement of Dr. Lerrick appears in the Submissions for the Record on page 44.]

Representative Saxton. Mr. Levinson, we have a vote on, and so Mr. English and I are going to have to leave. Is your testimony five minutes, 10 minutes?

Mr. Levinson. It won't be more than 10 minutes.

Representative Saxton. It won't be more than 10? If we leave near the end of it, you will understand. Sorry.

Mr. Levinson. Well I have—

Representative Saxton. Mr. Crapo is going to take the chair when Mr. English and I go to vote. So go ahead, sir.

OPENING STATEMENT OF JEROME I. LEVINSON, DISTINGUISHED LAWYER IN RESIDENCE, WASHINGTON COLLEGE OF LAW, AMERICAN UNIVERSITY

Mr. Levinson. Well, in the year that has passed since this Committee met to discuss this subject matter, we have descended from the realm of theories to the flesh-and-blood world of the real economy in which theory has real consequences. The event that illustrates this truism is Argentina. The crisis was so long in developing that the financial markets have had time to absorb the Argentine financial default without significant consequences for other borrowing countries. In other words, financial contagion has been contained. We can then consider how to think about the lessons of Argentina in other than crisis conditions for the international financial system.

And yet Argentina remains, in my opinion, a watershed event. It conclusively demonstrates first the hollowness of the Meltzer Majority Report of the Commission on International Financial Institutions, hereafter the Commission, recommendations for reform of the IMF, the limitations of the IMF, World Bank and neoclassical economic paradigm, which Joe Stiglitz, the former chief economist of the World Bank, and Nobel Prize winner in economics, has referred to as market fundamentalism, slightly modified in recent years as the Washington consensus elite that has governed development thinking for the past 15 years; and it further illustrates the excessively short-term economic mindset of the Secretary and Under Secretary of the Treasury. The Treasury proposal for additional grant funding for the IDA, the World Bank soft loan affiliate for dealing with the poorest of poor countries, while superficially appealing as presently formulated by the Treasury, is ill-conceived, impractical and probably harmful to any sustainable financing for development in the poorest countries.

I would be glad to respond in more detail to questions on this subject, but in this testimony I will concentrate on the Argentine case as illustrative of the above three theses.

Argentina is the country that most enthusiastically embraced the neoclassical economic model promoted by the IMF and the U.S. Treasury, market liberalization, opening to foreign investment, particularly foreign direct investment, and a reduced role for the state in direct production of goods and services.

The original heart of the Meltzer proposal is to divest the IMF of discretionary authority with respect to conditions that attach to member country access to IMF financing. Such financing after a suitable transition period is made conditional on prequalification of the country. Only countries with financial banking systems previously determined to be sound are eligible to draw upon IMF funding.

The key to assessing the soundness of the system is its openness to foreign investment, which, according to the majority, is a guarantee against unsound crony capitalism in which financial decisions such as the allocation of credit are made on the basis of criteria other than arm's-length credit analysis.

Fred Bergsten, who came late to the Commission's deliberations, immediately identified the flaw in the proposal. A country with a sound banking system but unsound macroeconomic policies would automatically be eligible for IMF funding, but without any conditions that addressed the underlying conditions, the policies that necessitated recourse to the IMF. In recognition of the validity of the Bergsten critique, the final report of the majority contained a few sentences referring to the need for a sound macroeconomic framework as an additional precondition for IMF financing.

Argentina takes the issue out of the realm of theory and into the real world. Argentina not only opened its banking system to foreign capital, but it permitted the sale of virtually all of the previously Argentine-owned banks, primarily to American and Spanish financial institutions. There are no banks of any stature any longer majority-owned by Argentine nationals, nor are there any local cronies of any consequence to whom the banks can lend. Argentina has sold the previously stated-owned water, telecommunications and utilities to foreign capital, primarily state-owned Spanish and French companies, a process less privatization than de-Argentization. The previously state-owned petroleum company, YFPB, has been auctioned off to a combination of domestic private and foreign capital.

Argentina has divested to private capital the previously state-owned railroad system. The signature industry of Argentina, the meatpacking companies have been sold to the major international groups. Today there is no Argentine-owned meat packing company of any size or importance.

In light of this record, the statement by Secretary O'Neill that Argentina has not carried out significant economic reforms is simply incredible.

Argentina ran into difficulties because of a variety of problems, most notably, most commented upon in this country, the currency board arrangement, and finds itself in intense negotiations with the IMF in the midst of a profound economic depression.

A country cannot be frozen in time. Conditions change. Policy may not adapt. A crisis ensues requiring the countries to go to the IMF for assistance, precisely the circumstances envisioned for IMF intervention. The need for judgment as to the appropriate policies to address the situation cannot be evaded. Argentina thus put paid to the Meltzer majority theory that recourse to the IMF can be automatic in accord with pre-established criteria.

The issue remains, what are the criteria for IMF assistance? And that brings us to the issue which I think unfortunately the Commission did not address and on which there probably could have been a very large amount of agreement. The Chairman in his opening statement referred to mission creep. I couldn't agree with him more. I was in Argentina in 1996 on a speaking tour for the – sponsored by the AFL-CIO and the CGT, Argentina Confederation of Labor. This was at the time when the World Bank and the IMF were beginning their push for labor market flexibility, which is a euphemism for making it easier for firms to fire workers without severance payments, and for changes in the collective bargaining system which would be to the disadvantage of labor and would reinforce the position of capital.

It happens that my wife and I had dinner with the president of the Olmos local of the metallurgical workers, and they were commenting – his wife is an American – that the IMF and World Bank were pressing for the unions to be divested of the responsibility for administering, what in Argentina are known as Obras Sociales, health plans, and she said to me that they must think that we are really stupid because we are union people. But we know what they are about. They want to divest the unions of responsibility for the health care plans, because those plans reinforce worker loyalty to the unions.

Her husband, the head of the Olmos union, was pressing, along with a bunch of young Turks, for a general strike at the time, 1996. The president of the meatpackers union offered a barbecue for my wife and myself. You can imagine what that is like when they come around with the slabs of beef, pork, chicken and cut whatever cut you want. But when we walked into the union hall, the offices, it is a step back in time, because on the walls are these larger-than-life blown-up photos of the great moments, at least for the Peronistas, in Peronist political life; the march of the meatpackers union, down to get Peron released from jail. Evita on the balcony. Evita passing out food to the poor. And you realize when you step in there the role that history has as a limiting factor in connection with a society.

I was seated next to the president of the union, and I asked him what he thought about this IMF-World Bank initiative to divest unions of the responsibility for the health plans, and what he thought about the prospects for the general strike; he told me that he did not think it was possible because the unions were too divided. President Menem was too clever in terms of dividing the unions, and he did not, therefore, believe in a general strike.

The young Turks won out. The leadership of the CGT was changed, and a general strike was called at the end of September of 1996; it was hugely successful, but what was significant about it was that it wasn't only supported by the workers, it had broad support in the middle class, and this should have been a warning signal to the IMF, World Bank and indeed our own Treasury at the time that the social and political base for the economic policy was slipping away from the Menem government. No government embraced more enthusiastically the neoclassical economic model than the Menem government in Argentina.

In this country most commentary has focused on the currency board arrangement and the pegging of the peso to the dollar. There is one argument, for example, in the Washington Post that Argentina stuck with the currency board arrangement for too long, but that otherwise there is nothing wrong with the free market economic model which Argentina adopted.

I would like to suggest to you that the economic model is more fundamentally flawed than just the currency board arrangement. It could not solve the unemployment program, which even in the years of high growth in the mid-1990s never got below 13 to 14 present. It has resulted in the devastation of an education system which delivered 95 percent literacy, and of a health system which may have had quality problems, but achieved wide coverage of the Argentine population. It has led to an increasingly alienated and embittered working class and a regressive distribution of income that finally discredited altogether the economic model.

The breaking point came in December of last year when the IMF and U.S. Treasury demanded and the government accepted a policy of still more austerity and unemployment.

Argentine society, not just the unions, rose up and drove the de la Rua government from office. It should be noted that at that time, the IMF staff understood that the currency board was no longer sustainable; the conversations between the staff and Domingo Cavallo, the Minister of Economy, assumed a surrealistic character in which Cavallo insisted that there was nothing wrong with the currency board; they just needed IMF money to fortify confidence, and the IMF staff felt that he was divorced from reality. The meetings ended inconclusively, and that is when the Argentines went back home and de la Rua tried to implement this austerity program, which led to his fall.

The best way, in my opinion, to understand the Duhalde government is in terms of the early months of the Roosevelt administration in 1933. Faced with a devastating depression and no good alternatives, FDR tried a bewildering variety of approaches. If asked to produce a coherent plan, as the IMF and Treasury have demanded of the Duhalde government, all of the creative experiments of the New Deal period would have been killed at their inception. Social Security would have been rejected in favor of private investment accounts, and the *Wagner Act* probably dismissed as an undesirable intervention in the labor market when the preferred objective of policy should be not to diminish the disparity of bargaining power between individual workers and firms, but to maximize that disparity in favor of capital.

Faced with this situation, what has Duhalde done? He has cobbled together the most broad-based government in the postmilitary era. He has an important part of the radical party, including the support of former President Alfonsin with whom he has been talking for some time, and who also hates the former economic model. He has also included Frepaso, the center left party. Both small and medium enterprises and the majority of the labor unions understand that Duhalde is their last chance. The alternative is a deepening of the "reforms," as demanded by the U.S. Treasury and the IMF, that they understand will be devastating for them.

No one, not the IMF, the Argentines or anyone else, had a good exit strategy for the currency board regime, but the Duhalde government finally did it, difficult as it has been. At first they experimented with a dual exchange rate. When that came under severe criticism, they backed off, and went to a floating rate. Duhalde attempted to allocate the burden of adjustment more equitably within Argentine society, placing the greatest cost upon the foreign-owned banks and utilities who had sweetheart deals from the Menem government and made big profits in the last years; he has concluded a difficult negotiation with the provinces in connection with revenues and expenditure cuts. And the papers report this morning that the Argentine Senate has passed the first reading of the budget. He probably has the best chance of any recent government to

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carry out a reasonable economic policy with a broad base of political and social support. But Duhalde confronts increasing outrage, at growing income inequality, declassing of the middle class and the reversal of social gains for the working class.

We can expect a period similar to the early New Deal era of trial and error, what works and what doesn't, what is socially and politically feasible and what is not. Understood in these terms, what the Duhalde government seeks to accomplish is not dissimilar to FDR's objective: to assure society that within the framework of representative political democracy and a market economy, there is room for a policy alternative that has as its objective not just economic efficiency, but a more just society. And that may be his problem, for that objective brings him into conflict with the IMF and our own Treasury that seems determined to force upon the Duhalde government the same policies and prescriptions that brought down the de la Rua government, a Herbert Hoover-type economic policy, deep cuts in fiscal expenditures in the midst of a crushing economic depression, and unemployment, which as Professor Meltzer says now may reach 30 percent, and labor market flexibility measures that only can drive a wedge between the government and the unions.

We have the Deputy Managing Director of the IMF warning about hyperinflation, hyperinflation with 30 percent unemployment in a four year recession-depression, with massive unused capacity in the consumer goods industry because of lack of demand. It may be that if they monetize the deficit without adding to capacity, in a year or so when they absorb existing capacity, they will have an inflation problem, but all she did was reinforce the difficulties facing the Duhalde government.

For years the IMF has been trying to convince critics that it does not have a cookie-cutter, one-size-fits-all approach. Yet we are now told that it is bringing in a new lead negotiator for the Argentine negotiations, an individual with no background in the country or the region, who does not speak the language, is ignorant of the history, culture and all of complex bargains, formal and informal, that make up a country's social compact.

Increasingly, the IMF resembles the Mad Hatter's tea party in Lewis Carroll's *Alice in Wonderland* fable. White is black. Black is white. Night is day. Day is night. Knowledge is vice. Ignorance is virtue. There is then a growing gap between the social and political reality of Argentina and the policy priorities of the U.S. Treasury, the Bretton Woods institutions and an important part of the American academic, and journalistic establishment for whom growing income inequality is irrelevant, the middle and working classes in Argentina pampered and undeserving of any special concern.

The significance of Argentina is, however, larger than Argentina. It is symptomatic of a disconnect between an increasingly conservative Washington establishment and a growing disenchantment in Latin America with the social consequences of the neoclassical economic model that for the past 15 years has been the preferred, and indeed the only, acceptable economic policy in Washington.

The leading candidate of the Cardoso government in Brazil – Brazil is going to face Presidential elections this year – the slogan he has adopted is revealing. (Speaking in Spanish.) That is to say, nothing against stability, but everything against inequality. I think that is indicative of the degree to which the equity and inequality issue is coming to the fore in Latin America.

So for me reform of the international financial institutions must start with a reconsideration of the economic model, its income distribution effects, and social and political consequence. In other words, for me the name of the game is political economy, not an economic technocracy run amok, which is what we now have at the IMF and, sad to say, with our own Treasury. Thank you.

[The prepared statement of Mr. Levinson appears in the Submissions for the Record on page 49.]

Senator Crapo. [Presiding.] Thank you very much, Mr. Levinson.

Dr. Bergsten.

OPENING STATEMENT OF DR. C. FRED BERGSTEN, DIRECTOR, INSTITUTE FOR INTERNATIONAL ECONOMICS

Dr. Bergsten. Thank you very much, Senator.

Let me try to do three things, if I might, in my opening remarks: first, address this question of Argentina, which, as Professor Levinson said, does raise in very stark terms the IMF and reform issues we have talked about; second, segue a bit, because Argentina, I think, has revealed several important implications about the functioning of the monetary system as a whole; and then finally, comment on changes, reforms, and improvements that have been made in the monetary system, and what that implies about the Meltzer recommendations and other proposals two years later.

First on Argentina. As I step back a bit from the immediate situation that Professor Levinson addressed, my conclusion is that the IMF is in great danger of whipsawing itself over Argentina. The fact is that for a long time, including quite recently, the IMF was not too tough on Argentina – it was too soft on Argentina. All of the time that Argentina was running very successful economic growth and price stability policies in the 1990s, it was letting its fiscal position deteriorate sharply.

The share of national debt to GDP has more than doubled from 1993 to now – from about 23 percent to 50 percent. It was during the good period, which lasted through 1998 or so, the boom period, when fiscal rectitude should have been pursued and the budget not permitted to get out of hand.

But the IMF said nothing about it despite continued close involvement with Argentina. Then, as the crisis came into clear appearance – and I think all of us on this panel plus many others were saying as long as two years ago that the fiscal situation, the currency board, and other circumstances were simply unsustainable and could not continue – the IMF poured not one, but two huge financial rescue packages into Argentina. It did not insist on change in those fundamental problems. It, therefore, encouraged those policies to continue and the crisis to come on.

So the problem in stage 1 was not the problem typically stated – that the IMF is too tough on poor countries – but rather it was too soft. It did not insist on necessary changes. Indeed, it financed unsustainable policies, made the situation worse, delayed the evil day, and therefore made it even more severe, as Professor Levinson has now so graphically developed.

Indeed, when the IMF made its second big loan to Argentina last summer, it seemed that the IMF was gambling for redemption, as we sometimes say about companies headed for bankruptcy. You seem to be in trouble, you make a huge last bet on some speculative outcome, and you bring yourself down in a heap, for example, Enron. That is what the IMF in a big sense did in Argentina.

Now that Argentina faces these desperate straits, as graphically described by Professor Levinson, the problem is that the IMF will go to the other extreme and be too tough, because in the circumstances he described, including the desire we all have to maintain a democratic political system in Argentina, we cannot be so insistent on all of the necessary reforms at the same time that we drive the country into total anarchy or a return of authoritarian government or worse.

Yet the IMF, if it sits back and does not offer a helping hand, does, in fact, I am afraid, risk that outcome. If it did it, it would be as bad as the commercial banks that we attack for seesaw behavior. The private banks throw huge amounts of money into countries when they are doing well, pull money out when the countries start to do poorly and make the situation worse – the famous seesaw, the famous gyrations from one extreme to another, which always make situations worse by overdoing the booms and then overdoing the downturns as well. And that is the risk for the IMF now if it does not find a way, pretty soon, to work constructively with the Argentine Government to come out of this difficulty.

I am afraid that our own administration has performed even worse. They have already whipsawed themselves. They came into office vowing not to support continued big bailouts of unsustainable situations, including clearly unsustainable exchange rates, but they did. They supported the big new rescue for Argentina. They supported one for Turkey as well, where we don't know the outcome yet. But clearly in Argentina they whipsawed themselves; they said they wouldn't support big bailouts, but did anyway. Their credibility is much in doubt. Professor Meltzer puts a positive spin on that and I hope he is right that a new day is coming. But I suggest that it could then go too far in that other direction as well, and therefore run the risk that the Argentine crisis would become even worse.

I am afraid that the situation in that sense is not better than it was a year or two ago when the Commission reported, but indeed worse, and the performance of both the IMF and the U.S. Government in the interim has made it worse.

Now, having painted a pretty bleak picture on that front, let me say there is some very good news. The good news is that the Argentine situation has had virtually no spillover effect on the rest of the region or the rest of the world. In other words, there has been virtually no contagion. Indeed, there has been some positive contagion. The Mexicans and others report that, in the wake of the Argentine meltdown, they have gotten increased capital inflow. Money moved from Argentina into Mexico. One reason the Mexican peso is the only currency in the world that has been stronger than the U.S. dollar for the last couple of years is because money has moved from other emerging markets, including Argentina, into Mexico.

Why is it that there has been so little contagion from Argentina to the rest of the world? I suggest it is largely because of improvements in the functioning of the international monetary system. Obviously this crisis was anticipated for a long time. Some people believe that is why there is no contagion. That was a factor. But Thailand had been anticipated for a long time by many people. Mexico in 1994 was anticipated by a lot of people. So that is not the sole explanation.

I think there are really three factors. First, the markets are learning to differentiate between different countries rather than to generalize about regions as they did in Asia in 1997 and 1998, and that increased differentiation has been helped substantially by the better data, the greater transparency, the data standards that the IMF has put out and begun to enforce. All of that has improved the functioning of the markets and, therefore, the lack of contagion in the system.

Second, all of the emerging-market economies, particularly those in Latin America, have strengthened their domestic banking systems. There is still a lot of reform to be done, but there has been substantial improvement, and that has reduced the risk of contagion.

We know that the common factor in all crisis countries in the 1990s was weak, vulnerable domestic financial systems that permitted the contagion to occur. Now those systems are being strengthened, in response to the Basel core principles adopted by the IMF and others in 1997, and to other international reform efforts, the standards developed by the Financial Stability Forum, and the like. That is improvement that reduces contagion and that is positive reform.

Third, and I think probably most important, has been the nearly universal adoption of floating exchange rates. Argentina was one of the last holdouts and it has paid the price. But all of its neighbors, fortunately, have adopted floating exchange rates – managed floats, not pure floats. Indeed, one of the crucial systemic issues now is how best to manage floats. Argentina's neighbors have gotten away from fixed pegs, they have gotten away from currency boards, et cetera, and that enables them to buffer shocks of the type coming from Argentina and reduce the risk of crisis.

So these three important reforms have lessened the impact of Argentina on the rest of the system and have indicated the virtues of the improvements in the international monetary system that have taken place.

Let me conclude by simply adding that a number of other developments are occurring, which I believe also promise improved functioning of the international monetary system. I agree with Professor Meltzer's comment today in his testimony, that we are in the early phase of a transition to a safer, sounder international financial system. But I don't think it is primarily, or even importantly, because of proposals that came from the Meltzer Commission.

I have already mentioned the improvements that are occurring: much greater data dissemination and openness, improvement in national banking and financial systems, and moves to floating exchange rates. All of those are very important.

In addition, there are several other things. The U.S. Government has proposed, as you, Mr. Chairman, and Professor Meltzer pointed out, shifting from loans to grants in the development banks. Here I differ with Professor Levinson. I think that is a good reform and it should be supported. One needs to make sure that it does not reduce the level of aid over time, and Adam Lerrick addressed how to do that. But if that is taken care of, it is clearly a good change because it avoids the risk of a new debt buildup, a new need for debt relief programs and the like.

In addition, the beleaguered IMF itself has now made some fairly far-reaching proposals for new procedures to handle debt work-out cases. This is another implication of Argentina, and also of many other countries in the last few years. We needed a more orderly work-out mechanism. Deputy Managing Director Anne Krueger has made a proposal that will do that in a sweeping way. We are holding a big conference on that at my institute on April 1-2 to try to look at its details. I think it is a very promising idea. I hope our own government gets behind it. They have not yet indicated that they will. I hope that they will. I think that would be a very constructive forward step.

Moreover, we are about to publish a study on debt relief, which makes a couple of proposals. One is to deal with the problem – where I agree with Meltzer and Lerrick – on the need to focus tasks separately on the Fund and the Bank. I oppose the idea of eliminating the Poverty Reduction and Growth Facility but strongly support moving it from the IMF to the World Bank where it belongs. That is another recommendation that we will be presenting in our new study.

In addition we are suggesting a doubling or more of the amount of debt relief to the poorest countries, financed in large part by mobilizing the rest of the sterile gold stock sitting in the vaults of the IMF and serving no purpose. You may recall that the stock was tapped to a modest extent a couple of years ago to help finance the first round of debt relief for the Highly Indebted Poor Countries (HIPC) Initiative. We are suggesting going the rest of the way, using the rest of that sterile gold supply to finance more HIPC debt relief and indeed finance debt relief for some of the other low-income countries that have not been included in the HIPC Initiative so far.

Finally, I think you might note that George Soros and some others have proposed that you in the Congress take up something that has lain fallow here for five years – the proposed fourth amendment to the IMF, which would not only create a new issue of Special Drawing Rights to provide more liquidity to countries that need it, but also to provide more assistance to the poorest countries in the world. Soros proposes a whole new delivery mechanism of such assistance, which is akin to the Meltzer-Lerrick proposal that was in the Meltzer Commission report – a market-based system for both the supply and demand sides of the foreign assistance market. Soros has put out a very interesting proposal on that that I commend to you.

The financing side would require action by the Congress. You may be aware, Mr. Chairman, that 72 percent of the IMF membership has approved the fourth amendment, this new creation of Special Drawing Rights, on a different basis than in the past. It is therefore awaiting U.S. action, because our 15 percent would put the number over the top. Without our 15 percent, it can't happen, because it requires 85 percent of the total membership.

So this is an area where the Congress, I think, could act very positively to support a strengthening, a further reform of the monetary system, but also do it in a way that would help promote the development objectives that I think all of us who are involved with the Meltzer Commission agree with.

So my bottom line is that Argentina has indeed raised a lot of further questions about the functioning of the IMF but I am worried that if we are too tough now, it is going to make it worse. The Argentine case does, however, have the very positive implication that contagion has been sharply reduced, I believe, because of fundamental systemic reform, only tangentially related to the Meltzer Commission proposals.

I think those reforms will continue. Other reforms are in train, and I believe it is true that, as Professor Meltzer said, we are in the early phase of a transition to a safer, sounder international financial system. Thank you.

Representative Saxton. [Presiding.] Thank you very much.

Let me begin with a question to Dr. Meltzer. Dr. Meltzer, throughout your testimony in various ways you have advocated for a higher level of involvement in the planning stages of economic assistance that may be offered to various countries, and you apparently believe that it is quite important that plans be developed not from the outside, but with strong inside participation. Perhaps the strongest indication is in the paragraph where you are talking about President Bush and Secretary O'Neill and others believing that Argentina must come forward with a consistent coherent plan that restores growth without inflation, increases productivity, and settles its default payment. The key to that sentence seems to be that Argentina must come forward. Tell us why you think that is important.

Dr. Meltzer. I think that is crucial, and the reason it is crucial is we have a long history of the IMF presenting countries with long lists or short lists of recommendations and requirements for the loan. We have a very, very short list of the – having those conditions adopted. Let's take the case of Korea, where the IMF presumably did a great deal to stem the crisis of Korea. Korea as a result of that agreed to privatization of many of its industries. Very little of that has happened. Why has it not happened? Once Korea began to improve, once the economy of Korea began to improve, most of the reform just couldn't be passed. The Korean Government would not agree to it, did not feel the necessity to agree to it, because the economy was on the mend.

In Argentina, people keep saying what is it the United States or the IMF want us to do? And the answer that Dr. Lerrick and I gave them when we were there is: This is your country. You have to want the reforms. The reforms will only work if you want them to work. You can promise lots of things to the IMF to get the money, but the important thing is that you adopt reforms that you will be willing to live with, that will improve the operation of your country and will bring more foreign capital at lower cost.

The long record – to be brief about it – the long record is one in which countries agree to make the reforms when they are in crisis. They will agree to almost anything. Once the crisis ends, they find it impossible either to get the reforms passed through their legislature or to implement them fully or even partially once they have passed them.

What we want – what we believe is essential is that they have – they see that these reforms are good for them, that they adopt reforms that are good for them, recognizing fully, as I am sure you recognize, that politically it is often very difficult to do things that would improve the body politic as a whole, because it tramples on the particular province of some very active, very vocal interest group. That is the problem in Argentina.

But reform won't come in Argentina or anywhere else until the people in that country are willing to adopt those reforms. That is the idea. Secretary O'Neill has said it, I think, extremely well by saying, the only way that countries grow is by increasing their productivity. We can't increase their productivity, they can increase their productivity.

Representative Saxton. Thank you.

Let me turn to Dr. Lerrick for a minute. In this morning's *Wall Street Journal* there appears an editorial that is critical of the leadership of the World Bank for suggesting that before reforms take place there should be a significant increase in the assets and the resources available to the World Bank for their activities around the world.

In your testimony, on the other hand, you talked about two concepts: one, moving from loans to grants; and second, I found very interesting that the World Bank apparently at this point has chosen not to accept the idea, but that measurable goals be put in place so that countries who fund the World Bank, can see whether or not progress is actually being made.

In your testimony you talk about easily quantified basic needs that improve the quality of life, and other preconditions to economic growth, health, primary education, water and sanitation, et cetera.

Can you talk about this subject a little bit for us so that we can have the benefit of your thinking?

Dr. Lerrick. Would it be helpful, Mr. Chairman, if I explained how the grant mechanism would actually work with a concrete example?

Representative Saxton. Sure.

Dr. Lerrick. If a country wished to vaccinate its children against measles, which is one of the greatest sources of fatality in Africa, the way it would be structured today is the country would apply to IDA, the concessional arm of the World Bank, for a loan to the Ministry of Health to provide health services to its people. The money would be guaranteed by the government, so the debt would be incurred by the government itself. The World Bank would disburse the funds, and there would be relatively little control over what the actual physical results were, whether children actually were vaccinated.

Under the grant proposal that has been put forward, the World Bank would set the mechanism up in a different manner. It would say to the country that it is an excellent idea to vaccinate your children against measles. Go out and ask for competitive bids from private sector contractors, from the Red Cross, from the Anglican Church, for the cost of vaccinating children in the rural areas for measles. If it was a very poor country, the Bank would pay 90 percent of the cost. So if the best bid from a qualifying contractor came back at five dollars per child vaccinated, the World Bank would say, fine, for every child you vaccinate, we will pay you directly $4.50, and the country will pay you 50 cents. However, we are only going to pay you upon audited, independent, truly independent, verification of delivery of service.

So at the end of the first month, if the contractor came back and said we vaccinated 10,000 children, there is an auditor that is independent of the Bank, independent of the country, independent of the contractor who would go out and verify how many children were vaccinated. If that was confirmed, the World Bank would write a check for $45,000 directly to the contractor. The country would write a check for $5,000. If the next month no children were vaccinated, no funds would be expended. So without results, there can be no funds expended whatsoever.

This same mechanism would be used for wastewater treatment. It would be paid per cubic meter of water treated. It is irrelevant whether the wastewater treatment plant is built. The only thing we care about is how many cubic meters of water are treated. Same with schools and children. We don't care whether the school is built on time and under budget, we care how many children have learned to read.

And that is the difference in the delivery mechanism, and by doing this, you reduce dramatically the possibility of the funds being diverted to unproductive uses, and you eliminate the possibility of an accumulation of unsustainable debt by the poor countries.

Representative Saxton. Okay.

Dr. Lerrick. And you increase the incentives for delivery of results.

Representative Saxton. Let me ask you a related question regarding the World Bank. Mr. Easterly made a number of observations about the failure of the IMF and the World Bank's development aid. According to him, he says, and I quote, "Consider the facts, and it soon becomes evident that the $1 trillion spent in aid since the 1960s, with the efforts of advisers, foreign aid givers, the International Monetary Fund, and the World Bank, have all failed to attain the desired results. With notable exceptions, government mismanagement usually continued in these countries. The growth rate of the income per person of a typical member of this group during the past two decades was zero."

Now, what you are suggesting is a different approach to try to get the growth rate somewhere above zero, I assume.

Dr. Lerrick. I certainly hope so. Yes, Mr. Chairman.

Representative Saxton. Would you – I know the answer to the question, but let me ask you it anyway so you can get it on the record. Is this an acceptable outcome for public policy?

Dr. Lerrick. Absolutely not. I don't think there is any outcome that is acceptable for public policy where vast amounts of taxpayer funds are used and no results are achieved.

One of the problems with past aid, and, in fact, one of the senior members of the World Bank staff, Michael Klein, described the bankruptcy of traditional aid results, is that because it is based on the wrong incentives. The goal is to create incentives to deliver results, not to cover up the problems with a blanket of money that can be used for whatever purposes, without any accountability either by the government or by the World Bank as to how funds were actually used and what results were achieved.

Representative Saxton. I had an experience with regard to failure regarding the IMF in the case of Russia. Some of us went to talk to the Russians about what went wrong with the IMF-Russian transaction, and while we were there members of the Russian Parliament, the Duma, actually spent an afternoon trying to convince us that the moneys were stolen by U.S. banks. Can you give us a better notion of perhaps what really happened in Russia?

Dr. Lerrick. Well, I did not follow the Russian situation closely enough to give you a precise opinion. I would say one of the problems in terms of the assistance that was provided to Russia was that the IMF's view was that its job was very simply to provide funds to the Central Bank of Russia in return for agreements to enact certain policies, or at least to propose those policies to Parliament.

One of the problems in Russia is the conditions did not even insist on enactment of the policies, they only insisted on proposal to the Parliament of the policies.

The IMF felt that once it delivered the funds to the Central Bank, its responsibilities were over. It was up to the Central Bank of Russia to police how the funds were used and where they went. And there are many who believe that this is a mistake in IMF policy. But that was their attitude, and that is how the funds went to wherever they wound up going.

Representative Saxton. Let me return to Mr. Easterly for just a moment. Apparently he has been under some kind of investigation by the World Bank. It almost seems as if perhaps he is being punished by the World Bank for having told what he believed to be the truth about World Bank problems. Do you have any feelings?

Dr. Lerrick. I am not close enough to that situation to comment. In fact, as I understand it, Mr. Easterly now works for Mr. Bergsten at the Institute for International Economics.

Dr. Bergsten. Yes. Dr. Easterly does now work for me, a joint appointment as a senior fellow at my Institute for International Economics and the new Center for Global Development that we have helped create to deal with the range of development issues.

You quote Easterly's conclusions exactly right, but you have to go the next step and ask why. His conclusion, which is based on very detailed, in-depth, and credible research, is that aid has gone to the wrong countries. Aid has been given to countries with lousy policies and, if countries have lousy policies, there is no reason to expect that aid or private capital or anything else is going to work.

We have given aid to the wrong countries because our goal has not been development, it has been to buy allies in the Cold War. It has been to provide political favors. It has been for numerous commercial purposes. But the aid that we are now flogging for not having achieved development was really never given to achieve development, and so in that sense it is an unfair knock.

The implication for the future, of course, is that you should only give aid to countries where you have some confidence that their policies are going to provide a fruitful environment where the aid can work. Lots of studies, including by Easterly, show that in those circumstances aid provides a substantial additional boost to economic growth, per capita income growth, and the like, though further improvements can forever be made.

On the World Bank point, it was a confused situation. Easterly was in the research department, which had published and was selling in its own book store at the World Bank a book by him that made all of these points and made all of these criticisms. So you might say the World Bank was being pretty open because one of their own people wrote a book that makes these same conclusions, which they were selling in their own book store and still do so today.

What Easterly did was write an op-ed in *The Financial Times* which put the point rather starkly, which had not gone through the clearance procedure within the World Bank. Like in most institutions, you are supposed to get clearance. They almost always say go ahead and do it. But he hadn't done that. Other people hadn't done it either so there was some debate about whether the criticism was on the substance or not. Our invitation to him had come before any of this brouhaha blew up, so he may have left anyway and I frankly think that is a less important part of the whole picture.

Representative Saxton. Wouldn't it be more productive for the management of the World Bank to be more concerned about the ineffectiveness of their programs than pursuing a point relative to someone who wrote an op-ed that they may have disagreed with?

Dr. Bergsten. Indeed.

Mr. Levinson. Mr. Chairman, might I take off from where Adam left off in describing how the system would work on grants, because I think it would be—

Representative Saxton. If you promise to do it in 2½ minutes or less.

Mr. Levinson. I will do it in 2½ minutes. Let's take his example whereby you are going to finance measles elimination by putting it out to bid, and that the contractor only gets paid after you show how many kids have been inoculated by an independent auditor, and he says the independent auditor is independent of the government and of the contractor. So who is the independent auditor? Is it going to be Arthur Andersen or Deloitte-Touche or one of the accounting firms? Are they going to go around in northeast Brazil and determine how many kids have been inoculated?

Under this scheme that they propose, the contractor goes out and borrows the money because he is not going to be paid until this independent auditor certifies that the thing has been done, so he is exposed in terms of having borrowed the money, and he is dependent upon the finding by this independent auditor.

What is the role of the government? Supposing you get the kids inoculated. Supposing you get the schools built or whatever project you have. Who assumes the responsibility for the recurring costs, having to be put it in place? The government? The government then turns around and says, wait a minute, we didn't have anything to do with this. This was put out to independent bids. If the cement is watered, we didn't do the inspection, someone – the independent auditors – did the inspection. We are not going to take the responsibility of maintaining potentially defective schools. So who takes the responsibility for the recurring costs of administration, salaries, maintenance in this scheme?

Everybody should be in favor of more grants, but the problem is that there is a basic contradiction because Adam also points out that the World Bank has a high degree of subsidy with these 40-year loans. They are very near grants, but at least it provides a self-renewing source of financing.

This business of loading the countries with debt – let me just conclude with this point that Fred made. You are extrapolating from a situation of the Cold War where we gave Mobutu $5 billion, which he stole. The Congo has nothing to show for it, or Zaire or whatever they are calling it these days. Other countries in Africa, the same thing. It is the Cold War debt that we are talking about writing off.

And to finally conclude within my 2½ minutes, part of the problem was that in the 1980s the World Bank and the development banks went over to what was called policy-based structural adjustment lending. Fancy term. The money went into the central bank, the front door, and the money went out the back door in return for policies with respect to promises. The country has debt and very little to show for it in terms of facilities which are going to add to the productivity of the country. So don't confuse that debt with debt incurred for productive purposes.

And as I say, I don't see how it functions in terms of a country is going to pay up on the basis of audits by people like Arthur Andersen. Who are they going to get to do this? I really doubt it.

Representative Saxton. Thank you.

Dr. Lerrick. Mr. Chairman, if I may just comment very quickly. The key to the grants proposal is that the ongoing maintenance, the operations expenses, all of these costs are assumed by the contractor. He is not being paid to build the school or build a hospital. He is being paid to teach children to read, to vaccinate children. Therefore, in the case of a poor country, the contractor is paid 90 percent by the World Bank, not by the government. The government is only paying 10 percent. As the Under Secretary of Treasury stated in his recent testimony, we are shifting the performance risk to the private sector. In other words, if the contractor comes and doesn't teach children to read, he doesn't get paid either by the Bank or the country.

And so we believe it is perfectly workable. And the country is going to choose the program. The Bank doesn't choose the program. It is the country that chooses the program chooses the contractor.

Representative Saxton. Mr. Crapo.

Senator Crapo. Thank you very much, Mr. Chairman. I have a lot of questions, but very little time, so I will only ask one of my questions, and that is relating to performance audits.

As members of the panel may know, a couple of years ago, well, about a year and a half ago, I introduced with Senator Enzi from Wyoming a concurrent resolution calling for basically an independent performance audit of the World Bank. One of the concerns that I have had, as I have tried to evaluate the issues surrounding the World Bank and the International Monetary Fund, is there seems to be a tremendous amount of difference of opinion based on alleged factual information about the effectiveness of the performance of either of the two institutions.

And that is not unusual in the political world we live in up here. We are debating ANWR over in the Senate today, or in the next little while, the exploration for oil in Alaska, and the data we are getting on what that is or is not going to do to the environment, or will or will not do in the terms of the production of oil is about as far apart as one could conceivably see it getting in terms of the information that we have upon which to make these policy decisions.

So I introduced the resolution to try to get some type of an independent performance evaluation of the World Bank.

Dr. Meltzer, maybe I could start with you and just ask you if you would comment on whether that is even possible. I mean, I know it is possible, but my point is, under what parameters – well, I guess the question is should we do it, and if so, under what parameters should it be done? How do we – do we define performance so it can then be audited, or do we let the auditors look at what is there and tell us what performance is? Or how do we accomplish the objective of getting a truly independent performance evaluation of the World Bank?

Dr. Meltzer. I share your view that an audit – the purpose of your bill, and I commend you for offering that piece of legislation. I think that is an important step forward.

As Dr. Lerrick pointed out in his testimony, we don't have very much information about what the World Bank accomplishes. What we have mostly is the observation that after having spent enormous amounts of money, if we look at the countries, we don't find any major progress either in the development of sanitary sewers or water in the villages or inoculations of children. There are just an enormous number of things where we have not systematic evidence, but we have very good casual evidence that the growth rates are negative and not very much is happening. So we know that nothing – that these programs are not working.

It is true that it will be difficult to audit every one of the programs. There will be some things where time will have to pass. It may take longer, there are lots of reasons, but there are going to be a very large subset where we should be able to get a measure of success or failure. And we certainly can do better than just deciding that the program is successful because when we gave the last amount of loan, the program was onstream.

Let me give you just one example, and then I will stop. We didn't learn this by visiting the country, we learned it at the World Bank. They gave us examples of schools that were built, but there were no books and no roads, so people didn't get to them. Now, when they made the last payment, the building was going up, so they count that as a success. I don't think any reasonable person would say that is what we mean by a success in development. We would count as a success in development that there are now 100 or 200 or 300 children who can now read, compute, add, subtract. That is what we would like to find out.

Those things should not be hard to do. Just as we can do audits on the performance of education here, which the Congress has now approved, we can do audits on the performance of education in Africa or in Latin America or in other places where the World Bank gives money.

One final example. When I visited people in Honduras, including a very imposing man named Cardinal Rodriguez, he told me that they came to Honduras, the World Bank came to Honduras. They were going to develop the wood industry. They spent a couple of million dollars. Most of the money went to consultants. There is no wood industry. That is what we want to get at. We ought to be able to find those things out. Like all things in life, it won't be perfect.

Senator Crapo. It looks like everybody on the panel wants to comment, so why don't we go right down the line.

Dr. Lerrick. Senator, I don't think it is that difficult. There are two bases for evaluation. First, every single loan or project that the World Bank group approves sets out its goals it said it was going to achieve. That certainly is one benchmark that you want to measure against. Were the goals achieved? Were they surpassed? Were they not achieved?

Second, if the goal says we are going to build five schools for $1 million in five different villages, just because they built the buildings on time and under budget, if there are no children in the schools, even though the Bank would qualify that as a success, I don't think any of us would. So it is not that difficult.

Now, to come up with the estimate of the cost of this audit, I asked two private sector firms that do this on a continuous basis, sometimes for the multilateral agencies, sometimes for private industry. The comment of one was quite interesting. His estimate of the cost was much lower than the $5 to $7 million. He said the reason is that, based on our experience, 30 to 40 percent of the projects we are going to find nothing, nothing whatsoever, and that will be a very quick audit. Only on 60 to 70 percent are we going to have to actually look at anything, because on 30 to 40 percent, when we arrive, there will be no building, there will be no road, there will be nothing there, and there will be no record of anything ever being there. I increased his estimate of the cost just in case he does find something.

But I think the way it can be structured is that you have contractors – inspectors – not necessarily accountants, but other firms that specialize in the applicable industry. NGOs could also perform audits that would go out and report back, and then you would publish the results project by project. You don't need to do every project. A representative third of the projects is more than enough. That is only 125 projects for three years of IDA lending. And then the auditors would report to the executive and legislative branches of the G-7 governments, and the GAO and its counterparts would review the methodologies, review how the audits were done, and report to their legislatures.

Senator Crapo. Thank you.

Mr. Levinson. Very briefly. The world they describe bears no resemblance to the world I knew as general counsel of the Inter-American Development Bank. In education, nobody builds schools without providing for teachers, without providing for teaching curricula. The argument usually is over the teaching standards, the content of the curriculum, whether or not there is sufficient teacher training, who is going to finance the recurring costs, et cetera. So this idea that the World Bank or the IDB or any of the development banks just go out and authorize money for things that aren't built is ridiculous. It doesn't happen, or if it does, it is an extraordinarily exceptional case. Even when I was at the IDB throughout the 1980s and the early 1990s, we were long past the idea that you build water without discussing tariff rates, water facilities without discussing tariff rates and agreeing on a tariff policy for the government so it is self-renewing. You don't build schools without determining how recurring costs are going to be financed, who is going to finance teachers.

So this world they are describing is just completely divorced from the reality that I knew as general counsel of the Inter-American Development Bank, which may prove your point that it is Kafka-like in terms of seeing the same reality. I didn't see that reality. I think it is ridiculous, frankly.

Dr. Lerrick. Mr. Crapo, may I interject? The example I gave of the schools was not my example, it was the example of World Bank President Wolfensohn in testimony when he described a project that they would rate satisfactory, and where the long-term benefits would be nonexistent because they built a series of schools where there were no roads, no teachers and no books.

Dr. Meltzer. In fact, Mr. Wolfensohn, in testifying before the Commission, said, you know, I don't know, when I came to the Bank, that is what I asked: Why do we evaluate the project only at the level when we give the money? Why don't we evaluate it after three to five years? I have been trying for years to try to get that changed.

Senator Crapo. Dr. Bergsten.

Dr. Bergsten. I am totally with you in spirit about the audits and the evaluations, but I think you have to make a critical distinction. One would be simply an audit of whether a school has been built or vaccines have been provided, and somebody could go and count buildings and I suppose count vaccinations given at hospitals and see if that has happened. So that should be done if it is not being done.

I thought you were calling for something more profound, and maybe the Chairman was, too, which was an audit of the results of the program in terms of whether it helped generate economic growth or improvement in life expectancy or various standards. If that is what you meant, then it is much, much more difficult for two reasons.

You have to ask what analysts call the counterfactual question: What would have happened in the absence of that particular aid or private investment or whatever program? And then you get into a realm of high uncertainty as to what the results were.

To be specific, there is the question of additionality. Suppose the World Bank waved a wand overnight and did everything that Mr. Lerrick just proposed. Let's assume that happened in Brazil and the Brazilian Government, instead of spending $10 billion that it would otherwise have spent on education, now lets the foreign funding, the 90 percent, go into place. The Brazilians take money that they would have otherwise spent on education and put it into buying more jet fighters for their military. So there is no net increase in the devotion of resources to education in the country.

This is the problem that has perplexed assistance programs from time immemorial, and how you come to grips with that requires you, the foreign lender, to then become more and more intrusive into the overall programs. You try to do some of the things that Mr. Levinson just indicated. You say, well, we are not just going to get water supply, we are going to figure out what your tariff is. And that in turn gets into your overall policy.

But then you can play off between sectors, so now you have to look at the overall budget. But that can be offset by monetary policy. So now you figure how to run the central bank. By that time you are running the country. And we all agreed at the start you can't do that.

I am not saying one shouldn't try this, I am only saying it is very, very difficult, because even if you did the Lerrick-Meltzer reforms overnight and put it in place perfectly – I have a lot of sympathy for some of the objectives of that – it would not get you to a very confident position in terms of the net bottom line outcome that you want, that I want, and the Chairman focused on, when he said economic growth has been zero as a result of development aid.

I am afraid that is not auditable in the sense we think of bringing one of the auditing firms into the act. That is a job of analysis, it is conjectural under the best of circumstances, and as one who made policy and has worked on these problems for more decades than I care to admit, it is a perpetual problem, and I am afraid there is no easy answer.

Dr. Lerrick. Senator Crapo, a quick comment.

Senator Crapo. I am going to have to leave quickly. You can have the last word.

Dr. Lerrick. First of all, Mr. Bergsten is absolutely right to raise the issue of what we call "fungibility." How are you sure that the money you gave for health care was not used for fighter jets?

First, that problem is greatly reduced since what we are focusing on here are the IDA countries, the very poorest countries that have very little access to foreign capital and where it is much easier to ensure additionality.

Aside from that, we are focusing on a much simpler analysis. We are not looking at the question of whether life expectancy has increased. That is certainly the long-term goal of aid. But what we are looking at is a very simple thing. It is an absolutely necessary condition to increase life expectancy that children be vaccinated. That in and of itself won't be sufficient, but what we are just trying to ensure is that on the immediate projects we are examining, we know there are immediate results.

What the long-term impact, which requires more analysis and assumptions as to how the country will grow or not grow or what policies it will follow, that requires a much more detailed analysis. But it is a necessary condition of aid to know that when a program is financed, the immediate results are achieved, and that is easily auditable for these types of.

Senator Crapo. Well, thank you. I am going to have to leave, and I would like to get into this in much more detail. I am sure that we will on other occasions. But I want to thank the Chairman for holding this hearing.

Representative Saxton. Let me turn to a very basic question on a very basic subject. Let's just assume for a minute that some or many of the reforms that you have talked about this morning, in terms of the subsidized interest rates and the necessity of planning, broad planning as you put it, including a major part of the planning effort by the recipient countries, that perhaps measurable programs be put into place and so on and so on.

As Members of Congress, those of us who are here this morning have always been concerned, particularly Mr. English and Senator Crapo, have always been concerned, because we are responsible for appropriating funds and ensuring that they are used effectively. However, if an agency that we fund is not transparent, it hampers our ability to exercise any kind of reasonable oversight. This has been a significant issue with respect to the archaic and confusing organization of the IMF financial statements, for example.

In fact, several years ago in questioning a member – actually it wasn't before this Committee, it was before the banking Committee, but I was invited to be a guest at the Banking Committee for this IMF hearing – one of the members of the IMF executive board it turned out actually was the U.S. Executive Director didn't understand the IMF's financial statements, and I felt bad for that person that day because it had to be fairly embarrassing.

In recent years now the IMF has made some improvements in transparency, providing for a good deal of information about its financial activities with borrowers on its official website. That is good. It has also attempted to clarify aspects of its financial operations. For example, it now publicly releases its operational budget. However, despite the improvement, the IMF reporting of its financial operation is still not transparent in many respects.

We feel we have pried their door open a little bit, but we have a long way to go. For example, standard IMF loans are not classified as loans. Further, the delay for transcripts of Executive Board meetings are not made public for 20 years, and I have a hard time understanding that. The operations of the SDR department are equally murky.

Would you agree that there is room for improvement in IMF financial transparency, and shouldn't the minutes of the executive board meetings be released before a period of two decades goes by?

Dr. Meltzer. Yes to both questions.

Let me just reinforce what you correctly pointed out. The transcripts of the executive board contain information about what they think is happening in the countries. That is valuable information to the markets. There is no reason that I can think of why that information has to be secret for 20 years.

I believe firmly that we need to insist upon two things. One is that they have a right to conduct their business by themselves in whatever way they find convenient to reach conclusions. Organizations need a certain amount of secrecy or lack of transparency in order to reach agreements. It makes it much harder to reach agreements if we have to do everything in the sunshine. But then the agreements should be there. We should know what it is that they have decided to do and hold them accountable for what they have agreed to do and see that it is enforced.

So I put great weight on the idea of allowing organizations, whether it is the U.S. Congress or the administration or the IMF, to be able to conduct their business in any way that they find useful so that they have the opportunity to reach an agreement. We should know what the agreements are, and we should be able to monitor them and see whether they accomplish what they set out to accomplish.

Dr. Lerrick. Mr. Chairman, I certainly agree with both of your statements. I will just raise one example: Stanley Fischer, the former first Deputy Managing Director of the IMF, said that he hoped that he would be able to finish his term at the IMF without ever having to understand how the SDR department works.

Certainly there is a great – I think a tremendous amount that needs to be done to render the Fund's financial operations transparent and even comprehensible to the outside world.

Representative Saxton. Well, you know, I think it was 1998, somewhere about that time, the IMF required additional money. And we appropriated $18 billion.

And I go back home and my constituents and the constituents of, I assume, all 435 of us in the House and all hundred in the Senate go back home and they say, how do they use that money? And when you stop and realize that the United States taxpayers provide somewhere around 25 percent of the usable resource that the IMF has at its disposal, it seems to me that we have a special responsibility to the people who provide those dollars in the form of tax revenues to be able to identify the programs that they are used for, and the effectiveness of these programs, and to be able to tell the taxpayers that their moneys are being well spent or maybe not well spent.

Certainly, as you correctly point out, the IMF has its own responsibility to make decisions in a way that it sees fit, but we need to see the results of those decisions and the deals that are put forward and be able to measure their effectiveness. And without transparency, without being able to see inside the organization to be able to evaluate those programs, we cannot meet our responsibility, and that has always bothered me.

Mr. Levinson.

Mr. Levinson. In one minute. What you say, I think, is unexceptionable up to a point. The argument is that if you make available the transcripts, after I think 20 years, you are absolutely right, is too long. That is foolish. But it inhibits candid discussion within the board.

So a sufficient time – it is not unreasonable, I think, for a sufficient time. Twenty years, I couldn't agree with you more, is far too long to hold the deliberations secret.

But I think in fairness, one has to say that the IMF has made a lot more information available. You get now the letters of intent of countries on the website, not while they are in negotiation, but—

Representative Saxton. If you could permit me to say, I agree. In fact, I said that here a few minutes ago, and I understand that.

Mr. Levinson. So all I am saying is that we shouldn't underestimate how far they have come under pressure from you and under pressure from the Congress. There is no doubt that the pressure from the Congress has been a big factor in terms of moving them to greater disclosure.

The only question I have is the discussions in the board can turn pretty candid and pretty contentious, and you don't want to inhibit that. But 20 years is ridiculous.

Representative Saxton. Actually, some of the things that have been done were a direct result of the reforms that we put in place with the $18 billion in 1998, and we are pleased that we have been partially successful, but, as Congress sets some kind of an example for openness, I hope that other institutions that do this important work will follow suit as well. In fact, given the opportunity, we are going to insist on it once again.

In the meantime, Dr. Meltzer has one final comment that he would like to make.

Dr. Meltzer. I just wanted to give you two brief pieces of evidence on the question of transparency. When the Commission was meeting, we asked for and got permission to read some of the Article 4 consultations, and I put one of the staff assigned to read the ones that were written before the Congress had required some release, and then to read the ones that were written after the Congress had required some release, and I audited what she did. To neither her naked eye nor mine could you see any difference in what people were saying or doing about the countries. That is one.

Second, for most of its history, the Federal Reserve records were private and not made available to anyone. They now are made available. I am reading most of them, and I have read them before and after they were permitted to be released. That is when people didn't believe they were talking for public consumption and after they knew that they were talking with a lag for public consumption. Again, I cannot detect any major difference in what they say or how they behaved in the two circumstances.

So I don't believe that people will be terribly hampered by the fact that they are doing this. Information of all kinds leaks out anyway, and we learn about these things formally or informally.

Representative Saxton. I would like to thank each of you for being here today to share your point of view with us. We appreciate it very much. I think this is an extremely important set of subjects that we talk about in this Committee at great length from time to time. However, it is important to have these public discussions so that members of the public and taxpayers and others can benefit from each of your backgrounds and knowledge about these issues.

Thank you very much for being here with us. We look forward to working with you in the future.

[Whereupon, at 11:50 a.m., the hearing was adjourned.]

SUBMISSIONS FOR THE RECORD

PREPARED STATEMENT OF REPRESENTATIVE JIM SAXTON, CHAIRMAN

I am pleased to welcome the panel of witnesses before us today. The members of the panel were all associated with the Meltzer Commission, and I would like to thank you for your service, and assure you that the commission's influence on international economic policy has been positive and profound.

In recent years a number of issues have been identified related to proposals for reform of the International Monetary Fund (IMF). The evidence shows that the IMF was not financially transparent, it provided below-market subsidized interest rates, and promoted moral hazard.

In addition, IMF mission creep was reflected in its drift into lending for development and structural reform, often involving longer loan maturities or rollovers of existing loans. Moreover, there was a lack of IMF accounting controls and lending safeguards that could result in misuse of taxpayer money. A number of other findings involved the IMF's heavy reliance on the G10 for resources, and the lack of meaningful financial support for the IMF by most of its members.

In the last few years, the IMF has made some limited progress in the area of financial transparency. However, a former IMF research director has also recently noted "the need to improve the financial structure of the Fund in terms of transparency, efficiency and equity." The basic problem here is that the IMF is saddled with an archaic accounting framework rooted in an economic and institutional environment that no longer exists. For example, the official IMF financial statements still present IMF loans as "currency purchases," instead of loans. Furthermore, the workings of the SDR department remain as murky as ever. In addition, the minutes of Executive Board meetings are still classified for 20 years.

I would also like to note the President's Council of Economic Advisers' (CEA) statements endorsing reform of the International Monetary Fund (IMF). According to the recent CEA report, IMF liquidity loan "programs would appropriately involve short-term lending at penalty interest rates, to encourage and facilitate the borrower's quick return to private capital markets." This is very consistent with the findings of the Meltzer Commission as well as the Congressional mandates for IMF reform that are currently in law.

The Administration's support for substantial grant financing of some World Bank activities is also very significant. This reform would offer the best approach to improving living standards and reducing poverty in the world's poorest nations. The traditional World Bank/IMF approach of saddling poor countries with loans they often cannot repay has failed. Moreover, the high failure rate of World Bank projects reflects a waste of resources that could have been better used to alleviate poverty.

Unfortunately, the defenders of the World Bank status quo are resisting the Administration's grants proposal. Ever since the idea of grants was first proposed, the World Bank's own evaluations of its performance have shown sudden improvement. However, we all realize that without truly independent review, performance can be misrepresented. An independent review of World Bank performance is urgently needed.

The Bush Administration has shown that it is serious about needed reforms of the IMF and World Bank. The work of the Meltzer Commission has been essential to this improvement in international economic policy. The recommendations of the Commission have led to U.S. government proposals to limit moral hazard, curb international financial instability, and reduce the waste of resources to the benefit of many millions of people around the world.

PREPARED STATEMENT OF SENATOR JACK REED, VICE CHAIRMAN

Thank you, Chairman Saxton, for calling this hearing on reform of the IMF and World Bank. I'd also like to thank our witnesses for taking the time to testify before us today. All four of you worked on the Congressional Commission on International Financial Institutions, making you uniquely well qualified to discuss this topic. Revisiting the issue for today's hearing with you is especially valuable given the international events that have occurred since your reports were published in 2000.

The IMF and World Bank were created as a response to World War II and the recognition that supporting global economic stability and prosperity would be an effective means of ensuring global peace. Today the economies of the world are even more interconnected. In the wake of September 11th and our ongoing war on terrorism, we are reminded that these institutions continue to serve a crucial role in our national, as well as economic, security.

Unfortunately, the recent economic crisis in Argentina suggests that the effectiveness of these organizations is sometimes insufficient. Economists and policymakers continue to debate over whether that is due to fundamental problems in the missions of these organizations, misguided policies, or simply mismanagement of well-intended policies.

Today's hearing should shed some light on what the Argentine experience teaches us about how well the IMF and World Bank are serving their missions, and what can be done to make these institutions stronger players in our efforts to support global economic and national security.

The International Monetary Fund Two Years After the IFIAC (Meltzer) Commission

by Allan H. Meltzer
the Allan H. Meltzer University Professor of Political Economy, Carnegie Mellon University and Visiting Scholar, American Enterprise Institute

Testimony prepared for the Joint Economic Committee hearing on:

Reform of the International Monetary Fund and the World Bank

Wednesday, March 6, 2002

The International Monetary Fund Two Years After the IFIAC (Meltzer) Commission

by Allan H. Meltzer

Mr. Chairman you, your colleagues and staff have played a major role in reforming and improving the operations of the International Monetary Fund (IMF) and the development banks. By insisting on greater transparency, increased accountability and improved performance, you have rendered a great service to the American public and the people in the developing countries. Your efforts have not only saved taxpayers money, they have raised standards of accountability for performance. I am pleased to have been part of that effort, an effort that is continuing and has the support of the Bush administration, Treasury Secretary O'Neill and his principal staff.

Today, we recognize the second anniversary of the commission report. My colleague Adam Lerrick and I have divided the review of the past two years and prospects for the future into two parts. I will discuss the IMF, and he will discuss the development banks, particularly the World Bank.

What Was and Was Not Done

The Commission proposed four kinds of changes at the IMF. First, it proposed improved transparency and information to permit outside observers to better understand what the IMF had done, what it recommended and what resources it had available. Before this Committee took an interest, even a trained accountant would have difficulty interpreting the IMF's financial statements. The Commission developed a balance sheet that the IMF adopted. Its accounting statements became less opaque. Reports of IMF surveillance of a majority of member countries, so called Article IV consultations, are now routinely posted on the IMF's website along with a lesser, but still substantial, number of staff reports. Improved quality and increased quantity of information helps markets to operate more efficiently and reduces risk. However, the IMF has not restructured accounting in the SDR department, and many countries have not improved the quality of their data. The IMF should do much more to get countries to improve data quality and to release it.

Second, the Commission found considerable overlap between the programs of the Fund and the development banks. It criticized the overlap and the large number of conditions that the IMF negotiated with borrowers, particularly borrowers in crisis. The IMF reduced the number of programs and the number of conditions attached to loans. It now limits conditions to matters directly related to the country's problem.

The Meltzer Commission proposed that troubled crisis countries should not look to the IMF to provide a reform program. Reform has a much better chance if the country adopts and implements its own choices of policy reforms. Management of the economy should remain in local hands. The IMF should confine its role to seeing that the promises are kept and that its loans are used effectively, not squandered on wasteful expenditures, paid to creditors, or used to support the exchange rate.

The IMF has now moved in this direction. A senior IMF official recently said:

> "The main aim is to have a minimum amount of conditionality that enables countries to meet these goals. ...
>
> How can these goals be achieved? ... The IMF needs to be more flexible, not dictating to a country what policies are needed. The country should be allowed to present a program to the IMF. There has to be broad participation in the discussion of policies in the country. And the IMF needs to be selective, patiently waiting for the country to be ready. Already, there are promising signs. The streamlining process is under way, and collaboration with the Bank has been strengthened."[1]

The IMF did not eliminate all duplication. The poverty reduction and growth fund, PRGF, continues. IMF management is sensitive to criticisms about the effect of disinflations on the poorest citizens of countries in adjustment. It does not want to give up poverty relief so that it can temper its macro policies with policies to help the poor during the transition or recession. I believe it does not have enough confidence in the development banks to relinquish PRGF programs to them, where they belong. Increased effectiveness of the development banks would help to make the case for closing the IMF's PRGF program and restricting the IMF to its principal functions: providing information, creating incentives that reduce the number, frequency, depth and virulence of financial crises, assisting governments to resolve crises, and preventing the spread of crises that occur.

[1] "IMF Conditionality: How Much is Enough? IMF Survey, 31 (January 14, 2002), p. 14.

Third, the Commission urged the IMF to phase in over five years an incentive system that induced countries to adopt prudent policies that reduced the risk of financial crises. We proposed a small list of observable, prudent policies (pre-conditions) that, if adopted and maintained, would obligate the IMF to assist the country when it faced a financial crisis.

The great advantage for the country of adopting pre-conditions is that, the IMF's commitment to assist in a crisis, and its monitoring, increase lenders' confidence that the country maintains prudent policies. Pre-conditions in place would act like a good conduct badge. The country would get more capital from the market at lower cost. This would foster development and reduce debt burdens.

IMF senior officials accept this idea. They have proposed a contingent credit line (CCL) to implement the proposal. Unfortunately, no country has agreed to join. I believe there are two principal reasons. First, the IMF bureaucracy will not offer automatic assistance to countries that join. Second, until very recently, all countries received assistance, so there was not much reason for lenders to favor countries with more prudent policies over countries that were riskier. The market does not lend to the poorest countries, with little prospect of repaying loans. But, as Argentina, Ecuador, Russia, and Indonesia have shown, the market has provided large loans to risky borrowers. Now that the IMF has not bailed out creditors of Argentina and others, I expect more discrimination by private lenders and more caution. Lenders who made "moral hazard" loans, expecting to be rescued by the IMF and the G-7, will improve their monitoring and demand better policies by borrowing governments.

If this proves to be correct, borrowers' incentives for prudent policies will be strengthened. More countries may willingly adopt more prudent policies and join an improved CCL. A critical condition is that incentives work both ways. Countries with imprudent policies should not get IMF assistance in a crisis once a five-year phase-in is completed.

Fourth, the Commission urged the IMF to improve crisis management by making different responses to prudent and imprudent lenders. The majority proposed that the IMF restrict its aid to two kinds of countries: those with prudent policies and those countries threatened by the policies and practices of imprudent neighbors and trading partners.

As Argentina moved toward crisis, the IMF approved a stand-by loan to Brazil, a country currently with responsible monetary and fiscal policies, that seemed to be injured by Argentina's decline. After mistakes in December 2000 and August 2001, the IMF stopped lending to

Argentina. Instead of offering Argentina a large loan with many conditions based on empty promises, the new IMF insisted on a coherent, consistent plan developed, adopted and implemented by the Argentine government. It has refused to finance Argentina's budget deficit or the bailout of international and domestic creditors. It has not provided additional billions to support an overvalued exchange rate or to finance capital flight.

If the IMF withstands the pressure to throw in more money, moral hazard will be reduced. Lenders will expect to bear losses, if they make risky loans. Countries that want to borrow to grow will have much greater incentive to adopt prudent policies, to rely more on foreign direct investment and less on short-term borrowing. They will invite foreign banks into their country and strengthen domestic financial institutions. The risk of crises will decline.

What Remains to be Done?

In the last decade, the global economy experienced severe crises in 1994-95, 1997-98, and 2001. This alone tells us that the system was not working well. Tens of billions in emergency loans attempted to stem the crises. In many of the crisis countries, the banking and financial systems collapsed, the exchange rate went into free fall, unemployment rose as output fell.

Argentina, the latest crisis country, has one of the most severe crises. Unemployment rates will reach 30% of the labor force or more. That is worse than the worst year of the Great Depression in the United States. Mistaken policies have paralyzed economic transactions and bankrupted financial institutions.

The main problem with bailouts is that they cover over today's problem but encourage a larger problem somewhere else. Twenty years of bailouts and conditional lending have failed. The crises have become larger. The promises to meet conditions are kept infrequently.

This should not come as a surprise. The system of conditional bailouts and conditional lending relied on command and control. Countries had good reason to promise reforms, but few incentives to carry them through once recovery was underway. Lenders came to expect that the IMF and the other international financial institutions would not just bail them out. They would reward them with higher interest rates and fees for renegotiating and extending the maturity of their debt.

We have started to replace command and control with incentives for lenders and borrowers. If we continue on this path, with patience and conviction in the face of pressures, we will achieve a better system. Lenders must have incentives to use the improved information that the IMF now provides to study the risks they have taken or are about to take. Borrowers must have heightened incentives to adopt and maintain prudent policies. Rapid support for countries that meet pre-conditions provides the incentives.

Some critics of the new policies assert that markets have failed, that openness, privatization and market incentives have been tried and have failed. This is a peculiar claim. It ignores such successes as Chile, China, Korea, Mexico, Poland, Taiwan and many others. It fails to mention that Argentina's problems are not novel. Their economy is barely open to trade. Their markets continue to suffer from the rigidities adopted by Juan Peron's governments. There can be little budget discipline until there is a financial responsibility law that restricts provincial spending. Argentina's exchange rate was overvalued, its budget in deficit. The current government has no plan as yet to restore economic activity without inflation.

Argentina journalists ask me repeatedly, what does Argentina have to do to get IMF assistance. President Bush, Secretary O'Neill, Mr. Koehler, Managing Director of the IMF, and many others have answered that question repeatedly. Argentina must come forward with a consistent, coherent plan that restores growth without inflation, increases productivity, and settles its defaulted debt.

Policy toward Argentina is an abrupt change from past policies. Having embarked on a new and better course, the IMF and the G-7 must not go back to the old ways.

We are in the early phase of a transition to a safer, sounder international financial system based on proposals for reform that this Committee and our Commission brought to public attention. Lenders now have reason to recognize the risks in lending to developing countries and therefore to be more prudent. Borrowers now have reason to recognize that excessive borrowing or imprudent behavior is costly to their country and, because they may be dismissed from office suddenly, to them personally. Recognition of the true risks and costs on both sides will do much more than so-called Basle standards to reduce moral hazard, promote more orderly development lending, save the taxpayers money, and reduce the frequency of crises and tragedies in developing countries.

With your support and the continued support of the new administrations at the IMF and the U.S. Treasury, we will achieve that safer, sounder system.

World Bank Reform

Statement Presented to the Joint Economic Committee

of the Congress of the United States

by

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and

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Carnegie Mellon University

March 6, 2002

It is a privilege to address the Joint Economic Committee. First, Mr. Chairman, I would like to thank you and Majority Leader Armey for the strong support you provided when violent attack came from almost all sides.

Two years ago, Minority Leader Gephardt greeted the publication of the Meltzer Commission report with the following appraisal: "...an extreme neo-isolationist attitude...(that) will undermine development efforts in the world's poorest countries ...(and) the stability of the world financial system." Then-Secretary of the Treasury Summers made a rare personal appearance on the pages of the Financial Times to claim that one of its key proposals, a shift from loans to grants, would "require an unworkable system for delivering assistance". World Bank President Wolfensohn deemed grants "unrealistic". One year ago, my fellow witness Mr. Bergsten stated that the Joint Economic Committee hearing on the first anniversary of the report's publication was appropriate as a burial service because none of the Commission's recommendations had been or would be adopted.

What a difference a year makes. Once branded "ivory tower" by some and "radical" by many, the report was recently termed the "blueprint" for international reform efforts by The Economist magazine. Today, we have a new Administration that supports international reform and a new International Monetary Fund with a disciplined approach to assistance. Many of the major recommendations of the Commission are on the way to becoming global public policy.

My remarks will focus on developments at the World Bank, particularly those current issues that would benefit from the intervention of the Congress. A critical look at the Bank is doubly important as the Bank assumes the leadership role in the United Nations campaign to double development aid flows to more than $100 billion each year.

When leaders from both the industrialized and developing world meet in Monterrey, Mexico on March 18 at the United Nations Conference on Financing for Development, two topics that originated in the Meltzer report will be high on the agenda. First, a change from loans to grants for the delivery of aid to the poorest countries. Second, a move to rigorous measures to increase the effectiveness of development assistance. President Bush launched these proposals at the Group of Seven meeting in Genoa last summer and the Secretary of the Treasury continues to speak out forcefully in support of the Administration's commitment to these policies.

Grants were proposed by the Commission to address the shortcomings endemic to the tradition of open-handed lending by the multilateral institutions. The poorest countries had accumulated debt they were clearly unable to repay. Funds had been diverted to unproductive ends. Donor contributions ended in write-offs instead of real improvements in the standard of living of the impoverished.

This grant format is new because it is performance-based. Counter to the trend of lending blanket sums for indeterminate government plans, grants will be project-linked and executed under competitive bid by private sector contractors and non-governmental organizations. For the easily quantified basic needs that improve the quality of life and are the preconditions for economic growth---health, primary education, water and sanitation--the grant system would count by independent audit and pay for output: numbers of babies vaccinated, children that can read and water and sewer services delivered to villages. No results: no funds expended. No funds diverted to off-shore bank accounts, vanity projects or private jets.

Opposition to the use of grants has been orchestrated by the World Bank around the faulty argument that grants will deplete its resources, together with its ability to help the poor, unless they are partnered with an immense infusion of new funding--$800 million more each year from the U.S. alone. It is worth taking the time to explode this false argument.

It would seem logical that if money is given away, instead of being lent, the stockpile of funds will eventually vanish. Not so. Grants will not cost more than loans. They deliver the same amount of aid without diminishing the funding pool and without asking for more taxpayer monies from the industrialized world.

The funding requirement is the same when the level of aid is the same. The arithmetic is straightforward.

The International Development Association (IDA), the arm of the Bank dedicated to 72 of the globe's neediest nations, extends 40-year loans at virtually zero interest. The interest free use of the money translates into a gift component equal to $73 out of every $100 loan. Although, ultimately $100 will be repaid, the real cost to the recipient is $27.

This is identical to an outright grant that pays $73 out of $100 of program outlays with the remaining $27 paid by the recipient. In both cases, the cost to the country is $27. Again, if the level of assistance is the same, grants cannot cost more than loans.

The grant format can produce the same reflows into the IDA pool of financial resources as traditional loans at the same level of aid. For each $100 of donor funds, $73 would be disbursed as grants and $27 invested in the capital markets. The proceeds of the investment will match the $100 of loan reflows over the life of a traditional 40-year IDA loan.

The effectiveness of World Bank performance has been another highly contested but not unrelated debate. Although the Bank claims 75-80% success rates, when the Meltzer Commission reviewed the Bank's own data, it found that more than half of World Bank programs overall and more than two thirds of projects in the poorest countries failed to achieve both satisfactory and sustainable results. Debate over the numbers is irrelevant because the Bank's auditors are captive, because the judgments are made too early--at the time of final loan disbursement but long before an operating history is established--and because sustainability, the sine qua non of development, is given little consideration in the evaluation.

After the publication of the Meltzer Commission report in 1999, World Bank sustainability ratings that had stagnated at 50% for years jumped to 72% in 2000. Was there such swift improvement or was the bar simply lowered?

Thinking has continued long after the official life of the Meltzer Commission. After 50 years and $500 billion of aid, we have no evaluation of World Bank performance except the one it chooses to promote. If the wrong people are applying the wrong criteria at the wrong time, how credible are the conclusions?

Why not establish a bona fide external audit by private sector firms, on site, to determine the lasting contribution of IDA projects after a credible operating history and to provide a continuing benchmark for Bank efforts in the poorest countries.

The World Bank is now seeking $13 billion in IDA replenishment funding. The U.S. share alone is $2.5-2.8 billion. $5-7 million dollars, or just ¼% of this commitment, would cover the cost of an audit. The condition of an external performance review of IDA programs, together with provision for its financing, should be written into the upcoming appropriation and into all funding going forward.[1]

[1] Senator Crapo of Idaho and Senator Enzi of Wyoming focused on the issue of an external performance audit of World Bank programs in the 106^{th} Congress. See S. Con. Res. 136 in the 2^{nd} session.

REFORM OF THE INTERNATIONAL FINANCIAL INSTITUTIONS

PROFESSOR JEROME L LEVINSON

Before

The JOINT ECONOMIC COMMITTEE

March 6, 2002

In the year that has passed since this Committee met to discuss this subject matter, we have descended from the realm of theory to the flesh and blood world of political economy in which theory has real consequences. The event that illustrates this truism is Argentina.

Because the crisis was so long in developing, the financial markets have had time to absorb the Argentine financial default without significant consequences for other borrowing countries. In other words, financial contagion has been contained. We can then consider how to think about the lessons of Argentina in other than crisis conditions for the international financial system.

And yet Argentina remains in my opinion a watershed event. It conclusively demonstrates (i) the hollowness of the Meltzer Majority report of the Congressional Commission on International Financial Institutions (the Commission) recommendations for reform of the IMF; (ii) the limitations of the IMF/World bank neo-classical economic paradigm, what Joe Stiglitz, the former Chief Economist of the World Bank, and a recent Nobel prize-winner in economics, has referred to as market-fundamentalism, slightly modified in recent years as the Washington Consensus Lite, that has governed development thinking for the past fifteen years; (iii) and the excessively economic mind-set of both the Secretary and Under-Secretary of the Treasury, Messrs Paul O'Neill and John Taylor.

The Treasury proposal for additional grant funding for the IDA, the World Bank soft loan affiliate for dealing with the poorest of poor countries, while superficially appealing, as presently formulated by the Treasury, is ill conceived, impractical and probably harmful to any sustainable financing for development in the poorest countries. I would be glad to respond in more detail to questions on this subject, but in this testimony I will concentrate on the Argentine case as illustrative of the above three theses.

THE MELTZER MAJORITY RECOMMENDATIONS FOR THE IMF

The heart of the original Meltzer Majority proposal is to divest the IMF of discretionary authority with respect to conditions that attach to member country access to IMF financing. Such financing, after a suitable transition period, is made conditional on pre-qualification of countries:

only countries with financial banking systems that have previously determined to be "sound" are eligible to draw upon IMF funding; key to assessing the soundness of the system is the openness to foreign investment, which, according to the Majority, is a guarantee against unsound crony capitalism in which financial decisions as to the allocation of credit are made on the basis of criteria other than arms length credit analysis. According to the Meltzer Majority, it was that crony capitalism which was the principal cause of the East Asian financial crisis of 1997-8.

Fred Bergsten, who came late to the Commission's deliberations, immediately identified the flaw in the proposal: a country with a sound banking system but unsound macro-economic policies would automatically be eligible for IMF funding but without any conditions that addressed the underlying policies that necessitated recourse to the IMF. In recognition of the validity of the Bergsten critique, the final report of the Majority contained a few sentences referring to the need for a sound macro-economic framework as an additional pre-condition for IMF financing.

Argentina takes the issue out of the realm of theory and into the real world of policy-making in imperfect circumstances. Argentina not only opened its banking system to foreign capital; it permitted the complete sale of the previously Argentine owned banks to primarily American and Spanish financial institutions. There are no banks of any stature any longer majority owned by Argentine nationals.

Nor are there any local cronies of any consequence to whom the banks can lend. Argentina has sold the previously state owned water, telecommunications and utilities to foreign capital, primarily state owned Spanish and French companies, a process less privatization than de-Argentization; the previously state owned petroleum company, YPFB, has been auctioned off to a combination of domestic private and foreign capital; similarly, Argentina has divested to private capital the previously state owned railroad system. The signature industry of Argentina--the meat- packing companies--have been sold to the major international groups in the industry: today there is no Argentine national owned meat-packing company of any size or importance. In light of this record, the statement by Secretary O'Neil that Argentina has not carried out significant economic reforms is simply incredible.

Argentina, which for most of the decade of the 1990's, had been acclaimed as a star of the international financial system, the country in Latin America, even more than Chile, which had most enthusiastically embraced the neo-classical economic paradigm promoted by the IMF/World bank and U.S. Treasury--privatization, openness to foreign direct investment, reduction of the role of the state in the economy--finds itself in intense negotiations with the IMF in the midst of a profound economic depression.

A country cannot be frozen in time. Conditions change. Policy may not adapt. A crisis ensues, requiring the country to recur to the IMF for assistance, precisely the circumstances envisioned for IMF intervention. The need for judgement as to the appropriate policies to address the situation cannot be evaded. Argentina puts paid to the Meltzer Majority theory that recourse to the IMF can be automatic in accord with pre-established criteria, IMF judgements and conditions no longer relevant. The issue remains: what are the criteria for IMF assistance?

THE IMF AND ARGENTINA: POLITICAL ECONOMY VERSUS ECONOMIC TECHNOCRACY

Because the Meltzer Majority went off on the tangent of pre-qualification as a condition for automatic access to IMF resources, the Commission lost a great opportunity to illuminate and provide guidance for the Congress on this central issue of IMF operations: conditionality. For, if there was one issue on which all members of the Commission concurred, it was that IMF conditionality had become too intrusive and had expanded into areas in which the IMF staff had little or no comparative advantage.

That view was not limited to the Commission. A Council on Foreign Relations Task Force on which Commissioner Bergsten served came to the same conclusion. And the new Managing Director of the IMF, Mr Horst Kohler, gave every indication that he recognized the validity of this concern and wanted to return the IMF to a more traditional strategy of dealing with macroeconomic policies which is its area of expertise.

At the same time, there were profound differences within the Commission over the degree, if any, to which additional issues such as core worker rights, and, more generally, human rights, as well as income inequality, should be an integral part of the policy framework which is the necessary pre-condition for financial assistance from the Bretton Woods Institutions. The degree to which this is feasible or desirable is, in my view, the central issue in any discussion of the future of these institutions, and U.S. policy with respect to them. Despite extensive, and I would say illuminating in depth testimony on such issues as core worker rights and the importance or lack thereof of income inequality, you will find no discussion at all in the Majority report of these issues.

Again, Argentina brings the discussion down from the level of the merely theoretical to the often excruciatingly difficult decisions involved in policy-making in the real world of political economy. The history of the currency board arrangement in Argentina in which the peso was linked to the dollar in a one to one relationship has been too much commented upon to require any extensive recapitulation here. Suffice it to note (i) the arrangement was not imposed upon Argentina but decided upon by the government of Carlos Saul Menem and his Minister of Economy, Domingo Cavallo in the early 1990's for the purpose of bringing a raging hyperinflation to a halt; (ii) it largely achieved the objective and therefore initially had broad support in Argentine society; (iii) it also divested policymakers of any discretionary decision making authority with respect to the level of economic activity in the country which was determined by the amount of dollars available to the government from export earnings and international borrowing to back each peso in circulation; (iv) the currency board arrangement therefore was market-fundamentalism carried to its logical conclusion: the level of economic activity was vested in the financial markets, creating a powerful incentive for international borrowing; (vi) with the peso linked to the dollar in such a direct way, a strong dollar constituted a disincentive for Argentine exports which became uncompetitive, especially after the Brazilian devaluation of the real, the major trading partner for Argentina; (vii) the result was that the debt to export ratio became increasingly unsustainable and the international financial markets closed to Argentina.

Whatever the original purpose served of the convertibility plan, as it is known in Argentina, and in Argentina it did initially have a purpose, once in, there is no good way out. Not the Argentines, nor the IMF, nor anyone else for that matter, had an exit strategy. Indeed, the discussions in late 2001 between Minister Cavallo, who had been recalled as Economy Minister by President Fernando De la Rua , the successor government to Menem, and the IMF assumed a surrealistic character: the IMF staff realized that the convertibility plan was no longer feasible, but Cavallo, the author of the plan, denied that there was any problem with the arrangement, only market ignorance which could be overcome by IMF financing, which was not forthcoming.

Determined to maintain the convertibility plan at any cost, the De la Rua government proposed still further austerity measures in face of a four year recession/depression and 22 percent unemployment. Argentine society rose up in revolt and drove the De la Rua Government from office. Most comment in the U.S. has focused on the convertibility plan as the main culprit in the Argentine drama. The Washington Post, for example, held that the Argentine government stuck with the convertibility plan too long but that there was nothing inherently wrong with the market liberalization strategy.

I disagree. The market liberalization strategy which Argentine followed since the early 1990's, strongly supported by the IMF/World Bank and U.S. Treasury was fatally flawed in two other respects: the basic theory of the IMF/World bank neo-classical economic strategy is that as the public sector is diminished in economic importance, a dynamic, export oriented industrial sector provides the motor for growth and employment but this did not happen in Argentina . Without a strong productive public sector to complement it, the private sector could not perform the role envisioned for it. Even in the years of relatively high economic growth in the mid-90s, unemployment never fell below 13-14 percent. Rather, throughout the decade of the 90's, the public sector was denigrated by both the Argentine governing authorities and the Bretton Woods institutions.

Since, under the convertibility plan, relative international prices could not be adjusted through the exchange rate, pressure mounted on the part of the IMF/World Bank for a more direct attack upon the cost structure of Argentine industry, particularly labor costs. The Menem government embraced the strategy. Strongly supported, indeed egged on by the Bretton Woods institutions, the Menem government tried to shift the balance of power between labor and capital in collective bargaining arrangements decisively in favor of capital.

The social gains for Argentine workers of the past fifty years were at risk. The basic compact in Argentine society through which the formerly despised working class, the descamisados, the shirtless ones, were integrated into Argentine society, in the age of globalization, was now declared too expensive. The unions reacted with fury, leading to general strikes of varying degrees of effectiveness and an increasingly embittered and disaffected working class.

Not strong enough by themselves to bring down the government, in December 2002 they were joined by an important part of an increasingly impoverished middle class, seeing no way out except more austerity, unemployment and loss of status. In both that middle and working class the economic model of the past decade was perceived to have disproportionately benefitted a small elite linked to international capital and business, widening income inequalities in a country which had not previously been notable for the exaggerated income disparities that permeate other societies in Latin America.

It is not too much to say then, that what is at stake in Argentina today are not merely economic policy choices, important as they are, but confidence that such choices can be made within the framework of representative political institutions. That is the situation which the government of Eduardo Duhalde faced when it came to power after the December 2001 political upheaval that dislodged from power both the De la Rua government and its immediate successor.

The best way, in my opinion, to understand the Duhalde government is to see it as the contemporary counterpart of FDR in 1933. FDR campaigned in 1932 on a platform of a balanced budget, but changed direction when convinced that such a policy followed by his predecessor, Herbert Hoover, would only deepen the depression and unemployment; he embraced the Keynesian prescription of using government spending to prime the pump and restart economic growth. This policy reversal was only one of a series of often bewildering stops and starts in economic policy-making as the Roosevelt Administration by trial and error experiments, determined what would work and what would not, what the political system could bear and what were the limits of social tolerance.

It had the great advantage, however, of not having an IMF and O'Neil Treasury looking over its shoulder. If asked to produce a coherent policy from its inception, it would have dismally failed; all of the creative energy which gave us the New Deal would have been strangled at birth. Indeed, it would have been told that social security was unacceptable and only private investment accounts could gain IMF/World Bank approval. The Wagner Act would probably have been rejected as an undesirable intervention in the labor market where the preferred objective of labor market policy should be not to diminish the disparity of bargaining power between individual workers and firms, but to maximize that disparity in favor of capital.

Duhalde faced with a similar crisis of confidence in the governance system itself has responded, like Roosevelt, with a trial and error approach. Confronted with the immediate issue of how to exit from the convertibility plan, the Dhualde government initially proposed a dual exchange rate plan, but then withdrew from it when faced with international and domestic criticism of its feasibility.

The Duhalde government has tried to allocate the burden of adjustment in Argentine society more equitably, placing the highest costs upon the foreign owned banks and utilities, who bought them on highly favorable terms: captive, monopoly market; repatriation of profits without limits; fixing tariffs in dollars, with an index linked to the U.S. inflation rate and virtually non-existent state regulation or controls. Consequently, the majority of concession holders in recent years obtained high profits, in comparison with other Argentine companies and similar industries in other parts of the world. Duhalde is obviously gambling that the French and Spanish investors have too much at stake not only in Argentina, but also more generally in Latin America to walk away from their Argentine investments.

In political terms, although not popularly elected but selected by the Congress in accordance with the law and constitution, he has crafted a broad based government; supported by former President Raul Alfonsin, who was the first elected post-military President, and represents the more nationalist small and medium industry and public sector employees, he has recruited an important part of the Radical Civic Union Party to complement his own Justicialista (Peronista) party; additionally, he has incorporated members of the Frepaso center-left coalition that tried to offer an alternative to the two great traditional powers, the Radicals and Peronistas.

Duhalde, if not enthusiastically supported by the majority of the unions affiliated with the CGT, the Argentine confederation of Labor, can count on their tolerance because they know that the alternative of deeper market reforms will devastate them still further than has already occurred; similarly, the small and medium entrepreneurs know, like the unions, that the Duhalde/Alfonsin combination is their only salvation.

And Duhalde has departed from the top down Argentine style of governing: in a weekly radio address, in which he also answers call-in questions, he has not minimized the hard choices for Argentina. Not quite the fire-side chats of FDR, in Argentine terms they are a major innovation in participatory democracy.

The respected senior Justicialista politician, Antonio Cafiero, observed that the Duhalde administration was not only burying the convertibility plan, but the economic model of the past decade. That statement set off alarm bells in Washington and the Duhalde team has backed off from Cafiero's defiant observation, but it represents an accurate expression of the anger at and desire for an alternative to the neo-classical economic model attempted to be implemented in the past decade

The Duhalde government has finally forged an agreement with the provinces on revenue sharing and provincial expenditures, but has not yet obtained Congressional approval of a budget. We can expect hard bargaining in the Congress and probably considerable back and forth in economic policy making direction. What Duhalde is trying to do is create an economic policy which responds to the demand of a broad swath of Argentine society for a policy that more explicitly takes into account the income distribution effect of policy, minimizes rather than exaggerates income disparities, and preserves as much as possible of the social gains of working class Argentina so as to avoid creating a permanently disaffected urban working class.

Understood in these terms what he seeks to accomplish is not dissimilar to the task that confronted FDR: to assure Argentine society that within the framework of representative political democracy and a market economy there is room for a policy alternative that explicitly seeks a more just society and not just economic efficiency at the sacrifice of equity.

What then has been the response of the IMF and the U.S. Treasury? They demand of the Duhalde government that it adopt Herbert Hoover economics: in the midst of a devastating economic depression with unemployment approaching 25 percent, they seek budget cuts, labor market flexibility reforms to weaken still further urban trade union bargaining power, and a "coherent" economic plan, which apparently means assurances that it will not depart substantially from the prior neo-classical economic model followed by the predecessor Menem and De la Rua governments.

They are impatient with the messy and time consuming give and take of negotiation between the center and the provinces over revenue distribution and expenditures, that is to say with representative democracy in a context of agonizing choices. They are indifferent to the income distribution effect of the policies they advocate. There is no indication that they understand that the collective bargaining regime in a country grows out of the history of labor relations, often beset, as in Argentina, by past sharp class conflict.

The Deputy Managing Director of the IMF, Anne O. Krueger, in the midst of an economic depression, unemployment in the 25 percent range and unused spare capacity in the industrial sector, warns of hyperinflation. Surely, if the Duhalde government were to monetize the deficit without adding to capacity, as demand increases there would be a risk of inflation further down the line in perhaps a year. But hyperinflation in the midst of economic depression, massive unemployment and a consumer goods industrial plant with substantial underutilized capacity?

In a country with a history of inflation like that of Argentina, the caution of the Duhalde government is understandable, but I confess to being baffled as to why the Argentines have not requested and obtained a $1 billion credit from the IDB for small and medium enterprises. Unlike Salvador Allende in Chile in 1972/3 and Alan Garcia in Peru in the 1980's, the Duhalde government has the confidence of that sector; he can demand of them that as profits increase with employment and demand restored, they invest in additional capacity rather than send the money out of the country as occurred in similar circumstances with Allende and Garcia. But what I think is less important than that the Duhalde government formulate a policy in which they–and Argentine society-can have confidence and which reflects the Argentine social and political reality.

For years, the IMF staff from the top on down has been trying to convince critics that it does not have a cookie-cutter approach in which one size fits all. Yet, we are now told that it is bringing in a new lead negotiator for the Argentine negotiations from the Asia region, an individual--and team-- with no background in the region, unable to speak the language, ignorant of the history, culture, and all of the complex bargains, formal and informal, that make up a country's social compact.

Apparently the IMF feels the need to be tough because of past failures of Argentine governments to fulfill commitments, but those failures are also a reflection of an unreality among the IMF staff as to what the political and social traffic would bear in Argentina. They were so infatuated with the Menem government commitment to the neo-classical model they were promoting they lost sight of the fact that the Menem government had lost its political and social base, a situation replicated with the De la Rua government.

Increasingly, the IMF is coming to resemble the mad-hatter's tea party in Lewis Carroll's Alice in Wonderland: night is day, day is night, white is black, black is white, knowledge is vice, ignorance is virtue.

Nor is this excessively technocratic mind-set mitigated at the political level by a U.S. Treasury leadership that understands that we do not start from ground zero, that there is a history here, an often tragic one at that, and that decision-making in political economy is different from pristine economic theory in controlled laboratory conditions. Instead of a largeness of vision to complement the so far impressive social and political sophistication of the Duhalde government, both the Treasury and the IMF top leadership evidence a small bore mind-set unworthy of the stakes that are at issue in Argentina.

President Ricardo Lagos of Chile contends, it is possible "to fight the region's gravest problem--gross income disparities between the wealthy and vast under classes--without violence and within the confines of the free markets and parliamentary democracies established over the past two decades."

I know that the Lagos formulation of the issue is not generally accepted here in Washington, or in important parts of American academic thinking where income inequality and equity issues are dismissed as irrelevant. We saw that view exhibited in the deliberations of the Commission: Professor Charles Calomiris, a Republican appointee, expressed the majority sentiment : "What I care about is poverty...and I don't care very much about inequality. I don't think it's part of our objective as a Commission to be talking much about inequality." (Calomiris, Transcript, January 4, 2000, p. 78). Or , with respect to core worker rights: " There simply is no basis aside from gross violations of human rights for a country to be told that they cannot participate as a trading partner with the rest of the world...denial of freedom of association and collective bargaining are not such gross violations: they don't come close." (Calomiris, Transcript , December 14, 1999, p. 135). Of course in a capitalist economy, collective bargaining is a critical element in determining the distribution of income in society.

The issue is not confined to Argentina. The research department of the IDB, the oldest and largest regional development bank, in a report last year notes that based upon extensive public opinion polling, despite economic growth, albeit modest in the past decade, 86 percent of the people in the region believe the distribution of income is unjust. The report notes that " income inequality has swept away many of the benefits of recent economic growth for large sectors of society. A prime example of this phenomenom is Mexico. Between 1996 and 1998, GDP per capita increased by 9.7 percent in real terms, which is a spectacular gain... However, poverty barely declined. The huge increase in median income was due entirely to income gains among the richest 30 percent–particularly the richest 10 percent–of the population. " It further notes that, " [n]o country in Latin America for which data on income distribution are available can boast a decline in inequality".

Last week, I participated in a workshop on Argentina in Bonn, Germany. At breakfast, a Brazilian participant told me how impressed he was with the comments of a senior former high official of the Argentine government. That individual stated that Argentine had become an "indecent" country in which poverty was now endemic and the gap between the rich and poor had become a chasm. My Brazilian friend observed that the Argentine commentator really seemed to care about such things. In Brazil, he said, poverty has been endemic and income distribution has been among the worst in the world for centuries and no one in the Brazilian elites really cares.

Perhaps these are random unrepresentative comments, but in my opinion they reflect an increasing disconnect between a Washington and American academic elite indifferent to equity and income distribution issues and a social and political reality in much of Latin America in which these issues are increasingly coming to the fore as central political questions.

So, for me, when we talk about reform of the IMF and the World Bank, organizational gimmicks and questions of process take a decidedly secondary importance to rethinking the economic paradigm they are inflicting upon their borrowing member countries.

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THE EMPLOYMENT SITUATION: MAY 2002

HEARING

before the

JOINT ECONOMIC COMMITTEE CONGRESS OF THE UNITED STATES

ONE HUNDRED SEVENTH CONGRESS

SECOND SESSION

June 7, 2002

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JOINT ECONOMIC COMMITTEE

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THE EMPLOYMENT SITUATION: MAY 2002

Friday, June 7, 2002

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

The Committee met, pursuant to notice, at 9:35 a.m., in Room 1334, Longworth House Office Building, the Honorable Jim Saxton, Chairman of the Committee, presiding.

Present: Representatives Saxton and Hill; Senator Reed.

Staff Present: Chris Frenze, Bob Keleher, Darryl Evans, Brian Higginbotham, Daphne Clones-Federing, and Matt Salomon.

OPENING STATEMENT OF REPRESENTATIVE JIM SAXTON, CHAIRMAN

Representative Saxton. Good morning. It is a pleasure to welcome Acting Commissioner Orr before the Joint Economic Committee (JEC) once again.

The employment report released today indicates that the job market is slow. Payroll employment increased by only 41,000 in May, while manufacturing employment declined. The diffusion index – an important measure of the proportion of industries with expanding employment – increased in May to 50.6 percent, while the unemployment rate slipped two-tenths of a point to 5.8 percent.

The payroll employment figures released today reflect the timing and unevenness of the economic recovery now underway. Although the economic recovery appears to have begun in the fourth quarter of last year, many employers have held off on new hiring until the sustainability of the recovery becomes clearer. As a result, the output of goods and services is rising, but at a much faster pace than employment. Consequently, labor productivity in the first quarter surged.

The weakness of current and expected business profits makes employers reluctant to incur higher costs, including labor costs related to the expansion of employment. In addition, certain sectors such as the telecommunications industry are still in financial distress and continue to lay off workers. So long as the profit outlook is unfavorable, firms will be hesitant to expand investment or employment. Thus, until the weakness in business profits and investment ends, the sustainability of economic recovery and employment growth will be in doubt.

The fragility of the expansion is reinforced by concerns about international tensions, terrorism and corporate accounting practices. As a result, the level of risk and uncertainty is significant, and this imposes additional costs on the economy and also is reflected in the weak stock market.

However, despite these problems, the remarkable resilience of the American people and the economy continues to be evident. As Chairman Greenspan testified before us several weeks ago, it appears likely that business profits and investment will recover in due course, consolidating and extending the U.S. economic expansion. The Federal Reserve's actions to reduce interest rates, and Congressional actions to reduce the tax burden, have improved the prospect for a sustained economic recovery.

At this point, I would like to recognize the Vice Chairman, Senator Reed.

[The prepared statement of Representative Saxton appears in the Submissions for the Record on page 10.]

OPENING STATEMENT OF SENATOR JACK REED, VICE CHAIRMAN

Senator Reed. Thank you, very much, Mr. Chairman.

Thank you for convening the hearing and thanks to Acting Commissioner Orr and her colleagues for joining us this morning.

Today's employment report suggests that we are by no means out of the woods. Even as the economy has begun to recover, unemployment has been little changed, leading to the continued worry of a jobless recovery. Today, there are 8.4 million unemployed Americans, and 1.5 million additional workers who want a job but are not counted among the unemployed.

It is job growth which will be the critical factor in determining whether or not the recession is indeed over. So far this year, job growth has been weak and not indicative of a robust recovery.

The May unemployment figures reflect the annual Bureau of Labor Statistics (BLS) benchmark revisions in the payroll data which track job growth. The slight downward revisions confirm that businesses remain uncertain about the recovery and reluctant to hire new workers.

Particularly troubling is the fact that the ranks of the long-term unemployed continued to swell as 1.6 million people have been looking for work for six months or more, an increase of one million people over the past year.

Today's employment report shows that our labor markets remain soft, and recovery is still fragile.

Mr. Chairman, I look forward to the testimony of Acting Commissioner Orr on the state of our labor markets. Thank you very much.

[The prepared statement of Senator Reed appears in the Submissions for the Record on page 11.]

Representative Saxton. Thank you very much, Mr. Reed.

Before we hear the Commissioner's statement, I would like to take a moment to welcome Baron Hill to the Committee. We look forward to working with Congressman Hill.

Just as a sidelight, Mr. Hill and I serve on the Armed Services Committee together, and there particularly on the Armed Services Oversight Committee on Terrorism. And just yesterday, Mr. Hill and I cooperated to send a letter to the President relative to the subject of terrorism where we got 51 Members of Congress to sign on with us.

So we look forward to doing many good things here, Mr. Hill; and we welcome you. Would you care to make some kind of opening statement?

Representative Hill. Let me just say that it is an honor for me to be on this Committee with you, Mr. Chairman, and Senator. I have enjoyed working with you, Mr. Chairman, on the antiterrorism Committee. I have enjoyed the list of people that you have asked to come to the Committee, and I am especially looking forward to serving with you on this Committee. Thank you very much.

Senator Reed. Mr. Chairman, if I could, too, add my words of welcome to Congressman Hill. We look forward to working with you. You bring a great deal of expertise and experience to this Committee.

Representative Saxton. Commissioner, welcome. The floor is yours.

OPENING STATEMENT OF LOIS ORR, ACTING COMMISSIONER, BUREAU OF LABOR STATISTICS; ACCOMPANIED BY KENNETH V. DALTON, ASSOCIATE COMMISSIONER, OFFICE OF PRICES AND LIVING CONDITIONS; AND PHILIP L. RONES, ASSISTANT COMMISSIONER OF CURRENT EMPLOYMENT ANALYSIS

Ms. Orr. Thank you. Good morning, Mr. Chairman and Members of the Committee.

I appreciate this opportunity, as I have during the past several months, to comment on the employment and unemployment data that we released this morning; and, of course, those are the data for May.

Both the unemployment rate at 5.8 percent and nonfarm payroll employment at 130.7 million were little changed in May. In 2001, the unemployment rate trended up, particularly following the terrorist attacks in September. Thus far this year, however, the trend has been far less clear.

Over the month, the jobless rate for blacks fell a full percentage rate to 10.2 percent, and the rate for Hispanics declined by nearly a percentage point to 7 percent.

Even though the unemployment level was about unchanged, the number of long-term unemployed – that is, those jobless 27 weeks and longer , as you have noted – continued to rise over the month. The increase over the month was 142,000. At 1.6 million, the number of long-term unemployed comprised about 20 percent of total unemployment in May, nearly twice its proportion of a year earlier.

Turning to the data from our establishment survey, nonfarm employment was little changed in May, up 41,000. Manufacturing employment declined by a monthly average of 112,000 during the year that ended this past January. Since then, however, losses have slowed; and for April and May the average decline was 21,000.

In May, job losses continued in computer equipment, electronic equipment, instruments, textiles, apparel, paper products, and printing and publishing. The factory workweek was unchanged at 40.9 hours, and factory overtime edged up by a tenth of an hour to 4.3 hours.

Following a large job loss in April, construction employment was flat over the month. Since March, 2001, the number of construction jobs has declined by 3.6 percent, substantially less than the declines posted in recent labor market downturns. For example, the 1990/1991 downturn had job losses that were more than twice that of 3.6 percent.

Within the service-producing sector, employment in services rose by 68,000 in May; and that was the third consecutive monthly job gain, following a year with no net job growth in the service-producing sector. Help supply employment rose by 25,000 in May and has risen by 126,000 over the past three months. It had declined by approximately 800,000 during the prior year and a half.

Engineering and management services also showed employment strength in May, adding 23,000 jobs. Health services employment rose by 16,000 over the month, about the same as in April, but at a far slower pace or off the trend from the prior year, that is, 2001.

For the 12-month period ending in March, job growth had averaged 26,000 per month. Employment in hotels and lodging places posted a large decline in May, the second consecutive month of job losses.

Retail trade employment was little changed in May, despite a loss of 33,000 jobs in eating and drinking places. Offsetting some of that decline, several retail industries posted small job gains.

Employment in each of the other major private sector industries – wholesale trade, transportation and public utilities and finance, insurance and real estate – was unchanged in May.

Within government, employment rose by 31,000 in local government, mostly in education, and at the same time declined by 12,000 in the noneducation component of state government.

Average hourly earnings for production or nonsupervisory workers in the nonfarm private sector rose by three cents in May to $14.70. Wage gains have been somewhat smaller so far this year than during 2001. Over the year, average hourly earnings were up 3.2 percent.

I would like now to comment about our annual benchmark revision and other kinds of adjustments we have made to our payroll establishment data. In your copy of my testimony, there are a couple of pages devoted to the benchmark and related revisions. I thought that I would just read a couple of them, and then if you have further questions in the question and answer period feel free to ask.

In accordance with our standard practice, the payroll survey figures this month incorporate regularly scheduled annual benchmark revisions. And the benchmarking process involves revising our sample-based estimates with information from a full universe count of employment, and that full universe count of employment is derived from the unemployment insurance tax records. In this year, of course, it is for March 2001.

The March 2001 benchmark revision was a downward adjustment of 123,000. Subsequent months also revised downward, to incorporate a number of other adjustments, including more recent data we had from unemployment insurance tax records, introduction of a probability sample for several of the major industries within our establishment survey, new seasonal adjustment factors, some reweighting and resizing of the sample, so that by April of 2002, the last month of the revision period, the unemployment level that we are reporting today was approximately 500,000 or four-tenths of one percent lower than the previously published unadjusted level. That is the data that we issued last month.

In summary, payroll employment remained essentially flat for the third month in a row; and the unemployment rate at 5.8 percent in May was little changed over the month.

My colleagues and I now would be glad to answer your questions. We will answer your questions. Maybe next time we won't use the word "glad" there.

[The prepared statement of Acting Commissioner Orr appears in the Submissions for the Record on page 12.]

Representative Saxton. Thank you, Commissioner.

I just have two short questions.

In my opening statement, I mentioned the diffusion index. Would you explain the diffusion index and its importance as you see it in terms of measuring economic growth?

Ms. Orr. The diffusion index attempts to measure the dispersion among industries of the change in employment. The diffusion index did increase modestly from April to May. So this means that we had approximately the same number of industries that had increases in employment as had decreases. The manufacturing diffusion index, however, has yet to get up to 50.

Phil, do you want to comment on that at all? Is that a good answer?

Mr. Rones. Yes.

Representative Saxton. The diffusion index was, according to your numbers, at 50.6 percent.

Ms. Orr. That is correct.

Representative Saxton. That means that 50.6 percent of the businesses are – of the industries – are expanding; is that correct?

Ms. Orr. Expanding or unchanged. An index value of 75 percent, for example, would indicate that growing industries predominated by a much larger margin than an index of say, 55 percent.

Representative Saxton. And the current level is the highest in over a year; is that correct?

Mr. Rones. Let me just clarify. The diffusion index looks at 353 private-sector industries that either grew or declined, and it includes half of industries that had no change. So what this means is, once you are at

50 percent, that means about equal numbers grew or declined or that all industries remained unchanged.

Representative Saxton. And in a robust economic expansion, what would we expect the diffusion index to look like?

Mr. Rones. As an example, if we go back to 1996, 1997, and early 1998, it is consistently around 60 percent. So you still have industries declining in almost any period, because we are talking about hundreds of very detailed industries in these calculations. But if you are up at 60, 65 percent, you have a very strong economy.

Representative Saxton. This is the highest rate that the diffusion index has seen in over a year; is that correct?

Mr. Rones. Yes, that is correct. You have to go back to the end of 2000 to have a higher rate.

Representative Saxton. Thank you.

Question number two. It appears to me that payroll employment figures that you report are consistent with the idea that employers are hesitant to hire workers. Is it fair to say that employers appear to be waiting for the economy to solidify prior to hiring significant numbers of people?

Ms. Orr. Well, I would offer some evidence in terms of employers having some demand for workers and, you know, beginning again to meet those demands through the help supply industry. That is the temporary help industry.

After more than a year of declines in the employment of the help supply industry, actually going from a high employment level of approximately three million and over a period between a couple of years ago and the start of this year losing 800,000 workers from this industry, we now see employers for the third consecutive month adding workers. 126,000 persons have been added to employment in help supply.

I would suggest that that gives us an indication that certainly there is some demand there.

Representative Saxton. So there is a demand, but employers are hesitant to hire permanent workers. They would rather hire temporary workers because of the uncertainty of the future?

Ms. Orr. There are a lot of folks that would argue that way.

Representative Saxton. Thank you.

Senator Reed.

Senator Reed. Thank you very much, Mr. Chairman; and thank you, Acting Commissioner Orr.

In your release you characterize the drop in the unemployment rate from six percent to 5.8 as little changed. Can I assume that means statistically insignificant?

Ms. Orr. Right. It did not meet our statistical significance test.

Phil, would you like to comment on that?

Mr. Rones. At the current level of unemployment or the current rate of unemployment, we need a change of 2.3 percentage points. This doesn't meet it. It was about 1.7.

Senator Reed. Thank you.

Ms. Orr. In the rounding the change looks larger than it was.

Senator Reed. Thank you, Commissioner.

When we were discussing extended benefits legislation, which has been passed, there was some concern that it would encourage people to stay on unemployment longer. I have noticed that the number of people unemployed for five to 14 weeks has increased, which is not the extended period. But, in general, have you seen any effect of extended benefits on the long-term unemployment rate?

Ms. Orr. I am going to ask Phil to comment on that.

That is not the business we are in. We don't have good measures that link the Current Population Survey (CPS) and extended benefits.

Mr. Rones. We have no way of disentangling specific effects on our unemployment data. In our survey, we don't even ask people whether they are receiving unemployment insurance benefits on a monthly basis. So we can't link those things up.

It is definitely the case, though, that the long-term unemployed tend to continue to grow, often for an extended period of time, even after the economy levels off or starts improving.

Senator Reed. Thank you.

We have all suggested a concern about a recovery that is without jobs, the jobless recovery, classically. Can you give us any insight as to why it appears that employment hours has not grown significantly even though output has increased rather dramatically? Is the recovery favoring industries that are less labor intensive, or does the relevant strength of defense production help to account for the current strength in productivity?

Again, any insights why it seems that unemployment is lagging, hours are lagging, yet GDP is growing robustly?

Ms. Orr. Well, first, I would say that, to date this year, 2002, we have seen some increase in the hours. You know, we saw little between April and May. But if you look at from the beginning of this year to present, there has been an increase in overtime hours and manufacturing as well as overall hours.

Senator Reed. You mentioned that there was a rather modest increase.

Ms. Orr. During the five months to date this year. I think that many of us are still trying to understand the substantial increase in productivity.

You know, part of the reason for the substantial reported increase in productivity for the first quarter of this year reflected a decline in the total hours and, you know, substantial increase in output.

If I might call upon one of my colleagues, who is our specialist in productivity, and ask if you would like to comment at all, Marilyn.

Ms. Manser. I don't have anything much to add to that.

Of course, these quarterly data are volatile. They certainly show strong productivity growth. Some of that clearly has come from hours declines, but the bulk of it does seem to be coming, certainly in the last quarter, with very strong output growth.

Senator Reed. Thank you. One reason that this is of concern is that even if output is substantial, if hours and wages don't increase, then revenues don't increase either. We are in a dilemma right now where we have seen significant shortfalls in revenues, which we are under great pressures to deal with here. So it is an issue of concern on many different levels.

Just a final question, if I may—

Ms. Orr. You – when you say revenues, you mean tax revenues?

Senator Reed. Tax revenues. Yes. I know that the BLS publishes alternate measures which try and incorporate the discouraged workers and others that have left the labor force, the U4, U5 and U6 numbers. Can you give us any sort of feeling for the composition of this group of people in your U4, U5 and U6 measures, demographically or any other way?

Ms. Orr. Yes, we have some information. I would like to ask Mr. Rones if he would respond.

Mr. Rones. We need to look at each of the categories in those measures separately.

Just for everyone's information, what we are talking about is starting with a base of unemployment and then adding other groups to that to come up with other measures; and particularly we talk about people who are part time for economic reasons, that is, they prefer a full-time job. People who are marginally attached to the labor force, they want a job, and have looked in the past year, but for various reasons are not looking now.

Then that very small group that you referred to, which is discouraged workers, which tends to run only three or 400,000 people.

The unemployed are, clearly, disproportionately young. We know that. We know that the unemployment rates for adults are often 3 percent or so, whereas the unemployment rates for teenagers can be in the teens, just as an example.

In the group of 16- to 24-year-olds, 16 percent of the labor force are in that group, but 29 percent of the part-time for economic reasons, 32 percent of the unemployed, almost 40 percent of the marginally attached. So all of these groups tend to be disproportionately young. And there is – nothing particularly interesting when you look at the gender differences.

But also you get what you would expect in the race categories. That is, that blacks in particular are disproportionately unemployed. They are also disproportionately in the part-time for economic, although the spread isn't quite as much, and also in those not in labor force categories, the marginally attached and discouraged.

Senator Reed. Thank you, Commissioner.

Representative Saxton. Thank you.

Mr. Hill, did you have questions?

Representative Hill. Thank you, Mr. Chairman.

As a new Member I had not intended to ask any questions, but I noticed that staff has prepared some questions. One of them caught my attention, and it was about adult women who were the hardest hit in unemployment. It increased from 5 percent to 5.4 percent. Can you tell us what that is all about? Is this a trend? Why is this happening?

Ms. Orr. The unemployment rate I think for adult men and women is identical at 5.2 percent this month.

Representative Hill. Well, the question that has been prepared here says adult women were the hardest hit last month. Their unemployment rate rose from 5 to 5.4 percent. At the same time, the number of women who maintained families who were employed declined. Is this an error?

Ms. Orr. Well, let me just relate to you the unemployment rate for adult women – that is, women ages 20 and over – started in January at 4.8. It was 5 percent, last month 5.4 and this month 5.2. That four-tenths of a percent, the change from 5 to 5.4 would be statistically significant. But it has been in sort of a similar range now for several months.

Representative Hill. Okay. Thank you.

Representative Saxton. Commissioner, I have no other questions at this point. Unless Mr. Reed does, we want to thank you for being here and we look forward to seeing you in the months ahead.

[Whereupon, at 10:00 a.m., the Committee was adjourned.]

SUBMISSIONS FOR THE RECORD

PREPARED STATEMENT OF REPRESENTATIVE JIM SAXTON, CHAIRMAN

It is a pleasure to welcome Acting Commissioner Orr before the Committee once again.

The employment report released today indicates that the job market is slow. Payroll employment increased by only 41,000 in May, while manufacturing employment declined. The diffusion index – an important measure of the proportion of industries with expanding employment – increased in May to 50.6. Meanwhile, the unemployment rate slipped two tenths of a percentage point to a level of 5.8 percent.

The payroll employment figures released today reflect the timing and unevenness of the economic recovery now underway. Although the economic recovery appears to have begun in the fourth quarter of last year, many employers have held off new hiring until the sustainability of the recovery becomes clearer. As a result, the output of goods and services is rising, but at a much faster pace than is employment. Consequently, labor productivity in the first quarter surged.

The weakness of current and expected business profits makes employers reluctant to incur higher costs, including labor costs related to expansion of employment. In addition, certain sectors such as the telecommunications industry are still in financial distress and continue to lay off workers. So long as the profit outlook is unfavorable, firms will be hesitant to expand investment or employment. Thus, until the weakness in business profits and investment ends, the sustainability of economic recovery and employment growth will be in doubt.

The fragility of the expansion is reinforced by concerns about international tensions, terrorism and corporate accounting practices. As a result, the level of risk and uncertainty is significant, and this imposes additional costs on the economy and also is reflected in the weak stock market.

However, despite these problems, the remarkable resilience of the American people and economy continues to be evident. As Chairman Greenspan testified before us several weeks ago, it appears likely that business profits and investment will recover in due course, consolidating and extending the U.S. economic expansion. The Federal Reserve's actions to reduce interest rates, and Congressional actions to reduce the tax burden, have improved the prospect of sustained economic expansion.

Prepared Statement of Senator Jack Reed, Vice Chairman

Thank you, Chairman Saxton, for convening this hearing. I also want to thank Acting Commissioner Orr for coming to testify before us today.

Today's employment report suggests that we are by no means out of the woods. Even as the economy has begun to recover, unemployment has been little changed, leading to the continued worry of a jobless recovery. Today there are 8.4 million unemployed Americans, and 1.5 million additional workers who want a job, but are not counted among the unemployed.

It is job growth which will be the critical factor in determining whether or not the recession is indeed over. So far this year, job growth has been weak and not indicative of a robust recovery.

The May employment figures reflect the annual BLS "benchmark" revisions in the payroll data, which track job growth. The slight downward revisions confirm that businesses remain uncertain about the recovery and reluctant to hire new workers.

Particularly troubling is the fact that the ranks of the long-term unemployed continue to swell as 1.6 million people have been looking for work for six months or more – an increase of one million people over the past year.

Today's employment report shows that our labor markets remain soft and the recovery is still fragile.

Mr. Chairman, I look forward to the testimony of Acting Commissioner Orr on the state of our labor markets.

Prepared Statement of Lois Orr, Acting Commissioner, Bureau of Labor Statistics

Mr. Chairman and Members of the Committee:

I appreciate this opportunity to comment on the May employment and unemployment data that we released this morning.

Both the unemployment rate, at 5.8 percent, and nonfarm payroll employment, at 130.7 million, were little changed in May. In 2001, the unemployment rate trended up, particularly following the terrorist attacks in September. Thus far this year, however, the trend has been less clear.

Over the month, the jobless rate for blacks fell a full percentage point to 10.2 percent, and the rate for Hispanics declined by nearly a percentage point to 7.0 percent. Even though the unemployment level was about unchanged, the number of long-term unemployed (those jobless 27 weeks and longer) continued to rise over the month, by 142,000. The number of long-term unemployed, at 1.6 million, comprised about 20 percent of total unemployment in May, nearly twice its proportion a year earlier.

Turning to the data from our establishment survey, nonfarm employment was little changed in May (+ 41,000). Manufacturing employment declined by a monthly average of 112,000 during the year ending in January 2002. Since then, losses have slowed, and, for April and May, the average decline was down to 21,000. In May, job losses continued in computer equipment, electronic equipment, instruments, textiles, apparel, paper products, and printing and publishing. The factory workweek was unchanged at 40.9 hours, and factory overtime edged up by 0.1 hour to 4.3 hours.

Following a large job loss in April, construction employment was flat over the month. Since March 2001, the number of construction jobs has declined by 3.6 percent, substantially less than the declines posted in recent labor market downturns.

Within the service-producing sector, employment in services rose by 68,000 in May, the third consecutive monthly job gain, following a year with no net job growth. Help supply employment rose by 25,000 in May, and has risen by 126,000 over the past 3 months. It had declined by 806,000 during the prior year and a half. Engineering and management services also showed strength in May, adding 23,000 jobs. Health services employment rose by 16,000 over the month, about the same as in April, but at a far slower pace than in the prior year. For the 12-month period ending in March, job growth had averaged 26,000 per month. Employment in hotels and lodging places posted a large decline in May, the second consecutive month of job losses.

Retail trade employment was little changed in May, despite a loss of 33,000 jobs in eating and drinking places. Offsetting some of this decline, several retail industries posted small job gains. Employment in each of the other major private-sector industries – wholesale trade, transportation and public utilities, and finance, insurance, and real estate – was unchanged in May.

Within government, employment rose by 31,000 in local government, mostly in education, and declined by 12,000 in the noneducation component of state government.

Average hourly earnings for production or nonsupervisory workers in the nonfarm private sector rose by 3 cents in May to $14.70. Wage gains have been somewhat smaller so far this year than during 2001. Over the year, average hourly earnings were up 3.2 percent.

In accordance with our standard practice, the payroll survey figures this month incorporate regularly scheduled annual benchmark revisions. The benchmarking process involves revising our sample-based employment estimates with information from a full universe count of employment derived from unemployment insurance tax records for March 2001.

The March 2001 benchmark revision was a downward adjustment of 123,000 or one-tenth of one percent. Subsequent months also revised downward, to incorporate a number of other adjustments. By April 2002, the last month of the revision period, the employment level was 501,000 or four-tenths of one percent lower than the previously published unadjusted level. There is no benchmark source for hours and earnings data, but these series also may be affected by the benchmark process because of changes in the industry employment weights and the introduction of new seasonal factors.

The downward adjustment of 123,000, or about one-tenth of one percent of the total nonfarm employment level, is slightly less than the average revision for the prior 10-year period. Payroll employment estimates for the post-benchmark period, April 2001 forward, have been revised to incorporate the new benchmark levels as well as revised seasonal adjustment factors, bias factors, birth/death models, and annual sample updates.

In addition to the routine benchmark revision, all estimates for transportation and public utilities and the finance, insurance, and real estate industry from April 2000 forward have been revised to incorporate a new sample design. The employment estimates for retail trade from April 2001 forward also incorporate the new sample design. These industries are the third group of industries to convert to a probability-based sample under a 4-year phase-in plan for the Current Employment Statistics survey sample- redesign project. The phase-in will conclude in June 2003 with the introduction of the services industries and the conversion to the North American Industrial Classification System (NAICS).

In summary, payroll employment remained essentially flat for the third month in a row, and the unemployment rate, at 5.8 percent in May, was little changed over the month.

My colleagues and I now would be glad to answer your questions.

News United States Department of Labor

Bureau of Labor Statistics Washington, D.C. 20212

Technical information:
Household data: (202) 691-6378 http://www.bls.gov/cps/
Establishment data: 691-6555 http://www.bls.gov/ces/
Media contact: 691-5902

USDL 02-332

Transmission of material in this release is embargoed until 8:30 A.M. (EDT), Friday, June 7, 2002.

THE EMPLOYMENT SITUATION: MAY 2002

Both payroll employment and the unemployment rate were little changed in May, the Bureau of Labor Statistics of the U.S. Department of Labor reported today. Employment rose in the services industry and edged down in manufacturing. Most other major industries showed no significant change.

Chart 1. Unemployment rate, seasonally adjusted, June 1999 - May 2002

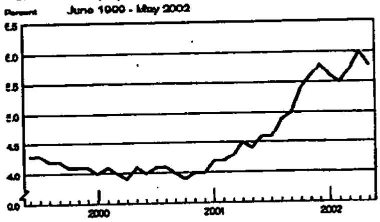
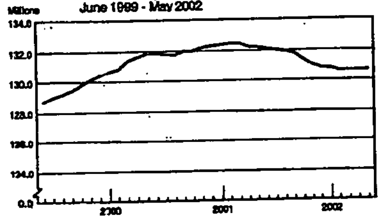


Chart 2. Nonfarm payroll employment, seasonally adjusted, June 1999 - May 2002



Unemployment (Household Survey Data)

The number of unemployed persons (8.4 million) and the unemployment rate (5.8 percent) were little changed over the month. The May unemployment rate is 1.9 percentage points above its most recent low of 3.9 percent in October 2000, and the number of unemployed persons is 2.8 million higher.

In May, the unemployment rates for blacks (10.2 percent) and Hispanics (7.0 percent) declined. The rates for the other major worker groups—adult men (5.2 percent), adult women (5.2 percent), teenagers (16.9 percent), and whites (5.2 percent)—were little changed. (See tables A-1 and A-2.)

The establishment data in this release have been revised as a result of the annual benchmarking process; the introduction of probability-based sample estimates for transportation and public utilities, retail trade, and finance, insurance, and real estate; and the updating of seasonal adjustment factors. More information on the revisions is contained in the note beginning on page 4.

Table A. Major indicators of labor market activity, seasonally adjusted
(Numbers in thousands)

Category	Quarterly averages 2001 IV	Quarterly averages 2002 I	Monthly data 2002 Mar.	Monthly data 2002 Apr.	Monthly data 2002 May	Apr.-May change
HOUSEHOLD DATA	Labor force status					
Civilian labor force	142,291	141,868	142,005	142,570	142,769	199
Employment	134,308	133,894	133,894	133,976	134,417	441
Unemployment	7,983	7,975	8,111	8,594	8,351	-243
Not in labor force	70,467	71,342	71,329	70,922	70,889	-33
	Unemployment rates					
All workers	5.6	5.6	5.7	6.0	5.8	-0.2
Adult men	5.0	5.1	5.2	5.4	5.2	-.2
Adult women	5.0	4.9	5.0	5.4	5.2	-.2
Teenagers	15.8	16.0	16.4	16.8	16.9	.1
White	4.9	5.0	5.0	5.3	5.2	-.1
Black	9.9	10.1	10.7	11.2	10.2	-1.0
Hispanic origin	7.5	7.5	7.3	7.9	7.0	-.9
ESTABLISHMENT DATA[1]	Employment					
Nonfarm employment	131,130	130,759	130,701	p130,707	p130,748	p41
Goods-producing[2]	24,375	24,049	23,975	p23,903	p23,880	p-23
Construction	6,635	6,602	6,593	p6,540	p6,539	p-1
Manufacturing	17,174	16,883	16,822	p16,800	p16,781	p-19
Service-producing[2]	106,755	106,711	106,726	p106,804	p106,868	p64
Retail trade	23,412	23,353	23,332	p23,357	p23,340	p-17
Services	40,880	40,924	40,963	p41,039	p41,107	p68
Government	21,096	21,165	21,196	p21,184	p21,198	p14
	Hours of work[3]					
Total private	34.1	34.2	34.2	p34.2	p34.2	p.0
Manufacturing	40.5	40.8	41.0	p40.9	p40.9	p.0
Overtime	3.8	4.0	4.1	p4.2	p4.3	p0.1
	Indexes of aggregate weekly hours (1982=100)[3]					
Total private	148.4	148.2	148.2	p148.3	p148.2	p-0.1
	Earnings[3]					
Average hourly earnings, total private	$14.51	$14.62	$14.65	p$14.67	p$14.70	p$0.03
Average weekly earnings, total private	494.42	499.52	501.03	p501.71	p502.74	p1.03

[1] Establishment data have been revised to reflect March 2001 benchmarks; the introduction of probability-based sample estimates for transportation and public utilities, retail trade, and finance, insurance, and real estate; and recomputed seasonal adjustment factors.
[2] Includes other industries, not shown separately.
[3] Data relate to private production or nonsupervisory workers.
p=preliminary.

The number of long-term unemployed persons—those unemployed 27 weeks or longer—rose by 142,000 in May, following increases of similar size in March and April. This measure has increased by about 1 million persons over the past 12 months. (See table A-6.)

Total Employment and the Labor Force (Household Survey Data)

The civilian labor force (142.8 million) was little changed over the month, and the labor force participation rate held steady at 66.8 percent. The number of employed persons rose in May by 441,000 to 134.4 million. The employment-population ratio edged up to 62.9 percent. (See table A-1.)

About 7.2 million persons (not seasonally adjusted) held more than one job in May. These multiple jobholders represented 5.3 percent of the total employed, compared with 5.5 percent a year earlier. (See table A-10.)

Persons Not in the Labor Force (Household Survey Data)

About 1.5 million persons (not seasonally adjusted) were marginally attached to the labor force in May, up from 1.1 million a year earlier. These individuals reported that they wanted and were available for work and had looked for a job sometime in the prior 12 months. They were not counted as unemployed, however, because they had not actively searched for work in the 4 weeks preceding the survey. The number of discouraged workers was 407,000 in May. Discouraged workers, a subset of the marginally attached, were not currently looking for work specifically because they believed no jobs were available for them. (See table A-10.)

Industry Payroll Employment (Establishment Survey Data)

Total nonfarm payroll employment, at 130.7 million, was little changed (+41,000) for the third consecutive month. From the start of the recession in March 2001 through February 2002, job losses had averaged 160,000 a month. (See table B-1.)

Employment in the services industry rose by 68,000 in May, following gains of similar magnitude in the prior 2 months. Employment growth in help supply services explains a large portion of the recent increases in the services industry. In May, help supply services added 25,000 jobs, for a gain of 126,000 since February. The industry had lost 806,000 jobs from September 2000 through February 2002. Engineering and management services added 23,000 jobs in May, notably in management and public relations. Health services also added jobs; the gain (16,000) was about the same as in April, but well below the average for the 12-month period ending in March. Job losses occurred in hotels and other lodging places (-13,000) for the second month in a row, following little change earlier in the year.

In retail trade, job losses in eating and drinking places and department stores were partly offset by small employment gains in other retail industries over the month. Eating and drinking places lost 33,000 jobs, bringing the decline in the industry so far this year to 59,000. Employment was unchanged in transportation and public utilities, following job losses totaling 347,000 from the industry's last employment peak in February 2001. Air transportation, communications, and transportation services accounted for approximately 85 percent of these losses. In government, employment in local education increased by 26,000 in May; this was partly offset by declines in the noneducation component of state government.

In the goods-producing sector, employment in manufacturing edged down by 19,000 in May; factory job losses have moderated substantially since the beginning of the year. Employment had declined by an average of 115,000 a month from March 2001 through January 2002. A number of manufacturing industries have fared better this year, including industrial machinery, electronic equipment, fabricated metals, and transportation equipment.

Employment in construction was about unchanged in May, as seasonal hiring just met expectations. Although construction has lost 242,000 jobs since March 2001, the decline has been relatively small compared with recent economic downturns. Employment in mining edged down by 3,000 in May. Since its recent peak last September, this industry has lost 11,000 jobs, primarily in oil and gas extraction.

Weekly Hours (Establishment Survey Data)

The average workweek for production or nonsupervisory workers on private nonfarm payrolls was unchanged in May at 34.2 hours, seasonally adjusted. The manufacturing workweek also was unchanged at 40.9 hours, and factory overtime was up by 0.1 hour to 4.3 hours. (See table B-2.)

The index of aggregate weekly hours of production or nonsupervisory workers on private nonfarm payrolls edged down by 0.1 percent in May to 148.2 (1982=100). The manufacturing index was down by 0.2 percent over the month. (See table B-5.)

Hourly and Weekly Earnings (Establishment Survey Data)

Average hourly earnings of production or nonsupervisory workers on private nonfarm payrolls increased by 3 cents in May to $14.70, seasonally adjusted. Average weekly earnings rose by 0.2 percent over the month to $502.74. Over the year, both average hourly earnings and average weekly earnings increased by 3.2 percent. (See table B-3.)

The Employment Situation for June 2002 is scheduled to be released on Friday, July 5, at 8:30 A.M. (EDT).

Revisions to Establishment Survey Data

In accordance with annual practice, the establishment survey data have been revised to reflect comprehensive universe counts of payroll jobs, or benchmarks. These counts are derived principally from unemployment insurance tax records for March 2001; the benchmark process resulted in revisions to all unadjusted data series from April 2000 forward, the time period since the last benchmark was established. All seasonally adjusted data beginning with January 1997 also have been revised, in accordance with the usual practice of revising 5 years of data.

In addition to the routine benchmark revisions, all estimates for the transportation and public utilities and finance, insurance, and real estate industries from April 2000 forward have been revised to incorporate a new sample design. The retail trade industry estimates from April 2001 forward incorporate the new sample design. These industries are the third group to convert to a probability-based sample under a 4-year phase-in plan for the Current Employment Statistics (CES) sample redesign project. The completion of the phase-in for the redesign, in June 2003 for the services industry, will coincide with the conversion of all establishment survey series from industry coding based on the 1987 Standard Industrial Classification (SIC) system to industry coding based on the North American Industrial Classification System (NAICS).

Table B presents revised total nonfarm employment data on a seasonally adjusted basis for the period January 2001 through April 2002. The revised data for April 2001 forward incorporate the effect of applying the rate of change measured by the sample to the new benchmark level, as well as updated bias and net business birth/death model adjustments and new seasonal adjustment factors. The total nonfarm employment level for March 2001 was revised downward by 123,000 (193,000 on a seasonally adjusted basis). The previously published level for April 2002 was revised downward by 501,000 (523,000 on a seasonally adjusted basis).

The June 2002 issue of *Employment and Earnings* will contain an article that discusses the benchmark, the post-benchmark revisions, and the introduction of probability-based sample estimates for transportation and public utilities; retail trade; and finance, insurance, and real estate. (The article is available on the Internet at the address shown below.) This issue also will provide revised seasonal adjustment factors for March through October 2002 and revised estimates for all regularly published tables containing national establishment survey data on employment, hours, and earnings.

LABSTAT, the BLS public database on the Internet, contains all revised historical CES data. The data can be accessed through the CES homepage at http://www.bls.gov/ces/.

Further information on the revisions released today may be obtained by calling 202-691-6555 or via the Internet on the CES homepage.

Table B. Revisions in total nonfarm employment, seasonally adjusted, January 2001-April 2002

(In thousands)

Year and month	As previously published	As revised	Difference
2001:			
January	132,428	132,382	-46
February	132,595	132,457	-138
March	132,654	132,461	-193
April	132,489	132,243	-246
May	132,530	132,229	-301
June	132,431	132,108	-323
July	132,449	132,045	-404
August	132,395	131,966	-429
September	132,230	131,819	-411
October	131,782	131,414	-368
November	131,427	131,087	-340
December	131,321	130,890	-431
2002:			
January	131,212	130,871	-341
February	131,208	130,706	-502
March	131,187	130,701	-486
April (p)	131,230	130,707	-523

p = preliminary.

Explanatory Note

This news release presents statistics from two major surveys, the Current Population Survey (household survey) and the Current Employment Statistics survey (establishment survey). The household survey provides the information on the labor force, employment, and unemployment that appears in the A tables, marked HOUSEHOLD DATA. It is a sample survey of about 60,000 households conducted by the U.S. Census Bureau for the Bureau of Labor Statistics (BLS).

The establishment survey provides the information on the employment, hours, and earnings of workers on nonfarm payrolls that appears in the B tables, marked ESTABLISHMENT DATA. This information is collected from payroll records by BLS in cooperation with State agencies. In June 2002, the sample included over 300,000 establishments employing about 37 million people.

For both surveys, the data for a given month relate to a particular week or pay period. In the household survey, the reference week is generally the calendar week that contains the 12th day of the month. In the establishment survey, the reference period is the pay period including the 12th, which may or may not correspond directly to the calendar week.

Coverage, definitions, and differences between surveys

Household survey. The sample is selected to reflect the entire civilian noninstitutional population. Based on responses to a series of questions on work and job search activities, each person 16 years and over in a sample household is classified as employed, unemployed, or not in the labor force.

People are classified as *employed* if they did any work at all as paid employees during the reference week; worked in their own business, profession, or on their own farm; or worked without pay at least 15 hours in a family business or farm. People are also counted as employed if they were temporarily absent from their jobs because of illness, bad weather, vacation, labor-management disputes, or personal reasons.

People are classified as *unemployed* if they meet all of the following criteria: They had no employment during the reference week; they were available for work at that time; and they made specific efforts to find employment sometime during the 4-week period ending with the reference week. Persons laid off from a job and expecting recall need not be looking for work to be counted as unemployed. The unemployment data derived from the household survey in no way depend upon the eligibility for or receipt of unemployment insurance benefits.

The *civilian labor force* is the sum of employed and unemployed persons. Those not classified as employed or unemployed are *not in the labor force*. The *unemployment rate* is the number unemployed as a percent of the labor force. The *labor force participation rate* is the labor force as a percent of the population, and the *employment-population ratio* is the employed as a percent of the population.

Establishment survey. The sample establishments are drawn from private nonfarm businesses such as factories, offices, and stores, as well as Federal, State, and local government entities. *Employees on nonfarm payrolls* are those who received pay for any part of the reference pay period, including persons on paid leave. Persons are counted in each job they hold. *Hours and earnings* data are for private businesses and relate only to production workers in the goods-producing sector and nonsupervisory workers in the service-producing sector.

Differences in employment estimates. The numerous conceptual and methodological differences between the household and establishment surveys result in important distinctions in the employment estimates derived from the surveys. Among these are:

- The household survey includes agricultural workers, the self-employed, unpaid family workers, and private household workers among the employed. These groups are excluded from the establishment survey.
- The household survey includes people on unpaid leave among the employed. The establishment survey does not.
- The household survey is limited to workers 16 years of age and older. The establishment survey is not limited by age.
- The household survey has no duplication of individuals, because individuals are counted only once, even if they hold more than one job. In the establishment survey, employees working at more than one job and thus appearing on more than one payroll would be counted separately for each appearance.

Other differences between the two surveys are described in "Comparing Employment Estimates from Household and Payroll Surveys," which may be obtained from BLS upon request.

Seasonal adjustment

Over the course of a year, the size of the nation's labor force and the levels of employment and unemployment undergo sharp fluctuations due to such seasonal events as changes in weather, reduced or expanded production, harvests, major holidays, and the opening and closing of schools. The effect of such seasonal variation can be very large; seasonal fluctuations may account for as much as 95 percent of the month-to-month changes in unemployment.

Because these seasonal events follow a more or less regular pattern each year, their influence on statistical trends can be eliminated by adjusting the statistics from month to month. These adjustments make nonseasonal developments, such as declines in economic activity or increases in the participation of women in the labor force, easier to spot. For example, the large number of youth entering the labor force each June is likely to obscure any other changes that have taken place relative to May, making it difficult to determine if the level of economic activity has risen or declined. However, because the effect of students finishing school in previous years is known, the statistics for the current year can be adjusted to allow for a comparable change. Insofar as the seasonal adjustment is made correctly, the adjusted figure provides a more useful tool with which to analyze changes in economic activity.

In both the household and establishment surveys, most seasonally adjusted series are independently adjusted. However, the adjusted series for many major estimates, such as total payroll employment, employment in most major industry divisions, total employment, and unemployment are computed by aggregating independently adjusted component series. For example, total unemployment is derived by summing the adjusted series for four major age-sex components; this differs from the unemployment estimate that would be obtained by directly adjusting the total or by combining the duration, reasons, or more detailed age categories.

The numerical factors used to make the seasonal adjustments are recalculated twice a year. For the household survey, the factors are calculated for the January-June period and again for the July-December period. For the establishment survey, updated factors for seasonal adjustment are calculated for the May-October period and introduced along with new benchmarks, and again for the November-April period. In both surveys, revisions to historical data are made once a year.

Reliability of the estimates

Statistics based on the household and establishment surveys are subject to both sampling and nonsampling error. When a sample rather than the entire population is surveyed, there is a chance that the sample estimates may differ from the "true" population values they represent. The exact difference, or *sampling error*, varies depending on the particular sample selected, and this variability is measured by the standard error of the estimate. There is about a 90-percent chance, or level of confidence, that an estimate based on a sample will differ by no more than 1.6 standard errors from the "true" population value because of sampling error. BLS analyses are generally conducted at the 90-percent level of confidence.

For example, the confidence interval for the monthly change in total employment from the household survey is on the order of plus or minus 292,000. Suppose the estimate of total employment increases by 100,000 from one month to the next. The 90-percent confidence interval on the monthly change would range from -192,000 to 392,000 (100,000 +/- 292,000). These figures do not mean that the sample results are off by these magnitudes, but rather that there is about a 90-percent chance that the "true" over-the-month change lies within this interval. Since this range includes values of less than zero, we could not say with confidence that employment had, in fact, increased. If, however, the reported employment rise was half a million, then all of the values within the 90-percent confidence interval would be greater than zero. In this case, it is likely (at least a 90-percent chance) that an employment rise had, in fact, occurred. The 90-percent confidence interval for the monthly change in unemployment is +/- 273,000, and for the monthly change in the unemployment rate it is +/- .19 percentage point.

In general, estimates involving many individuals or establishments have lower standard errors (relative to the size of the estimate) than estimates which are based on a small number of observations. The precision of estimates is also improved when the data are cumulated over time such as for quarterly and annual averages. The seasonal adjustment process can also improve the stability of the monthly estimates.

The household and establishment surveys are also affected by *nonsampling error*. Nonsampling errors can occur for many reasons, including the failure to sample a segment of the population, inability to obtain information for all respondents in the sample, inability or unwillingness of respondents to provide correct information on a timely basis, mistakes made by respondents, and errors made in the collection or processing of the data.

For example, in the establishment survey, estimates for the most recent 2 months are based on substantially incomplete returns; for this reason, these estimates are labeled preliminary in the tables. It is only after two successive revisions to a monthly estimate, when nearly all sample reports have been received, that the estimate is considered final.

Another major source of nonsampling error in the establishment survey is the inability to capture, on a timely basis, employment generated by new firms. To correct for this systematic underestimation of employment growth (and other sources of error), a process known as bias adjustment is included in the survey's estimating procedures, whereby a specified number of jobs is added to the monthly sample-based change. The size of the monthly bias adjustment is based largely on past relationships between the sample-based estimates of employment and the total counts of employment described below.

The sample-based estimates from the establishment survey are adjusted once a year (on a lagged basis) to universe counts of payroll employment obtained from administrative records of the unemployment insurance program. The difference between the March sample-based employment estimates and the March universe counts is known as a benchmark revision, and serves as a rough proxy for total survey error. The new benchmarks also incorporate changes in the classification of industries. Over the past decade, the benchmark revision for total nonfarm employment has averaged 0.3 percent, ranging from zero to 0.7 percent.

Additional statistics and other information

More comprehensive statistics are contained in *Employment and Earnings*, published each month by BLS. It is available for $26.00 per issue or $50.00 per year from the U.S. Government Printing Office, Washington, DC 20402. All orders must be prepaid by sending a check or money order payable to the Superintendent of Documents, or by charging to Mastercard or Visa.

Employment and Earnings also provides measures of sampling error for the household survey data published in this release. For unemployment and other labor force categories, these measures appear in tables 1-B through 1-D of its "Explanatory Notes." Measures of the reliability of the data drawn from the establishment survey and the actual amounts of revision due to benchmark adjustments are provided in tables 2-B through 2-H of that publication.

Information in this release will be made available to sensory impaired individuals upon request. Voice phone: 202-691-5200; TDD message referral phone: 1-800-877-8339.

 HOUSEHOLD DATA

Table A-1. Employment status of the civilian population by sex and age

(Numbers in thousands)

Employment status, sex, and age	Not seasonally adjusted			Seasonally adjusted[1]					
	May 2001	Apr. 2002	May 2002	May 2001	Jan. 2002	Feb. 2002	Mar. 2002	Apr. 2002	May 2002
TOTAL									
Civilian noninstitutional population	211,525	213,492	213,658	211,525	213,089	213,208	213,334	213,402	213,658
Civilian labor force	141,048	141,886	142,253	141,445	141,390	142,211	142,005	142,570	142,769
Participation rate	66.7	66.5	66.6	66.9	66.4	66.7	66.6	66.8	66.8
Employed	[illegible]	133,740	134,365	135,233	133,468	134,319	133,894	133,976	134,417
Employment-population ratio	63.9	62.6	62.9	63.9	62.6	63.0	62.8	62.8	62.9
Agriculture	3,381	3,150	3,282	3,103	3,273	3,246	3,126	3,154	3,097
Nonagricultural industries	131,822	130,561	131,083	132,042	130,195	131,073	130,768	130,823	131,320
Unemployed	5,846	8,146	7,888	6,210	7,922	7,891	8,111	8,564	8,351
Unemployment rate	4.1	5.7	5.5	4.4	5.6	5.5	5.7	6.0	5.8
Not in labor force	70,477	71,605	71,405	70,080	71,699	70,996	71,329	70,822	70,888
Persons who currently want a job	5,161	4,509	5,472	4,518	4,824	4,375	4,527	4,466	4,779
Men, 16 years and over									
Civilian noninstitutional population	101,684	102,682	102,765	101,684	102,484	102,542	102,607	102,682	102,765
Civilian labor force	75,274	75,612	76,071	75,524	75,469	75,685	75,756	76,008	76,415
Participation rate	74.0	73.6	74.0	74.3	73.6	73.8	73.8	74.0	74.4
Employed	72,131	71,141	71,864	72,131	71,114	71,457	71,299	71,397	71,894
Employment-population ratio	70.9	69.3	69.9	70.9	69.4	69.7	69.5	69.5	70.0
Unemployed	3,143	4,471	4,207	3,393	4,356	4,228	4,457	4,611	4,521
Unemployment rate	4.2	5.9	5.5	4.5	5.8	5.6	5.9	6.1	5.9
Men, 20 years and over									
Civilian noninstitutional population	93,541	94,414	94,479	93,541	94,228	94,282	94,315	94,414	94,479
Civilian labor force	71,360	71,873	72,230	71,469	71,534	71,718	71,723	72,098	72,428
Participation rate	76.3	76.2	76.5	76.4	75.9	76.1	76.0	76.4	76.7
Employed	68,772	68,138	68,691	68,695	67,818	68,157	68,013	68,193	68,647
Employment-population ratio	73.5	72.2	72.7	73.4	72.0	72.3	72.1	72.2	72.7
Agriculture	2,290	2,224	2,233	2,166	2,207	2,185	2,084	2,213	2,125
Nonagricultural industries	66,482	65,915	66,458	66,530	65,611	65,973	65,929	65,980	66,522
Unemployed	2,588	3,535	3,539	2,770	3,716	3,560	3,710	3,905	3,781
Unemployment rate	3.6	5.3	4.9	3.9	5.2	5.0	5.2	5.4	5.2
Women, 16 years and over									
Civilian noninstitutional population	109,842	110,809	110,893	109,842	110,605	110,663	110,726	110,820	110,893
Civilian labor force	65,774	66,274	66,183	65,921	65,920	66,525	66,249	66,561	66,354
Participation rate	59.9	59.8	59.7	60.0	59.6	60.1	59.8	60.1	59.8
Employed	63,071	62,600	62,501	63,104	62,364	62,860	62,605	62,579	62,524
Employment-population ratio	57.4	56.5	56.4	57.5	56.4	56.8	56.5	56.5	56.4
Unemployed	2,703	3,675	3,621	2,817	3,566	3,663	3,654	3,982	3,830
Unemployment rate	4.1	5.5	5.5	4.3	5.4	5.5	5.5	6.0	5.8
Women, 20 years and over									
Civilian noninstitutional population	101,938	102,847	102,936	101,938	102,650	102,651	102,728	102,847	102,936
Civilian labor force	62,049	62,673	62,558	62,068	62,056	62,703	62,320	62,724	62,597
Participation rate	60.9	60.9	60.8	60.9	60.5	61.1	60.7	61.0	60.8
Employed	59,804	59,529	59,438	59,716	59,102	59,588	59,227	59,333	59,337
Employment-population ratio	58.7	57.9	57.7	58.6	57.6	58.0	57.7	57.7	57.6
Agriculture	860	751	803	816	824	829	804	732	760
Nonagricultural industries	58,943	58,778	58,635	58,900	58,277	58,759	58,423	58,602	58,577
Unemployed	2,245	3,150	3,120	2,352	2,954	3,116	3,093	3,391	3,260
Unemployment rate	3.6	5.0	5.0	3.8	4.8	5.0	5.0	5.4	5.2
Both sexes, 16 to 19 years									
Civilian noninstitutional population	16,046	16,231	16,243	16,046	16,310	16,295	16,298	16,231	16,243
Civilian labor force	7,839	7,235	7,465	7,908	7,800	7,790	7,962	7,748	7,744
Participation rate	47.8	44.6	46.0	49.3	47.8	47.8	48.9	47.7	47.7
Employed	6,627	6,074	6,236	6,821	6,548	6,575	6,655	6,450	6,434
Employment-population ratio	41.3	37.4	38.4	42.5	40.1	40.4	40.9	39.7	39.6
Agriculture	240	176	243	209	241	233	239	209	213
Nonagricultural industries	6,386	5,898	5,992	6,612	6,307	6,342	6,416	6,240	6,221
Unemployed	1,013	1,161	1,229	1,086	1,252	1,216	1,308	1,298	1,310
Unemployment rate	13.3	16.1	16.5	13.8	16.1	15.6	16.4	16.8	16.9

[1] The population figures are not adjusted for seasonal variation; therefore, identical numbers appear in the unadjusted and seasonally adjusted columns.

Table A-2. Employment status of the civilian population by race, sex, age, and Hispanic origin

(Numbers in thousands)

Employment status, race, sex, age, and Hispanic origin	Not seasonally adjusted			Seasonally adjusted[1]					
	May 2001	Apr. 2002	May 2002	May 2001	Jan. 2002	Feb. 2002	Mar. 2002	Apr. 2002	May 2002
WHITE									
Civilian noninstitutional population	175,653	176,972	177,087	175,653	176,713	176,783	176,866	176,972	177,087
Civilian labor force	117,491	118,068	118,369	117,714	117,759	118,472	118,159	118,661	118,742
Participation rate	66.9	66.7	66.9	67.0	66.6	67.0	66.8	67.1	67.1
Employed	113,261	112,107	112,632	113,173	111,876	112,632	112,286	112,425	112,563
Employment-population ratio	64.5	63.3	63.6	64.4	63.3	63.7	63.5	63.5	63.6
Unemployed	4,230	5,961	5,737	4,541	5,883	5,840	5,873	6,236	6,179
Unemployment rate	3.6	5.0	4.8	3.9	5.0	4.9	5.0	5.3	5.2
Men, 20 years and over									
Civilian labor force	60,483	60,771	61,030	60,450	60,473	60,714	60,521	60,867	61,096
Participation rate	76.6	76.3	76.6	76.7	76.3	76.6	76.3	76.6	76.9
Employed	58,610	57,863	58,344	58,410	57,858	58,063	57,793	57,921	58,170
Employment-population ratio	74.4	72.9	73.4	74.2	72.7	73.2	72.8	72.9	73.2
Unemployed	1,873	2,908	2,686	2,040	2,615	2,651	2,728	2,946	2,926
Unemployment rate	3.1	4.8	4.4	3.4	4.3	4.4	4.5	4.8	4.8
Women, 20 years and over									
Civilian labor force	50,535	51,174	51,063	50,615	50,698	51,190	50,938	51,289	51,163
Participation rate	60.1	60.4	60.2	60.2	59.9	60.5	60.2	60.5	60.4
Employed	48,951	48,957	48,920	48,915	48,562	48,941	48,765	48,908	48,871
Employment-population ratio	58.2	57.8	57.7	58.2	57.4	57.8	57.6	57.7	57.7
Unemployed	1,584	2,217	2,143	1,700	2,136	2,249	2,174	2,381	2,292
Unemployment rate	3.1	4.3	4.2	3.4	4.2	4.4	4.3	4.6	4.5
Both sexes, 16 to 19 years									
Civilian labor force	6,473	6,122	6,296	6,649	6,588	6,558	6,699	6,805	6,483
Participation rate	50.7	47.7	49.0	52.1	51.2	51.0	52.1	53.7	50.5
Employed	5,700	5,287	5,368	5,848	5,656	5,638	5,728	5,896	5,522
Employment-population ratio	44.6	41.2	41.8	45.8	44.0	43.9	44.6	43.6	43.0
Unemployed	773	834	928	801	932	920	971	908	961
Unemployment rate	11.9	13.6	14.7	12.0	14.2	14.0	14.5	14.0	14.8
Men	12.7	15.3	14.7	13.3	13.7	15.4	16.3	15.4	15.4
Women	11.1	12.0	14.7	10.7	14.6	12.6	12.7	12.5	14.2
BLACK									
Civilian noninstitutional population	25,501	25,868	25,898	25,501	25,785	25,813	25,839	25,868	25,898
Civilian labor force	16,808	16,792	16,848	16,644	16,769	16,747	16,759	16,941	16,887
Participation rate	65.9	64.9	65.1	65.3	65.0	64.9	64.9	65.5	65.2
Employed	15,514	15,078	15,170	15,311	15,119	15,131	14,960	15,045	15,168
Employment-population ratio	60.8	58.3	58.6	60.0	58.6	58.6	57.9	58.2	58.6
Unemployed	1,294	1,714	1,678	1,333	1,650	1,616	1,799	1,896	1,719
Unemployment rate	7.7	10.2	10.0	8.0	9.8	9.6	10.7	11.2	10.2
Men, 20 years and over									
Civilian labor force	7,289	7,511	7,551	7,304	7,546	7,444	7,579	7,529	7,573
Participation rate	71.3	72.3	72.6	71.4	72.8	71.8	73.0	72.5	72.8
Employed	6,750	6,838	6,925	6,747	6,872	6,798	6,814	6,831	6,925
Employment-population ratio	66.0	65.8	66.6	66.0	66.4	65.6	65.7	65.6	65.8
Unemployed	539	673	626	557	674	645	765	698	649
Unemployment rate	7.4	9.0	8.3	7.6	8.9	8.7	10.1	9.3	8.6
Women, 20 years and over									
Civilian labor force	8,424	8,423	8,427	8,403	8,330	8,561	8,567	8,447	8,400
Participation rate	65.8	64.9	64.8	65.6	64.4	64.5	63.7	65.1	64.6
Employed	7,882	7,666	7,622	7,867	7,628	7,853	7,826	7,587	7,606
Employment-population ratio	61.6	59.0	58.6	61.5	58.9	59.1	59.0	58.6	58.5
Unemployed	542	757	805	536	702	708	742	860	794
Unemployment rate	6.4	9.0	9.6	6.4	8.4	8.3	8.7	10.2	9.5
Both sexes, 16 to 19 years									
Civilian labor force	895	858	870	839	894	943	912	954	913
Participation rate	36.1	34.4	34.8	37.9	35.6	37.8	36.6	38.3	36.6
Employed	682	578	623	598	619	680	630	617	637
Employment-population ratio	27.5	23.1	25.0	25.1	24.8	27.2	25.3	24.7	25.6
Unemployed	213	284	247	241	274	263	282	338	276
Unemployment rate	23.8	33.0	28.4	28.7	30.7	27.9	31.0	35.4	30.2
Men	27.2	35.4	34.7	30.0	32.1	30.3	36.9	37.3	38.8
Women	20.8	30.8	20.7	21.5	29.8	25.6	24.7	33.5	22.5

See footnotes at end of table.

Table A-2. Employment status of the civilian population by race, sex, age, and Hispanic origin — Continued

(Numbers in thousands)

Employment status, race, sex, age, and Hispanic origin	Not seasonally adjusted			Seasonally adjusted[1]					
	May 2001	Apr. 2002	May 2002	May 2001	Jan. 2002	Feb. 2002	Mar. 2002	Apr. 2002	May 2002
HISPANIC ORIGIN									
Civilian noninstitutional population	23,021	23,732	23,797	23,021	23,642	23,604	23,664	23,732	23,797
Civilian labor force	15,592	16,135	16,002	15,658	15,968	16,011	15,906	16,156	16,065
Participation rate	67.7	68.0	67.2	68.0	67.9	67.8	67.2	68.1	67.6
Employed	14,707	14,906	14,978	14,684	14,700	14,867	14,743	14,877	14,963
Employment-population ratio	63.9	62.8	62.9	63.6	62.4	63.0	62.3	62.7	62.9
Unemployed	885	1,229	1,024	972	1,268	1,143	1,165	1,279	1,102
Unemployment rate	5.7	7.6	6.4	6.2	8.1	7.1	7.3	7.9	7.0

[1] The population figures are not adjusted for seasonal variation; therefore, identical numbers appear in the unadjusted and seasonally adjusted columns.

NOTE: Detail for the above race and Hispanic-origin groups will not sum to totals because data for the "other races" group are not presented and Hispanics are included in both the white and black population groups.

Table A-3. Employment status of the civilian population 25 years and over by educational attainment

(Numbers in thousands)

Educational attainment	Not seasonally adjusted			Seasonally adjusted[1]					
	May 2001	Apr. 2002	May 2002	May 2001	Jan. 2002	Feb. 2002	Mar. 2002	Apr. 2002	May 2002
Less than a high school diploma									
Civilian noninstitutional population	28,350	28,155	28,073	28,350	28,078	27,920	27,858	28,155	28,073
Civilian labor force	12,297	12,530	12,436	12,187	12,112	12,172	12,187	12,410	12,356
Percent of population	43.4	44.5	44.3	43.0	43.1	44.4	43.7	44.1	44.0
Employed	11,580	11,458	11,508	11,374	11,126	11,165	11,206	11,297	11,306
Employment-population ratio	40.8	40.7	41.0	40.1	39.6	40.7	40.2	40.1	40.3
Unemployed	718	1,072	928	813	986	1,008	980	1,113	1,051
Unemployment rate	5.8	8.6	7.4	6.7	8.1	8.3	8.0	8.9	8.5
High school graduates, no college[2]									
Civilian noninstitutional population	57,458	56,904	57,083	57,458	57,606	57,382	57,327	56,904	57,083
Civilian labor force	37,146	36,711	36,774	36,954	36,673	37,023	36,411	36,527	36,647
Percent of population	64.7	64.5	64.5	64.3	63.7	64.5	63.5	64.2	64.2
Employed	35,826	34,700	34,917	35,509	34,766	35,078	34,450	34,458	34,605
Employment-population ratio	62.4	61.0	61.2	61.8	60.4	61.2	60.1	60.6	60.6
Unemployed	1,323	2,011	1,857	1,445	1,907	1,945	1,961	2,069	2,042
Unemployment rate	3.6	5.5	5.1	3.9	5.2	5.3	5.4	5.7	5.6
Less than a bachelor's degree[3]									
Civilian noninstitutional population	44,676	44,670	44,541	44,676	45,073	45,350	45,064	44,670	44,541
Civilian labor force	32,983	32,593	32,556	33,184	33,516	32,894	32,866	32,845	32,786
Percent of population	74.0	73.0	73.1	74.4	74.4	72.5	72.9	73.5	73.6
Employed	32,063	31,095	31,090	32,180	32,117	31,527	31,467	31,314	31,184
Employment-population ratio	71.9	69.6	69.8	72.2	71.3	69.5	69.8	70.1	70.0
Unemployed	921	1,498	1,466	1,004	1,398	1,369	1,399	1,532	1,602
Unemployment rate	2.8	4.6	4.5	3.0	4.2	4.1	4.3	4.7	4.9
College graduates									
Civilian noninstitutional population	48,271	48,373	48,583	48,271	46,965	47,636	47,676	48,373	48,583
Civilian labor force	38,282	38,356	38,358	38,669	37,106	37,773	37,852	38,394	38,358
Percent of population	79.3	79.3	79.0	79.2	79.0	79.3	79.4	79.4	79.0
Employed	37,567	37,311	37,313	37,911	36,013	36,681	36,833	37,236	37,239
Employment-population ratio	77.8	77.1	76.8	77.8	76.6	77.0	77.3	77.0	76.6
Unemployed	704	1,045	1,044	758	1,093	1,092	1,019	1,158	1,121
Unemployment rate	1.9	2.7	2.7	2.1	2.9	2.9	2.7	3.0	2.9

[1] The population figures are not adjusted for seasonal variation; therefore, identical numbers appear in the unadjusted and seasonally adjusted columns.

[2] Includes high school diploma or equivalent.

[3] Includes the categories, some college, no degree; and associate degree.

Table A-4. Selected employment indicators

(In thousands)

Category	Not seasonally adjusted			Seasonally adjusted					
	May 2001	Apr. 2002	May 2002	May 2001	Jan. 2002	Feb. 2002	Mar. 2002	Apr. 2002	May 2002
CHARACTERISTIC									
Total employed, 16 years and over	135,202	133,740	134,385	135,235	133,468	134,319	133,894	133,976	134,417
Married men, spouse present	43,471	43,081	43,374	43,633	42,823	43,275	43,317	43,167	43,548
Married women, spouse present	33,787	33,680	33,471	33,892	33,174	33,703	33,352	33,446	33,371
Women who maintain families	8,318	8,282	8,372	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
OCCUPATION									
Managerial and professional specialty	41,984	42,216	41,987	41,913	41,658	41,966	41,908	42,157	41,901
Technical, sales, and administrative support	38,743	39,102	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Service occupations	18,260	19,768	18,891	18,272	18,553	18,612	18,722	18,749	18,909
Precision production, craft, and repair	15,007	14,117	14,437	14,939	14,432	14,335	14,412	14,274	14,385
Operators, fabricators, and laborers	17,736	17,265	17,292	17,911	17,032	17,868	17,482	17,377	17,403
Farming, forestry, and fishing	3,472	3,274	3,490	3,249	3,487	3,334	3,238	3,290	3,265
CLASS OF WORKER									
Agriculture:									
Wage and salary workers	2,080	1,902	2,031	1,957	1,977	1,930	1,825	1,898	1,911
Self-employed workers	1,264	1,218	1,208	1,208	1,311	1,293	1,264	1,218	1,156
Unpaid family workers	30	31	43	34	49	21	29	34	40
Nonagricultural industries:									
Wage and salary workers	123,166	122,184	122,875	123,530	122,145	122,770	122,545	122,366	123,071
Government	19,106	19,541	19,851	19,068	19,047	19,286	19,218	19,347	19,811
Private industries	104,061	102,643	102,825	104,462	103,098	103,485	103,327	103,019	103,260
Private households	792	805	773	795	726	709	677	791	775
Other industries	103,268	101,838	102,052	103,667	102,373	102,776	102,650	102,228	102,485
Self-employed workers	8,555	8,308	8,314	8,540	8,213	8,257	8,200	8,234	8,305
Unpaid family workers	100	99	94	111	97	86	89	103	105
PERSONS AT WORK PART TIME									
All industries:									
Part time for economic reasons	3,270	3,927	3,856	3,369	3,973	4,228	3,897	4,151	3,998
Slack work or business conditions	2,094	2,599	2,497	2,205	2,549	2,755	2,721	2,680	2,828
Could only find part-time work	917	1,091	1,058	921	1,089	1,120	1,021	1,131	1,064
Part time for noneconomic reasons	18,697	19,774	19,152	18,634	18,291	18,395	18,530	18,783	18,687
Nonagricultural industries:									
Part time for economic reasons	3,124	3,812	3,689	3,231	3,787	3,998	3,848	4,009	3,818
Slack work or business conditions	1,989	2,509	2,382	2,101	2,448	2,615	2,606	2,587	2,515
Could only find part-time work	891	1,080	1,022	890	1,068	1,080	1,001	1,180	1,080
Part time for noneconomic reasons	18,368	19,206	18,806	18,097	17,717	17,886	18,004	18,274	18,359

NOTE: Persons at work excludes employed persons who were absent from their jobs during the entire reference week for reasons such as vacation, illness, or industrial dispute. Part time for noneconomic reasons excludes persons who usually work full time but worked only 1 to 34 hours during the reference week for reasons such as holidays, illness, and bad weather.

Table A-5. Selected unemployment indicators, seasonally adjusted

Category	Number of unemployed persons (in thousands)			Unemployment rates[1]					
	May 2001	Apr. 2002	May 2002	May 2001	Jan. 2002	Feb. 2002	Mar. 2002	Apr. 2002	May 2002
CHARACTERISTIC									
Total, 16 years and over	6,210	8,594	8,351	4.4	5.6	5.5	5.7	6.0	5.8
Men, 20 years and over	2,770	3,905	3,781	3.9	5.2	5.0	5.2	5.4	5.2
Women, 20 years and over	2,352	3,391	3,260	3.8	4.8	5.0	[illegible]	5.4	[illegible]
Both sexes, 16 to 19 years	1,088	1,298	1,310	13.3	16.1	15.6	16.4	16.8	16.9
Married men, spouse present	1,147	1,771	1,646	2.5	3.5	3.4	3.4	3.9	3.6
Married women, spouse present	1,002	1,368	1,354	2.9	3.4	3.8	3.7	3.8	3.9
Women who maintain families	560	779	738	6.2	7.9	8.0	7.3	8.8	8.1
Full-time workers	5,077	7,329	6,951	4.3	5.7	5.7	5.8	6.2	5.9
Part-time workers	1,154	1,290	1,426	4.8	5.2	4.8	5.2	5.2	5.6
OCCUPATION[2]									
Managerial and professional specialty	844	1,333	1,372	2.0	2.9	3.1	3.3	3.1	3.2
Technical, sales, and administrative support	1,529	2,205	2,109	3.8	4.9	5.0	5.3	5.5	5.2
Precision production, craft, and repair	685	939	904	4.4	6.3	5.6	6.3	6.5	5.9
Operators, fabricators, and laborers	1,400	1,785	1,709	7.2	8.5	8.7	8.7	8.4	8.8
Farming, forestry, and fishing	247	213	210	7.1	7.9	7.1	[illegible]	6.1	6.6
INDUSTRY									
Nonagricultural private wage and salary workers	5,001	7,135	6,821	4.6	5.9	6.0	6.1	6.5	6.3
Goods-producing industries	1,529	2,148	2,001	5.5	7.4	7.1	7.8	7.9	7.4
Mining	30	33	21	4.9	5.9	4.5	6.3	6.0	4.4
Construction	544	778	729	6.7	9.4	7.9	8.8	9.2	8.9
Manufacturing	955	1,338	1,251	4.5	6.6	6.7	7.0	7.2	6.7
Durable goods	590	838	695	4.8	7.0	7.5	7.5	7.8	6.3
Nondurable goods	365	499	556	4.6	5.9	5.5	6.3	6.6	7.5
Service-producing industries	3,472	4,987	4,821	4.3	5.4	5.5	5.5	6.0	5.9
Transportation and public utilities	300	497	467	3.2	6.2	5.8	5.4	6.1	5.7
Wholesale and retail trade	1,445	2,008	2,001	5.2	6.3	6.5	6.5	7.2	7.0
Finance, insurance, and real estate	192	270	337	2.4	3.2	2.8	3.1	3.2	4.0
Services	1,535	2,212	2,115	4.2	6.4	5.5	5.4	5.8	5.6
Government workers	392	503	537	2.7	[illegible]	2.7	2.9	2.6	2.9
Agricultural wage and salary workers	160	188	191	8.4	10.3	9.5	12.4	9.0	9.1

[1] Unemployment as a percent of the civilian labor force.
[2] Seasonally adjusted unemployment data for service occupations are not available because the seasonal component, which is small relative to the trend-cycle and irregular components, cannot be separated with sufficient precision.

Table A-6. Duration of unemployment

(Numbers in thousands)

Duration	Not seasonally adjusted			Seasonally adjusted					
	May 2001	Apr. 2002	May 2002	May 2001	Jan. 2002	Feb. 2002	Mar. 2002	Apr. 2002	May 2002
NUMBER OF UNEMPLOYED									
Less than 5 weeks	2,552	2,511	2,501	2,714	2,878	2,228	3,078	2,793	2,676
5 to 14 weeks	1,673	2,572	2,103	2,021	2,368	2,615	2,411	2,818	2,531
15 weeks and over	1,521	3,052	2,984	1,503	2,546	2,561	2,638	2,854	2,852
15 to 26 weeks	917	1,573	1,443	862	1,418	1,383	1,365	1,393	1,316
27 weeks and over	634	1,480	1,541	641	1,127	1,178	1,333	1,464	1,536
Average (mean) duration, in weeks	12.4	17.2	17.1	12.4	14.6	15.0	15.4	16.6	17.1
Median duration, in weeks	6.2	10.4	8.4	6.4	8.8	8.1	8.1	8.9	9.6
PERCENT DISTRIBUTION									
Total unemployed	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Less than 5 weeks	45.4	30.8	35.5	43.6	36.7	35.8	37.6	33.0	34.4
5 to 14 weeks	28.6	31.6	25.7	32.4	31.9	31.8	29.6	33.3	30.3
15 weeks and over	26.0	37.6	37.8	24.1	31.4	32.4	32.9	33.7	35.3
15 to 26 weeks	15.7	19.3	18.3	13.8	17.5	17.5	16.6	16.1	16.7
27 weeks and over	10.3	18.3	19.5	10.3	13.8	14.9	16.3	17.6	19.6

Table A-7. Reason for unemployment

(Numbers in thousands)

Reason	Not seasonally adjusted			Seasonally adjusted					
	May 2001	Apr. 2002	May 2002	May 2001	Jan. 2002	Feb. 2002	Mar. 2002	Apr. 2002	May 2002
NUMBER OF UNEMPLOYED									
Job losers and persons who completed temporary jobs	[illegible]	4,488	4,115	[illegible]	4,354	4,320	4,270	4,523	4,596
On temporary layoff	801	1,089	836	1,055	1,124	1,108	1,066	1,095	1,091
Not on temporary layoff	2,001	3,399	3,279	2,077	3,231	3,220	3,204	3,430	3,506
Permanent job losers	1,602	2,666	2,447	(1)	(1)	(1)	(1)	(1)	(1)
Persons who completed temporary jobs	400	732	832	(1)	(1)	(1)	(1)	(1)	(1)
Job leavers	733	945	809	818	879	877	862	1,017	902
Reentrants	1,956	2,281	2,474	1,927	2,191	2,268	2,471	2,450	2,433
New entrants	455	473	491	467	479	485	557	519	489
PERCENT DISTRIBUTION									
Total unemployed	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Job losers and persons who completed temporary jobs	47.9	54.8	52.2	50.2	55.1	54.4	52.3	53.2	54.5
On temporary layoff	13.7	13.1	10.6	16.9	14.2	13.9	13.1	12.9	12.9
Not on temporary layoff	34.2	41.7	41.6	33.3	40.9	40.5	39.3	40.3	41.6
Job leavers	12.5	11.6	10.3	13.1	11.1	11.0	10.6	12.0	10.7
Reentrants	31.7	27.8	31.4	29.3	27.7	29.6	30.3	28.8	28.9
New entrants	7.8	5.8	6.2	7.5	6.1	6.1	6.8	6.1	5.9
UNEMPLOYED AS A PERCENT OF THE CIVILIAN LABOR FORCE									
Job losers and persons who completed temporary jobs	2.0	3.1	2.9	2.2	3.1	3.0	3.0	3.2	3.2
Job leavers	.5	.7	.6	.6	.5	.5	.5	.7	.6
Reentrants	1.3	1.6	1.7	1.3	1.5	1.5	1.7	1.7	1.7
New entrants	.3	.3	.3	.3	.3	.3	.4	.4	.3

[1] Not available.

Table A-8. Range of alternative measures of labor underutilization

(Percent)

Measure	Not seasonally adjusted			Seasonally adjusted					
	May 2001	Apr. 2002	May 2002	May 2001	Jan. 2002	Feb. 2002	Mar. 2002	Apr. 2002	May 2002
U-1 Persons unemployed 15 weeks or longer, as a percent of the civilian labor force	1.1	2.2	2.1	1.1	1.8	1.9	1.9	2.0	2.1
U-2 Job losers and persons who completed temporary jobs, as a percent of the civilian labor force	2.0	3.1	2.9	2.2	3.1	3.0	3.0	3.2	3.2
U-3 Total unemployed, as a percent of the civilian labor force (official unemployment rate)	4.1	5.7	5.5	4.4	5.6	5.5	5.7	6.0	5.8
U-4 Total unemployed plus discouraged workers, as a percent of the civilian labor force plus discouraged workers	4.4	6.0	5.8	(1)	(1)	(1)	(1)	(1)	(1)
U-5 Total unemployed, plus discouraged workers, plus all other marginally attached workers, as a percent of the civilian labor force plus all marginally attached workers	4.9	6.7	6.6	(1)	(1)	(1)	(1)	(1)	(1)
U-6 Total unemployed, plus all marginally attached workers, plus total employed part time for economic reasons, as a percent of the civilian labor force plus all marginally attached workers	7.2	9.4	9.2	(1)	(1)	(1)	(1)	(1)	(1)

[1] Not available.

NOTE: This range of alternative measures of labor underutilization replaces the U1-U7 range published in table A-7 of this release prior to 1994. Marginally attached workers are persons who currently are neither working nor looking for work but indicate that they want and are available for a job and have looked for work sometime in the recent past. Discouraged workers, a subset of the marginally attached, have given a job-market related reason for not currently looking for a job. Persons employed part time for economic reasons are those who want and are available for full-time work but have had to settle for a part-time schedule. For further information, see "BLS introduces new range of alternative unemployment measures," in the October 1995 issue of the *Monthly Labor Review*.

HOUSEHOLD DATA

Table A-9. Unemployed persons by sex and age, seasonally adjusted

Age and sex	Number of unemployed persons (in thousands)			Unemployment rates[1]					
	May 2001	Apr. 2002	May 2002	May 2001	Jan. 2002	Feb. 2002	Mar. 2002	Apr. 2002	May 2002
Total, 16 years and over	6,210	8,584	8,351	4.4	5.6	5.5	5.7	6.0	5.8
16 to 24 years	2,230	2,764	2,627	10.0	11.9	11.6	12.6	12.2	11.4
16 to 19 years	1,088	1,258	1,310	13.3	16.1	15.6	16.4	16.8	16.9
16 to 17 years	498	587	596	15.8	17.0	16.6	19.0	18.4	20.7
18 to 19 years	591	730	717	12.5	15.2	14.7	15.1	15.1	14.8
20 to 24 years	1,142	1,406	1,318	7.9	9.7	9.5	10.3	10.0	9.9
25 years and over	3,987	5,881	5,781	3.4	4.4	4.5	4.6	4.9	4.8
25 to 54 years	3,350	4,972	4,991	3.5	4.7	4.8	4.7	5.0	5.0
55 years and over	483	788	838	2.6	3.5	3.8	3.5	4.0	4.2
Men, 16 years and over	3,383	4,511	4,521	4.5	5.8	5.8	5.9	6.1	5.9
16 to 24 years	1,252	1,500	1,471	11.0	12.5	12.4	13.7	13.0	12.6
16 to 19 years	629	707	740	14.4	16.5	16.9	19.6	19.1	19.9
16 to 17 years	293	287	358	17.2	17.8	19.5	20.8	19.8	23.7
18 to 19 years	340	423	382	13.9	15.1	15.4	16.7	17.2	15.8
20 to 24 years	639	794	730	8.7	10.8	10.2	11.1	10.3	8.4
25 years and over	2,132	3,108	3,110	3.5	4.5	4.4	4.6	4.8	4.8
25 to 54 years	1,843	2,618	2,631	3.4	4.7	4.5	4.7	4.9	4.9
55 years and over	289	[illegible]	[illegible]	2.9	3.8	4.1	3.6	4.3	4.6
Women, 16 years and over	2,817	3,982	3,830	4.3	5.4	5.5	5.5	6.0	5.8
16 to 24 years	948	1,264	1,156	8.6	11.3	10.7	11.2	11.8	10.7
16 to 19 years	463	582	570	12.1	15.8	14.3	14.3	15.4	15.2
16 to 17 years	215	278	236	12.8	16.4	13.5	15.8	19.0	17.4
18 to 19 years	251	308	335	11.0	15.2	13.9	13.4	12.9	14.1
20 to 24 years	483	682	586	7.0	8.7	8.7	9.4	8.6	8.3
25 years and over	1,865	2,704	2,681	3.4	4.3	4.6	4.4	5.0	4.8
25 to 54 years	1,667	2,367	2,381	3.6	4.8	4.7	4.6	5.1	5.1
55 years and over	200	334	341	2.4	3.0	3.5	3.4	3.7	3.7

[1] Unemployment as a percent of the civilian labor force.

Table A-10. Persons not in the labor force and multiple jobholders by sex, not seasonally adjusted

(Numbers in thousands)

Category	Total		Men		Women	
	May 2001	May 2002	May 2001	May 2002	May 2001	May 2002
NOT IN THE LABOR FORCE						
Total not in the labor force	70,477	71,405	26,410	26,694	44,067	44,710
Persons who currently want a job	5,161	5,472	2,352	2,523	2,810	2,949
Searched for work and available to work now[1]	1,149	1,450	639	785	510	664
Reason not currently looking:						
Discouragement over job prospects[2]	325	407	236	245	89	162
Reasons other than discouragement[3]	824	1,043	403	639	421	403
MULTIPLE JOBHOLDERS						
Total multiple jobholders[4]	7,482	7,161	3,880	3,679	3,602	3,482
Percent of total employed	5.6	5.3	5.4	5.1	5.7	5.6
Primary job full time, secondary job part time	3,942	3,828	2,273	2,158	1,672	1,668
Primary and secondary jobs both part time	1,640	1,666	540	606	1,100	1,060
Primary and secondary jobs both full time	274	289	184	196	91	93
Hours vary on primary or secondary job	1,585	1,439	879	787	705	632

[1] Data refer to persons who have searched for work during the prior 12 months and were available to take a job during the reference week.

[2] Includes thinks no work available, could not find work, lacks schooling or training, employer thinks too young or old, and other types of discrimination.

[3] Includes those who did not actively look for work in the prior 4 weeks for such reasons as child-care and transportation problems, as well as a small number for which reason for nonparticipation was not determined.

[4] Includes persons who work part time on their primary job and full time on their secondary job(s), not shown separately.

Table B-1. Employees on nonfarm payrolls by industry

(In thousands)

Industry	Not seasonally adjusted				Seasonally adjusted					
	May 2001	Mar. 2002	Apr. 2002p	May 2002p	May 2001	Jan. 2002	Feb. 2002	Mar. 2002	Apr. 2002p	May 2002p
Total	132,851	129,875	130,637	131,477	132,229	130,871	130,705	130,701	130,707	130,748
Total private	111,602	108,368	109,046	109,849	111,376	109,724	109,544	109,505	109,539	109,550
Goods-producing	25,172	23,818	23,701	23,925	25,147	24,130	24,041	23,975	23,903	23,860
Mining	566	550	557	551	565	558	564	560	563	560
Metal mining	38.5	31.8	32.1	32.2	37	33	33	32	33	32
Coal mining	73.1	80.7	80.8	80.2	78	82	82	81	81	80
Oil and gas extraction	337.7	331.0	333.4	333.1	340	342	339	336	338	335
Nonmetallic minerals, except fuels	118.2	106.5	110.7	115.3	111	111	111	111	112	113
Construction	6,768	6,206	6,399	6,595	6,714	6,615	6,597	6,593	6,540	6,539
General building contractors	1,460.6	1,307.7	1,414.8	1,443.4	1,465	1,459	1,458	1,462	1,451	1,448
Heavy construction, except building	950.0	810.6	875.4	932.2	921	919	914	908	901	900
Special trade contractors	4,357.1	3,997.3	4,108.4	4,219.7	4,328	4,237	4,225	4,223	4,188	4,191
Manufacturing	17,838	16,762	16,745	16,769	17,867	16,947	16,880	16,822	16,800	16,781
Production workers	12,044	11,225	11,222	11,247	12,065	11,362	11,305	11,264	11,256	11,246
Durable goods	10,767	9,868	9,983	9,976	10,769	10,070	10,023	9,976	9,977	9,971
Production workers	7,236	6,614	6,622	6,636	7,230	6,690	6,653	6,625	6,624	6,619
Lumber and wood products	784.0	753.7	756.6	768.5	788	771	771	769	767	759
Furniture and fixtures	529.8	493.3	488.9	486.5	529	492	491	491	496	493
Stone, clay, and glass products	577.4	541.1	549.0	556.3	574	556	551	550	551	550
Primary metal industries	664.3	597.1	596.4	596.1	666	607	601	596	596	598
Blast furnaces and basic steel products	210.9	186.6	186.9	187.3	(1)	(1)	(1)	(1)	(1)	(1)
Fabricated metal products	1,498.5	1,419.7	1,422.7	1,422.9	1,493	1,427	1,426	1,422	1,425	1,427
Industrial machinery and equipment	2,053.3	1,861.3	1,844.8	1,842.3	2,049	1,868	1,856	1,846	1,843	1,837
Computer and office equipment	352.8	314.2	310.8	306.2	353	317	315	315	313	306
Electronic and other electrical equipment	1,666.8	1,449.5	1,441.1	1,434.1	1,672	1,478	1,459	1,445	1,442	1,437
Electronic components and accessories	682.6	570.2	566.2	563.2	684	582	571	566	565	566
Transportation equipment	1,774.1	1,672.8	1,673.6	1,682.1	1,771	1,680	1,682	1,674	1,672	1,679
Motor vehicles and equipment	955.3	915.2	913.5	917.7	952	902	913	915	912	914
Aircraft and parts	462.3	417.2	415.2	414.6	464	437	427	419	417	417
Instruments and related products	843.9	810.6	809.0	807.3	845	818	816	813	811	807
Miscellaneous manufacturing	381.1	368.9	371.0	371.9	382	374	372	370	372	373
Nondurable goods	7,071	6,894	6,762	6,793	7,098	6,877	6,857	6,846	6,823	6,810
Production workers	4,809	4,611	4,600	4,611	4,835	4,672	4,652	4,639	4,632	4,628
Food and kindred products	1,688.4	1,655.3	1,657.6	1,668.2	1,691	1,686	1,686	1,685	1,680	1,686
Tobacco products	31.8	32.9	32.3	32.3	34	34	33	34	33	34
Textile mill products	485.1	438.0	435.3	434.9	485	444	441	440	436	434
Apparel and other textile products	579.8	527.9	523.3	523.2	576	536	531	527	523	520
Paper and allied products	636.6	617.1	612.4	611.6	636	622	621	620	615	612
Printing and publishing	1,498.0	1,418.9	1,407.2	1,402.3	1,503	1,437	1,426	1,419	1,411	1,407
Chemicals and allied products	1,022.8	1,009.2	1,007.2	1,007.2	1,022	1,008	1,011	1,010	1,008	1,007
Petroleum and coal products	125.6	123.0	124.0	125.9	126	126	126	126	124	125
Rubber and misc. plastics products	984.3	927.3	927.2	930.9	984	928	924	929	927	930
Leather and leather products	61.7	58.2	55.6	58.2	61	56	56	56	56	55
Service-producing	107,679	106,057	106,936	107,552	107,082	106,741	106,666	106,726	106,804	106,888
Transportation and public utilities	7,137	6,757	6,769	6,810	7,131	6,850	6,837	6,814	6,802	6,802
Transportation	4,552	4,282	4,305	4,341	4,546	4,343	4,341	4,330	4,331	4,331
Railroad transportation	235.8	231.8	233.9	234.8	236	235	234	233	233	233
Local and interurban passenger transit	499.3	481.3	488.8	494.8	480	481	479	478	477	476
Trucking and warehousing	1,850.7	1,791.2	1,808.4	1,828.9	1,856	1,824	1,826	1,819	1,830	1,829
Water transportation	193.5	177.0	184.7	193.6	192	188	187	186	189	191
Transportation by air	1,284.4	1,159.8	1,148.9	1,152.0	1,296	1,171	1,171	1,172	1,160	1,161
Pipelines, except natural gas	14.9	14.9	14.8	14.4	15	15	15	15	15	15
Transportation services	473.1	428.0	425.7	424.9	473	429	429	427	427	426
Communications and public utilities	2,585	2,475	2,464	2,469	2,585	2,507	2,496	2,484	2,471	2,471
Communications	1,732.9	1,638.9	1,625.8	1,628.2	1,732	1,660	1,652	1,643	1,629	1,630
Electric, gas, and sanitary services	851.7	836.9	838.1	841.0	853	847	844	841	842	841
Wholesale trade	6,795	6,646	6,663	6,682	6,794	6,702	6,689	6,681	6,679	6,678
Durable goods	4,042	3,897	3,902	3,913	4,044	3,940	3,924	3,912	3,909	3,915
Nondurable goods	2,753	2,749	2,761	2,769	2,750	2,762	2,765	2,769	2,770	2,763

See footnotes at end of table.

ESTABLISHMENT DATA

Table B-1. Employees on nonfarm payrolls by industry—Continued

(In thousands)

Industry	Not seasonally adjusted				Seasonally adjusted					
	May 2001	Mar. 2002	Apr. 2002p	May 2002p	May 2001	Jan. 2002	Feb. 2002	Mar. 2002	Apr. 2002p	May 2002p
Retail trade	23,582	22,887	23,124	23,372	23,566	23,398	23,331	23,332	23,367	23,340
Building materials and garden supplies	1,087.6	1,019.0	1,074.2	1,115.0	1,041	1,049	1,048	1,053	1,081	1,057
General merchandise stores	2,843.7	2,804.8	2,824.0	2,828.3	2,916	2,868	2,892	2,901	2,918	2,899
Department stores	2,512.8	2,475.2	2,495.5	2,498.8	2,577	2,520	2,550	2,560	2,576	2,562
Food stores	3,432.3	3,360.3	3,362.3	3,385.8	3,453	3,421	3,402	3,392	3,390	3,399
Automotive dealers and service stations	2,425.1	2,404.3	2,421.7	2,440.5	2,427	2,438	2,430	2,428	2,429	2,437
New and used car dealers	1,117.0	1,126.8	1,127.5	1,132.8	1,118	1,133	1,134	1,131	1,129	1,135
Apparel and accessory stores	1,173.9	1,137.9	1,142.1	1,151.8	1,199	1,187	1,172	1,175	1,171	1,174
Furniture and home furnishings stores	1,118.5	1,135.8	1,128.0	1,131.8	1,135	1,138	1,143	1,143	1,141	1,147
Eating and drinking places	8,404.0	8,023.7	8,148.8	8,272.0	8,270	8,238	8,161	8,154	8,184	8,131
Miscellaneous retail establishments	3,095.7	3,025.1	3,022.8	3,047.0	3,131	3,089	3,083	3,068	3,095	3,083
Finance, insurance, and real estate	7,719	7,700	7,714	7,749	7,719	7,748	7,745	7,740	7,743	7,743
Finance	3,803	3,802	3,803	3,816	3,807	3,819	3,812	3,809	3,813	3,817
Depository institutions	2,050.0	2,070.0	2,068.8	2,073.2	2,062	2,078	2,072	2,074	2,075	2,075
Commercial banks	1,432.7	1,442.5	1,441.8	1,446.1	1,433	1,450	1,446	1,447	1,448	1,447
Savings institutions	254.6	284.2	283.7	283.8	255	282	283	284	284	284
Nondepository institutions	712.9	753.2	764.1	767.0	713	755	754	753	758	757
Mortgage bankers and brokers	321.4	360.0	359.0	361.2	320	363	359	357	354	358
Security and commodity brokers	782.7	718.4	720.9	722.4	785	729	726	722	723	723
Holding and other investment offices	257.8	260.6	259.8	263.2	257	259	260	260	259	262
Insurance	2,365	2,373	2,369	2,371	2,367	2,372	2,376	2,375	2,375	2,373
Insurance carriers	1,595.2	1,589.3	1,587.0	1,586.1	1,596	1,594	1,593	1,591	1,590	1,586
Insurance agents, brokers, and service	769.8	783.6	782.4	785.3	771	778	783	784	785	787
Real estate	1,561	1,525	1,542	1,562	1,543	1,557	1,557	1,558	1,555	1,553
Services[2]	41,187	40,738	41,074	41,305	41,018	40,908	40,901	40,963	41,039	41,107
Agricultural services	908.3	783.0	870.8	927.8	848	866	868	872	858	869
Hotels and other lodging places	1,902.8	1,740.9	1,753.4	1,799.7	1,809	1,811	1,811	1,811	1,795	1,783
Personal services	1,249.3	1,357.1	1,357.0	1,285.0	1,287	1,290	1,282	1,289	1,289	1,279
Business services	9,619.5	9,120.3	9,207.8	9,312.1	9,846	9,231	9,207	9,237	9,318	9,337
Services to buildings	1,025.1	1,012.1	1,025.0	1,028.9	1,021	1,022	1,018	1,021	1,020	1,021
Personnel supply services	3,503.0	3,012.9	3,088.9	3,183.3	3,519	3,088	3,070	3,137	3,179	3,198
Help supply services	3,100.0	2,703.9	2,772.9	2,862.3	3,149	2,701	2,756	2,785	2,858	2,884
Computer and data processing services	2,227.5	2,205.0	2,192.0	2,192.0	2,232	2,213	2,208	2,198	2,190	2,194
Auto repair, services, and parking	1,253.3	1,258.5	1,262.4	1,264.9	1,262	1,262	1,262	1,260	1,262	1,263
Miscellaneous repair services	374.4	374.3	375.9	376.1	374	378	379	377	376	375
Motion pictures	578.4	572.9	572.6	580.2	578	581	574	572	574	579
Amusement and recreation services	1,840.8	1,469.2	1,600.9	1,711.0	1,747	1,609	1,640	1,636	1,614	1,619
Health services	10,317.9	10,588.4	10,596.0	10,625.8	10,333	10,551	10,575	10,602	10,618	10,631
Offices and clinics of medical doctors	1,993.0	2,341.6	2,042.2	2,053.7	1,996	2,033	2,041	2,048	2,048	2,364
Nursing and personal care facilities	1,832.8	1,876.5	1,877.6	1,879.4	1,837	1,876	1,875	1,879	1,862	1,852
Hospitals	4,062.5	4,189.4	4,190.8	4,203.3	4,072	4,174	4,184	4,193	4,199	4,209
Home health care services	633.9	642.6	645.0	647.0	636	640	642	643	646	646
Legal services	1,028.6	1,049.9	1,049.9	1,058.7	1,036	1,053	1,054	1,058	1,058	1,064
Educational services	2,496.0	2,839.9	2,880.4	2,868.5	2,450	2,473	2,485	2,489	2,502	2,520
Social services	3,066.0	3,172.4	3,186.5	3,194.9	3,036	3,149	3,155	3,162	3,167	3,184
Child day care services	737.4	740.6	748.3	763.2	713	723	722	723	728	722
Residential care	856.6	887.7	889.2	889.0	857	896	899	902	902	900
Museums and botanical and zoological gardens	113.6	102.5	108.7	111.3	110	110	109	109	109	108
Membership organizations	2,462.7	2,450.1	2,466.0	2,475.4	2,468	2,471	2,471	2,470	2,478	2,479
Engineering and management services	3,572.3	3,640.2	3,639.9	3,645.3	3,582	3,624	3,629	3,631	3,634	3,657
Engineering and architectural services	1,051.2	1,032.9	1,029.7	1,039.8	1,054	1,047	1,044	1,044	1,039	1,043
Management and public relations	1,160.2	1,187.1	1,199.3	1,211.3	1,160	1,192	1,193	1,191	1,202	1,214
Services, nec	50.1	46.3	46.1	46.5	(1)	(1)	(1)	(1)	(1)	(1)
Government	21,259	21,509	21,592	21,634	20,854	21,137	21,162	21,196	21,184	21,198
Federal	2,815	2,601	2,603	2,609	2,812	2,609	2,606	2,611	2,611	2,604
Federal, except Postal Service	1,762.6	1,775.1	1,781.3	1,789.6	1,755	1,778	1,777	1,782	1,785	1,781
State	4,919	5,073	5,077	4,980	4,866	4,935	4,937	4,940	4,940	4,930
Education	2,136.0	2,283.3	2,282.7	2,184.7	2,081	2,127	2,130	2,133	2,133	2,136
Other State government	2,783.6	2,789.6	2,794.3	2,795.6	2,785	2,808	2,807	2,807	2,807	2,795
Local	13,725	13,935	13,912	14,045	13,376	13,593	13,617	13,645	13,633	13,664
Education	7,987.1	8,169.3	8,125.8	8,188.0	7,607	7,732	7,746	7,767	7,754	7,780
Other local government	5,737.7	5,765.4	5,785.9	5,857.4	5,769	5,861	5,871	5,878	5,879	5,884

[1] These series are not published seasonally adjusted because the seasonal component, which is small relative to the trend-cycle and irregular components, cannot be separated with sufficient precision.
[2] Includes other industries, not shown separately.
p = preliminary.

NOTE: Data have been revised to reflect March 2001 benchmarks; the introduction of probability-based sample estimates for transportation and public utilities; retail trade; and finance, insurance, and real estate; and recomputed seasonal adjustment factors.

Table B-2. Average weekly hours of production or nonsupervisory workers[1] on private nonfarm payrolls by industry

Industry	Not seasonally adjusted				Seasonally adjusted					
	May 2001	Mar. 2002	Apr. 2002p	May 2002p	May 2001	Jan. 2002	Feb. 2002	Mar. 2002	Apr. 2002p	May 2002p
Total private	34.1	33.9	34.0	34.1	34.2	34.1	34.2	34.2	34.2	34.2
Goods-producing	40.6	40.2	40.2	40.4	40.5	40.3	40.4	40.5	40.4	40.3
Mining	44.1	42.7	42.3	42.9	43.6	43.0	[illegible]	[illegible]	[illegible]	[illegible]
Construction	40.2	38.4	38.8	39.0	39.6	39.5	39.4	39.1	39.1	38.7
Manufacturing	40.7	40.9	40.9	40.9	40.8	40.6	40.7	41.0	40.9	40.9
Overtime hours	3.9	4.0	4.0	4.1	3.9	3.9	3.9	4.1	4.2	4.3
Durable goods	41.1	41.3	41.3	41.4	41.1	41.0	41.1	41.3	41.4	41.3
Overtime hours	3.9	4.0	4.0	4.2	3.9	3.9	3.9	4.1	4.1	4.2
Lumber and wood products	40.9	40.8	40.9	41.2	40.6	40.5	40.9	41.1	40.8	40.9
Furniture and fixtures	38.2	40.5	40.4	40.1	38.7	40.1	40.3	40.6	40.8	40.4
Stone, clay, and glass products	44.3	42.7	43.5	43.7	43.8	43.8	44.1	43.6	43.8	43.3
Primary metal industries	43.5	44.1	44.3	44.2	43.5	43.6	43.8	44.4	44.4	44.1
Blast furnaces and basic steel products	44.4	45.2	45.2	45.6	44.5	44.5	44.8	45.5	45.0	45.5
Fabricated metal products	41.4	41.6	41.4	41.7	41.5	41.3	41.6	41.7	41.6	41.6
Industrial machinery and equipment	40.8	40.7	40.4	40.7	40.8	40.1	40.1	40.5	40.5	40.7
Electronic and other electrical equipment	39.0	39.4	39.1	39.0	39.2	38.7	38.9	39.4	39.5	39.3
Transportation equipment	42.7	42.5	43.0	43.0	42.3	42.7	42.3	42.4	42.7	42.4
Motor vehicles and equipment	43.8	44.0	44.9	44.9	43.2	44.3	43.7	43.9	44.4	44.2
Instruments and related products	40.9	40.8	40.3	40.2	41.0	40.5	40.4	40.6	40.5	40.4
Miscellaneous manufacturing	37.9	39.0	38.6	38.4	37.9	38.2	38.4	38.8	38.6	38.4
Nondurable goods	40.1	40.2	40.1	40.2	40.3	40.0	40.2	40.4	40.3	40.4
Overtime hours	3.8	4.0	3.9	4.1	3.9	4.0	3.3	4.2	4.3	4.3
Food and kindred products	40.7	40.7	40.6	40.9	41.1	41.0	41.0	41.4	41.2	41.1
Tobacco products	38.9	40.8	41.1	41.7	38.9	41.4	41.4	41.2	41.5	41.6
Textile mill products	40.2	41.5	41.8	41.3	40.2	40.2	40.9	41.4	41.6	41.2
Apparel and other textile products	38.0	37.5	37.2	37.1	37.7	36.7	36.7	37.4	37.1	36.9
Paper and allied products	41.3	41.3	41.4	41.7	41.6	41.1	41.5	41.5	41.6	42.0
Printing and publishing	37.7	37.6	37.1	37.1	38.1	37.3	37.4	37.5	37.2	37.4
Chemicals and allied products	42.3	41.9	41.8	42.0	42.4	41.9	41.9	42.0	41.8	42.1
Petroleum and coal products	41.8	41.1	43.1	40.4	(2)	(2)	(2)	(2)	(2)	(2)
Rubber and misc. plastics products	40.6	41.1	41.2	41.2	40.6	40.5	40.9	41.1	41.5	41.2
Leather and leather products	38.2	37.2	37.6	37.2	[illegible]	37.0	37.2	37.3	37.7	37.2
Service-producing	32.6	32.6	32.5	32.8	32.7	32.7	32.7	32.8	32.8	32.8
Transportation and public utilities	38.1	38.0	38.0	38.3	38.2	38.1	38.2	[illegible]	[illegible]	[illegible]
Wholesale trade	38.2	38.1	38.2	38.3	38.3	38.2	38.3	38.4	[illegible]	[illegible]
Retail trade	28.7	28.7	28.8	29.1	28.8	28.9	29.0	29.1	29.1	29.2
Finance, insurance, and real estate	35.6	[illegible]	[illegible]	[illegible]	36.0	36.1	36.2	36.2	36.1	36.2
Services	32.5	32.5	32.4	32.4	32.7	32.8	32.6	32.6	32.6	32.6

[1] Data relate to production workers in mining and manufacturing; construction workers in construction; and nonsupervisory workers in transportation and public utilities; wholesale and retail trade; finance, insurance, and real estate; and services. These groups account for approximately four-fifths of the total employees on private nonfarm payrolls.

[2] This series is not published seasonally adjusted because the seasonal component, which is small relative to the trend-cycle and irregular components, cannot be separated with sufficient precision.

p = preliminary.

NOTE: Data have been revised to reflect March 2001 benchmarks; the introduction of probability-based sample estimates for transportation and public utilities; retail trade; and finance, insurance, and real estate; and recomputed seasonal adjustment factors.

 ESTABLISHMENT DATA

Table B-3. Average hourly and weekly earnings of production or nonsupervisory workers[1] on private nonfarm payrolls by industry

Industry	Average hourly earnings				Average weekly earnings			
	May 2001	Mar. 2002	Apr. 2002p	May 2002p	May 2001	Mar. 2002	Apr. 2002p	May 2002p
Total private	$14.21	$14.67	$14.63	$14.67	$484.68	$497.31	$498.46	$500.25
Seasonally adjusted	14.24	14.65	14.67	14.70	487.01	501.03	501.7	502.74
Goods-producing	15.83	16.19	16.28	16.30	642.70	650.84	653.65	658.52
Mining	17.42	17.73	17.68	17.68	768.22	757.07	747.86	758.47
Construction	18.18	18.66	18.68	18.65	730.84	718.64	724.78	727.36
Manufacturing	14.75	15.16	15.20	15.25	[illegible]	[illegible]	620.16	622.91
Durable goods	15.19	15.63	15.66	15.69	624.31	646.52	646.76	649.57
Lumber and wood products	12.16	12.36	12.32	12.44	497.34	503.83	503.89	512.53
Furniture and fixtures	12.13	12.57	12.65	12.60	483.37	509.09	507.02	505.26
Stone, clay, and glass products	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	673.85
Primary metal industries	16.78	17.20	17.25	17.32	729.93	758.52	764.18	765.54
Blast furnaces and basic steel products	20.26	20.66	20.71	20.80	899.64	933.83	936.09	948.48
Fabricated metal products	14.22	14.60	14.67	14.66	588.71	607.36	607.34	611.32
Industrial machinery and equipment	15.76	16.31	16.30	16.30	643.0	663.62	656.52	663.4
Electronic and other electrical equipment	14.30	14.83	14.86	14.92	[illegible]	[illegible]	581.33	581.88
Transportation equipment	18.88	19.65	19.72	19.67	806.18	836.13	847.96	845.8
Motor vehicles and equipment	19.23	20.09	20.24	20.18	842.27	883.96	906.78	905.18
Instruments and related products	14.67	15.12	15.11	15.13	600.00	6?8.90	606.93	608.23
Miscellaneous manufacturing	12.11	12.39	12.39	12.35	458.97	483.21	478.25	474.62
Nondurable goods	14.08	14.46	14.52	14.57	563.81	581.29	582.25	585.71
Food and kindred products	12.86	13.10	13.18	13.29	523.00	533.17	533.79	543.56
Tobacco products	22.39	22.47	22.92	23.12	870.97	912.28	942.01	984.10
Textile mill products	11.30	11.65	11.65	11.71	464.26	483.48	486.97	483.62
Apparel and other textile products	9.30	9.82	9.98	10.02	355.68	368.26	370.61	371.74
Paper and allied products	16.72	17.25	17.30	17.49	690.54	712.43	718.22	729.33
Printing and publishing	14.78	15.12	15.1	15.05	558.46	568.51	580.58	658.36
Chemicals and allied products	18.52	18.93	18.90	18.98	783.40	793.17	793.78	797.16
Petroleum and coal products	21.81	22.29	22.34	21.86	911.68	920.23	895.83	883.14
Rubber and misc. plastics products	13.29	13.61	13.69	13.63	539.57	559.37	564.03	563.62
Leather and leather products	10.24	10.40	10.43	10.39	370.69	388.88	392.17	386.51
Service-producing	13.72	14.25	14.25	14.21	447.27	463.13	463.13	463.25
Transportation and public utilities	16.65	17.24	17.31	17.24	634.37	658.12	657.78	660.29
Wholesale trade	15.71	16.13	16.09	16.09	630.12	614.55	614.64	616.25
Retail trade	9.67	9.96	10.01	9.97	277.53	286.43	288.29	290.13
Finance, insurance, and real estate	15.72	16.17	16.23	16.20	559.63	580.50	581.03	579.96
Services	14.52	15.16	15.15	15.13	471.90	492.70	490.86	490.21

[1] See footnote 1, table B-2.
p = preliminary.
NOTE: Data have been revised to reflect March 2001 benchmarks; the introduction of probability-based sample estimates for transportation and public utilities; retail trade; and finance, insurance, and real estate; and recomputed seasonal adjustment factors.

Table B-4. Average hourly earnings of production or nonsupervisory workers[1] on private nonfarm payrolls by industry, seasonally adjusted

Industry	May 2001	Jan. 2002	Feb. 2002	Mar. 2002	Apr. 2002[p]	May 2002[p]	Percent change from: Apr. 2002-May 2002
Total private:							
Current dollars	$14.24	$14.58	$14.62	$14.63	$14.67	$14.70	0.2
Constant (1982) dollars[2]	7.93	8.14	8.14	8.13	8.10	N.A.	(3)
Goods-producing	15.85	16.24	16.28	16.29	16.31	16.35	.2
Mining	17.49	17.59	17.66	17.72	17.61	17.81	1.1
Construction	18.24	18.65	18.69	18.74	18.81	18.73	-.3
Manufacturing	14.78	15.13	15.17	15.19	15.19	15.27	.5
Excluding overtime[4]	14.09	14.42	14.46	14.45	14.44	14.53	.6
Service-producing	13.76	14.11	14.14	14.18	14.21	14.24	.2
Transportation and public utilities	16.71	17.13	17.16	17.26	17.26	17.31	.3
Wholesale trade	15.75	16.10	16.19	16.23	16.09	16.13	.2
Retail trade	9.69	9.90	9.92	9.95	9.98	9.98	.0
Finance, insurance, and real estate	15.71	16.06	16.06	16.14	16.18	16.19	.1
Services	14.58	15.01	15.04	15.08	15.12	15.17	.3

1 See footnote 1, table B-2.

2 The Consumer Price Index for Urban Wage Earners and Clerical Workers (CPI-W) is used to deflate this series.

3 Change was -.4 percent from March 2002 to April 2002, the latest month available.

4 Derived by assuming that overtime hours are paid at the rate of time and one-half.

N.A. = not available.

p = preliminary.

NOTE: Data have been revised to reflect March 2001 benchmarks; the introduction of probability-based sample estimates for transportation and public utilities; retail trade; and finance, insurance, and real estate; and recomputed seasonal adjustment factors.

Table B-5. Indexes of aggregate weekly hours of production or nonsupervisory workers[1] on private nonfarm payrolls by industry

(1982=100)

Industry	Not seasonally adjusted				Seasonally adjusted					
	May 2001	Mar. 2002	Apr. 2002p	May 2002p	May 2001	Jan. 2002	Feb. 2002	Mar. 2002	Apr. 2002p	May 2002p
Total private	150.9	145.3	146.5	148.3	151.0	148.1	148.3	148.2	148.3	148.2
Goods-producing	112.6	100.8	100.0	100.3	111.8	106.2	106.1	106.0	105.5	[illegible]
Mining	55.7	52.1	52.6	53.5	55.5	54.2	54.6	54.0	53.3	53.4
Construction	192.3	164.1	172.2	179.5	187.4	182.4	182.3	178.1	178.8	176.3
Manufacturing	98.9	92.5	92.3	92.7	99.2	93.0	92.8	93.0	92.9	92.7
Durable goods	103.8	95.2	95.3	95.7	103.6	95.7	95.4	95.5	95.6	95.3
Lumber and wood products	137.0	130.7	131.6	134.9	136.7	132.8	134.1	134.7	133.9	134.6
Furniture and fixtures	126.0	[illegible]	[illegible]	[illegible]	127.4	121.3	121.9	123.2	124.7	122.6
Stone, clay, and glass products	121.3	108.8	112.7	115.3	118.9	114.4	114.6	113.1	113.6	112.6
Primary metal industries	86.0	78.3	78.7	76.7	85.3	78.4	78.4	78.7	77.1	78.7
Blast furnaces and basic steel products	65.0	57.8	58.1	58.7	65.5	57.9	57.9	58.4	58.2	58.8
Fabricated metal products	114.1	108.8	108.4	109.1	114.5	108.4	109.0	109.2	109.1	109.6
Industrial machinery and equipment	84.7	83.3	83.0	83.4	84.3	83.3	82.6	83.1	82.9	82.9
Electronic and other electrical equipment	97.7	83.4	82.1	81.2	98.4	83.9	82.5	83.1	82.9	81.8
Transportation equipment	114.7	106.0	107.4	108.1	113.1	107.3	108.2	105.5	108.2	108.1
Motor vehicles and equipment	151.5	143.9	146.9	147.5	148.2	143.9	142.8	143.0	144.2	144.0
Instruments and related products	73.0	68.8	67.8	67.7	73.1	69.1	68.7	68.6	68.4	67.9
Miscellaneous manufacturing	91.6	[illegible]	[illegible]	89.5	92.0	89.2	89.3	90.2	89.7	89.6
Nondurable goods	92.2	88.7	88.1	88.6	93.1	89.3	88.3	89.8	89.3	89.2
Food and kindred products	112.1	111.5	110.9	112.6	115.5	114.8	114.8	115.5	115.8	115.2
Tobacco products	43.4	48.8	47.4	47.9	48.2	51.3	51.3	51.0	49.3	51.5
Textile mill products	67.6	62.5	62.5	61.8	67.8	61.5	62.0	62.4	62.2	61.8
Apparel and other textile products	49.9	44.8	43.8	44.0	48.1	44.4	43.7	44.1	43.7	43.3
Paper and allied products	97.1	94.5	94.0	94.6	98.2	94.8	95.5	96.5	94.9	95.2
Printing and publishing	114.5	108.8	105.1	104.8	116.2	108.3	107.4	106.8	106.8	105.7
Chemicals and allied products	96.9	94.6	94.0	94.6	97.0	94.0	94.2	94.4	93.6	95.0
Petroleum and coal products	68.6	68.8	68.4	70.1	69.0	71.8	71.8	70.9	67.8	70.3
Rubber and misc. plastics products	137.8	133.6	133.9	134.6	137.9	131.7	132.8	133.8	136.0	134.0
Leather and leather products	25.9	23.7	23.7	23.8	25.5	23.3	23.4	23.5	23.8	23.4
Service-producing	168.1	164.5	165.7	167.5	168.5	167.0	167.2	167.4	167.5	167.7
Transportation and public utilities	140.3	132.4	132.8	134.4	140.8	134.9	135.2	134.4	134.5	134.4
Wholesale trade	128.8	124.1	124.8	125.4	128.8	125.3	125.6	125.8	125.8	126.4
Retail trade	148.6	142.8	143.9	147.4	148.8	146.3	146.8	147.8	147.3	147.6
Finance, insurance, and real estate	137.9	138.7	139.0	139.8	139.5	140.3	140.8	140.7	140.9	141.2
Services	212.5	208.1	210.7	212.0	212.7	211.1	211.1	211.3	211.6	211.9

[1] See footnote 1, table B-2.
p = preliminary.
NOTE: Data have been revised to reflect March 2001 benchmarks; the introduction of probability-based sample estimates for transportation and public utilities; retail trade; and finance, insurance, and real estate; and recomputed seasonal adjustment factors.

ESTABLISHMENT DATA

Table B-6. Diffusion indexes of employment change, seasonally adjusted

(Percent)

Time span	Jan.	Feb.	Mar.	Apr.	May	June	July	Aug.	Sept.	Oct.	Nov.	Dec.
	Private nonfarm payrolls, 347 industries[1]											
Over 1-month span:												
1998	62.4	57.5	59.1	60.2	57.5	56.6	54.6	59.1	57.2	53.0	57.9	58.8
1999	65.3	58.6	53.6	59.4	55.5	57.9	57.1	54.9	57.1	57.2	60.4	59.1
2000	55.9	57.5	57.9	51.2	50.1	58.8	57.8	51.4	52.4	52.4	53.2	52.7
2001	49.4	45.7	50.3	42.4	47.3	43.2	44.5	42.5	42.4	40.5	38.3	44.1
2002	47.3	41.4	49.7	P49.7	P50.6							
Over 3-month span:												
1998	65.3	66.3	65.3	65.9	62.7	58.2	58.9	59.1	59.8	57.9	57.1	58.8
1999	59.2	57.6	59.5	56.2	60.2	57.2	59.4	59.2	59.7	58.9	61.2	60.7
2000	60.4	61.4	58.4	53.2	52.4	55.5	56.6	56.2	51.2	51.0	53.2	51.6
2001	45.5	46.1	40.9	40.4	[illegible]	40.6	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
2002	40.1	43.2	P43.9	P47.4								
Over 6-month span:												
1998	70.2	67.4	64.7	61.6	64.1	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
1999	60.2	58.9	58.5	58.7	57.2	60.8	61.2	62.5	62.7	61.8	61.2	62.8
2000	61.1	58.4	58.1	57.9	54.2	52.4	52.9	54.2	52.4	48.7	45.7	46.5
2001	44.7	42.7	39.5	40.1	40.8	35.6	37.0	32.4	34.3	33.1	34.1	35.6
2002	P37.9	P42.5										
Over 12-month span:												
1998	69.9	67.9	67.6	65.6	64.1	62.7	61.7	62.2	60.8	59.4	60.8	58.3
1999	61.2	60.1	58.2	61.0	60.7	61.5	62.2	61.1	53.8	62.2	58.7	60.5
2000	61.4	59.9	[illegible]	[illegible]	[illegible]	[illegible]	53.0	51.0	47.7	43.2	44.0	42.3
2001	41.6	41.5	38.9	37.5	37.3	36.2	34.1	33.6	34.4	P34.3	P32.9	
2002												
	Manufacturing payrolls, 136 industries[1]											
Over 1-month span:												
1998	57.0	52.6	52.2	52.9	44.9	47.4	38.2	52.9	44.3	38.6	42.3	41.5
1999	47.4	41.2	42.6	46.0	46.3	43.4	60.0	42.6	46.0	43.6	51.5	49.3
2000	44.9	52.2	49.3	40.0	49.3	50.7	67.4	[illegible]	[illegible]	42.3	47.1	40.6
2001	34.9	26.8	38.2	29.0	28.3	30.5	34.9	25.7	31.6	31.3	25.0	30.9
2002	36.3	37.9	40.4	P47.1	P48.7							
Over 3-month span:												
1998	59.2	57.0	54.8	51.8	48.2	38.2	41.9	43.0	43.0	38.2	32.7	40.4
1999	39.3	39.3	39.7	40.1	41.2	43.8	44.1	46.3	42.3	44.1	47.8	45.2
2000	48.2	48.9	46.9	44.5	46.7	52.2	46.0	38.6	29.0	34.2	39.0	36.0
2001	21.9	21.3	18.4	23.5	19.9	23.2	17.3	19.1	16.2	18.0	18.4	18.0
2002	24.6	30.1	P37.9	P38.7								
Over 6-month span:												
1998	60.7	54.4	49.3	40.1	46.2	42.6	39.0	38.2	34.6	41.2	36.7	33.1
1999	36.4	36.0	37.5	40.4	37.5	42.3	43.0	44.6	48.2	43.0	44.5	47.4
2000	47.6	45.2	44.5	50.0	41.9	37.9	36.0	36.3	32.4	26.1	21.3	21.7
2001	20.2	18.9	14.0	16.2	16.5	13.2	14.7	11.8	14.0	13.2	17.6	16.5
2002	P20.2	P26.1										
Over 12-month span:												
1998	64.6	52.2	51.6	46.7	40.4	40.1	38.2	37.5	36.4	34.6	35.7	34.2
1999	38.6	34.6	32.4	38.0	37.9	38.0	40.1	40.4	44.6	44.5	43.4	44.6
2000	49.3	44.1	39.3	36.9	35.3	34.2	33.8	28.7	22.1	19.1	17.6	14.0
2001	13.6	13.6	13.6	15.4	12.1	11.0	11.3	11.3	12.9	P13.6	P13.6	
2002												

[1] Based on seasonally adjusted data for 1-, 3-, and 6-month spans and unadjusted data for the 12-month span. Data are centered within the span.

P = preliminary.

NOTE: Figures are the percent of industries with employment increasing plus one-half of the industries with unchanged employment, where 50 percent indicates an equal balance between industries with increasing and decreasing employment. Data have been revised to reflect March 2001 benchmarks; the introduction of probability-based sample estimates for transportation and public utilities; retail trade; and finance, insurance, and real estate; and recomputed seasonal adjustment factors.

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MONETARY POLICY AND THE ECONOMIC OUTLOOK

HEARING

before the

JOINT ECONOMIC COMMITTEE CONGRESS OF THE UNITED STATES

ONE HUNDRED SEVENTH CONGRESS

SECOND SESSION

April 17, 2002

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WITNESS

SUBMISSIONS FOR THE RECORD

MONETARY POLICY AND THE ECONOMIC OUTLOOK

Wednesday, April 17, 2002

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

The Committee met, pursuant to notice, at 10 a.m., in Room 2118, Rayburn House Office Building, the Honorable Jim Saxton, Chairman of the Committee, presiding.

Present: Representatives Saxton, Smith, Dunn, Putnam; Senators Reed, Corzine, Crapo, and Bennett.

Also Present: Representative Sherwood.

Staff Present: Chris Frenze, Bob Keleher, Colleen J. Healy, Darryl Evans, Brian Higginbotham, Patricia Ruggles, and Matthew Salomon.

OPENING STATEMENT OF REPRESENTATIVE JIM SAXTON, CHAIRMAN

Representative Saxton. Good morning. I am pleased to welcome Chairman Greenspan to testify before the Joint Economic Committee (JEC) this morning. We appreciate your appearance here today, Mr. Chairman, to discuss the monetary policy and the improved economic situation that has emerged in recent months.

The economy appears to be recovering from the slowdown that began in the middle of 2000 and turned into to a mild recession in March of 2001. The September 11th terrorist attacks inflicted further economic damage. Nevertheless, in the last quarter of 2001, real GDP increased 1.7 percent, with personal consumption spending surging at a 6.1 percent rate.

In addition, manufacturing output has stabilized and appears to be expanding. Home sales have held up well, and large payroll employment declines have subsided. The liquidation of inventories last year has established the basis for inventory rebuilding later in 2002. Another positive aspect of the current outlook is that good productivity growth has been sustained through the business cycle and appears likely in the future. Economic forecasts generally anticipate a strengthening of economic growth during 2002. Leading market price indicators show no significant threat of inflation in the pipeline.

The recovery has begun, but there are potential weaknesses and vulnerabilities that could affect the depth, breadth and sustainability of the economic rebound. As the Federal Reserve has pointed out, the declines in business profits and investments were important factors in the recession, and these remain problematic. Despite improvement in fourth quarter GDP, investment spending fell sharply. Business and household debt levels are relatively high by historic standards and could restrain growth. In addition, the weakness in the economies of some of our international trading partners limits overseas markets for U.S. production.

Meanwhile, costs imposed by terrorism, the instability in the Middle East and the increase in oil prices provide other potential impediments to faster U.S. growth.

Unfortunately, there are a number of major risks to U.S. economic recovery. Given these risks, the current stance of the Federal Reserve monetary policy seems quite appropriate. The Federal Reserve wisely has shown restraint in not tightening monetary policy as the economic rebound consolidates. With little threat of inflation, there has been no reason for tightening of monetary policy by the Federal Reserve.

Mr. Chairman, before we turn the floor over to you, let me just say that unfortunately there are votes, apparently, scheduled in the Senate, and so our brethren in the Senate are not here yet. We expect them to arrive at the conclusion of their votes. And, in addition, the Members of the House are scattered here and there, and they will be along as well.

I would also just like to ask unanimous consent that Congressman Sherwood, who is not a member of this panel, be invited and permitted to sit at the desk.

Mr. Chairman, thank you again for being with us. We always appreciate your appearance here before the Joint Economic Committee, and of course today is no exception. The floor is yours, sir. We are ready to hear your testimony.

[The prepared statement of Representative Saxton appears in the Submissions for the Record on page 25.]

OPENING STATEMENT OF ALAN GREENSPAN, CHAIRMAN, BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

Mr. Greenspan. Thank you very much, Mr. Chairman. As always, I appreciate the opportunity to appear here to discuss the current state of the economy. This morning, I am speaking for myself and not necessarily for the Federal Open Market Committee (FOMC). I am also excerpting from a rather extended prepared testimony and request that the full text be included for the record.

Representative Saxton. Without objection.

Mr. Greenspan. Mr. Chairman, as we noted in our statement following the Federal Open Market Committee meeting in March, "The economy, bolstered by a marked swing in inventory investment, is expanding at a significant pace. Nonetheless, the degree of strengthening in final demand over coming quarters, an essential element in sustained economic expansion, is still uncertain." Mr. Chairman, little, if anything, has happened since the FOMC meeting to alter that assessment.

This morning I would like to elaborate on some of the forces that are likely to shape activity in the months ahead.

A number of crosscurrents are likely to influence household spending this year. Through much of last year's slowdown, housing and consumption spending held up well and proved to be a major stabilizing force. But because there was little retrenchment during the cyclical downturn, the potential for a significant acceleration in activity in the household sector is likely to be more limited than in past business cycles.

One important source of support to household spending late last year, energy prices, will likely be less favorable in the months ahead. With the rise in the world price of crude oil since the middle of January, higher energy costs are again sapping the purchasing power of households. To the extent that the increase in energy prices is limited in dimension, with prices not materially exceeding the trading range of recent weeks, the negative effects on spending in the aggregate should prove to be small. However, a price hike that drove oil prices well above existing levels for an appreciable period of time would likely have more far-reaching consequences.

Another factor likely to dampen the growth of consumer spending in the period ahead, at least to some extent, is the change in overall household financial positions. Over the past two years, household wealth relative to income has dropped from a peak multiple of about 6.3 at the end of 1999 to around 5.3 currently. About nine-tenths of the decline in the personal savings rate from 1995 to 1999 can be attributed to the rise in the ratio of wealth to income. And the subsequent decline in that ratio is doubtless restraining the growth of consumption.

Much of the movement in household net worth in recent years has been driven by changes on the asset side of the household balance sheet, but household liabilities have generally moved higher as well. Accordingly, the aggregate household debt service burden, defined as the ratio of a household's required debt payments to their disposable personal income, rose considerably in recent years, returning last year to close to its previous cyclical peak of the mid-1980s, where it has remained.

Neither wealth nor the burden of debt is distributed evenly across households. For example, increased debt burdens appear disproportionately attributable to higher-income households.

Although high-income households should not experience much strain in meeting their debt service obligations, others might. Indeed, repayment difficulties have already increased, particularly in the subprime markets for consumer loans and mortgages. Delinquency rates may worsen as a result of the strains on household finances over the past two years. Large erosions, however, do not seem likely, and the overall level of debt and repayment delinquencies do not as of now appear to pose a major impediment to a moderate expansion of consumer spending going forward.

Although the macroeconomic effects of debt burdens may be limited, we have already observed significant spending restraint among the top fifth of income earners, who accounted for around 44 percent of total after-tax household income last year, presumably owing to the drop in equity prices, on net, over the past two years. The effect of the stock market on other household spending has been less evident.

Perhaps most central to the outlook for consumer spending will be developments in the labor market, which has improved some in recent months. The pace of layoffs quickened last fall, especially after September 11, and the unemployment rate rose sharply. But layoffs have diminished noticeably in 2002, and payrolls grew again in March. In typical cyclical fashion, the unemployment rate has lagged the pickup in demand somewhat, but it has remained between 5-1/2 and 5-3/4 percent of late after rising rapidly in 2001.

Over the longer haul, incomes and spending are driven most importantly by the behavior of labor productivity, and here the most recent readings have been very encouraging. Output per hour continued to grow last year. Indeed it rose at an annual rate of 5-1/2 percent in the fourth quarter of last year and appears to have posted another sharp advance in the first quarter. No doubt some of the recent acceleration reflects normal statistical noise. More fundamentally, however, some of this pickup probably occurred because businesses have remained cautious about boosting labor input in response to this surprising strength of demand in recent months. But the magnitude of the gains in productivity over the past year provides further evidence of improvement in the underlying pace of structural labor productivity.

In housing markets, low mortgage interest rates and favorable weather have provided considerable support to home building in recent months. Moreover, attractive mortgage rates have bolstered the sales of existing sales homes and the extraction of capital gains embedded in home equity that those sales engender. Low rates have also encouraged households to take on larger mortgages when refinancing their homes.

The ongoing strength in the housing market has raised concerns about the possible emergence of a bubble in home prices. However, the analogy often made to the building and busting of a stock price bubble is imperfect. First, unlike in the stock markets, sales in the real estate market incur substantial transaction costs, and when most homes are sold, the seller must physically move out. Doing so often entails significant financial and emotional costs and is an obvious impediment to stimulating a bubble through speculative trading in homes. Thus, while stock market turnover is more than 100 percent annually, the turnover of home ownership is less than 10 percent annually, scarcely tinder for speculative conflagration.

Second, arbitrage opportunities are much more limited in housing markets than in securities markets. A home in Portland, Oregon, is not a close substitute for a home in Portland, Maine. And the national housing market is better understood as a collection of small local housing markets. Even if a bubble were to develop in a local market, it would not necessarily have implications for the nation as a whole.

These factors do not mean that bubbles cannot develop in housing markets and that home prices cannot decline. Indeed, home prices fell significantly in several parts of the country in the early 1990s. But because the turnover of homes is so much smaller than that of stocks, and because the underlying demand for living space tends to be revised very gradually, the speed and magnitude of price rises and declines observed in markets for securities are more difficult to create in markets for homes.

Technological advances contributing to the gains in productivity that we have achieved over the past year should provide support not only to the household sector, but also to the business sector through a recovery in corporate profits and capital investment.

The retrenchment in capital spending over the past year and a half was central to the sharp slowing in overall activity. These cutbacks in capital spending interacted with and were reinforced by falling profits and equity prices. Indeed, a striking feature of the current cyclical episode relative to many earlier ones has been the virtual absence of pricing power across much of American business as increasing globalization and deregulation have enhanced competition.

Part of the reduction in pricing power observed in this cycle should be reversed as firming demand enables businesses to take back large price discounts. Though such an adjustment would tend to elevate price levels, underlying inflationary cost pressures should remain contained. A lack of pressures in labor markets and increases in productivity are holding labor costs in check, resulting in rising profit margins even with inflation remaining low.

To be sure, over time, the current accommodative stance of monetary policy is not likely to be consistent with maintaining price stability. But prospects for low inflation and inflation expectations in the period ahead mean that the Federal Reserve should have ample opportunity to adjust policy to keep inflation pressures contained once sustained, solid, economic expansion is in view.

Improved margins over time and more assured prospects for rising final demand would likely be accompanied by a decline in risk premiums from their current elevated levels toward a more normal range. With real rates of return on high-tech equipment still attractive, the lowering of risk premiums should be an additional spur to new investment.

Recent evidence suggests that a recovery in at least some forms of high-tech investment is under way. But the pickup this year in overall spending on business fixed investment is likely to be gradual.

The U.S. economy has displayed a remarkable resilience over the past six months in the face of some very significant adverse shocks. But the strength of the economic expansion that is under way remains to be clarified. Some of the forces that have weighed heavily on the economy over the past year or so have begun to dissipate, but other factors, such as the sharp increase in world oil prices, have arisen that pose new challenges. As a result, the course of final demand will need to be monitored closely.

Still there can be little doubt that prospects have brightened. Spending in the household sector has held up well, and some signs of improvement are evident in business profits and investment. Fiscal policy continues to provide stimulus to aggregate demand, and monetary policy is currently accommodative. With the growth of productivity well maintained, and inflation pressures largely absent, the foundation for economic expansion has been laid.

Thank you very much, Mr. Chairman. I look forward to your questions.

[The prepared statement of Chairman Greenspan appears in the Submissions for the Record on page 28.]

Representative Saxton. Mr. Chairman, thank you very much for the very articulate statement that we have come to expect when you visit with us. We appreciate it very much.

It seems to me, Mr. Chairman, that in recent months there have been many signs that the economic recession that began last March has ended. For example, in the fourth quarter of 2001, growth was positive. The manufacturing sector seems to have bottomed out, and large payroll employment declines seemed to have subsided. So looking at those factors, it would seem to me that the future looks bright.

At the same time, you mentioned in your statement that there are continuing problems or potential problems looming on the horizon, and some that are already with us. You talked about the accumulation of debt. The consumption rebound that took place in the last quarter of last year was quite remarkable, and we are glad that it happened, but it takes away some of the consumption rebound potential for the current period and perhaps for the period ahead.

The investment rebound has not occurred as strongly as we could have hoped. Energy prices continue to be a worry. International sluggishness in some of our trading partners, particularly Japan and Central and South America, is evident, and the costs associated with terrorism continue to be – and will continue to be – a drag on the economy.

So my question is: How do we balance the good with the potential negative factors that we have all talked about here in the last month or so?

Mr. Greenspan. Mr. Chairman, this is a very important question, because one aspect of the dilemma that you raise is the remarkable and unusual divergence between the economic outlook as evaluated by economists on the one hand, and a significant part of the business community on the other. As you know, the latter are showing far less optimism about what is apparently going on than those of us who are evaluating the gross domestic product, the larger aspect of the economy. And what we are observing obviously is that retail sales and consumption generally are holding up, home building is up, and we are seeing a very significant swing from inventory liquidations ultimately to either some degree of small accumulation or at least inventory balance.

What this does is it creates a really quite different view of the economy depending on where you are looking at it from. We add up the so-called net consolidated production of the economy, which is essentially what the gross domestic product is. But, from the business point of view, what they see is a low level of sales, because remember, a goodly part of consumption is coming out of inventory, and a significant decline in profit margins and virtually no pricing power. So, from that point of view, the lower end of the economy if you want to put it that way, where the business sector largely is functioning, you are getting a continued degree of weakness.

Obviously you cannot have this process going on indefinitely. Either we are going to get a significant increase in production, in profits, in capital investment, which is what our forecast is and what the data, as far as we can judge, seem to portend, or we are going to get real slippage, in which case production will not move materially, nor will profits or investment.

This is an issue which will be resolved within the next two to four months. The odds are very strongly in favor of it being resolved in continued economic growth, resumption of profitability, and capital investment, but clearly there are concerns out there, and there are risks, and you mentioned a few of them, and I think quite correctly.

Representative Saxton. Mr. Chairman, in your statement you referred to monetary policy, and in the same context of that, you said that monetary policy might be adjusted when sustained solid economic expansion is in view.

You have said here that we have laid the basis or the foundation for economic growth, but you haven't said that sustained solid economic expansion is in view. Is that correct?

Mr. Greenspan. It is not sufficiently in view to be comfortable with the outlook. As I indicated in the testimony before the Senate and the House a month ago, what we are aware of is a very strong recovery currently under way as a consequence of the dramatic reduction in the degree of inventory liquidation.

But the crucial issue which I repeat in my testimony today is whether so-called final demand, which has been growing very modestly, continues to grow and indeed accelerates before the very strong impetus coming from the swing in inventories dissipates. We are nowhere near a judgment of that as yet. I mean, we haven't yet gotten to the point in the cycle where we know exactly how that is resolving.

But my impression is that as the quarters go on, things will become obviously very clear in retrospect. Hopefully we will be able to get a reasonably good judgment of what is happening sufficiently in advance. But as I also pointed out in the sentence to which you refer, we are very fortunate in that there is literally no evidence of inflationary pressures building, and that means that the urgency of responding to economic events is less than it would be were we dealing with that other possibility.

Representative Saxton. You anticipated my next question in your response on your statement on inflation. So let me move to one other subject that I feel is very interesting, and then we will go to Mr. Reed.

One of the most positive aspects of economic growth over the last period of time, over the last five years, is based on strong productivity performance, and this was something that I hadn't fully understood, and maybe still don't. But this productivity trend was rooted in earlier technological innovation and investments, in people, equipment, as well as improved production methods.

The Fed's recent monetary policy report to Congress noted, and I quote, that productivity was impressive. Does it appear that strong productivity growth in recent years has been carried through the business cycle? Do we still see strong productivity, and does this strong productivity performance increase the ability of the economy to continue to grow without inflation?

Mr. Greenspan. It does, Mr. Chairman. One aspect of an evaluation of the effect of the dramatic changes in technology that occurred in application in the second half of the 1990s was the fact that numbers clearly showed growth in output per hour far exceeding those that we had experienced generally in the previous quarter century. And the question that we had was how much of that was merely a cyclical phenomenon, because productivity is pro-cyclical. We wouldn't know until we ran into some cyclical downturn. We have done that, and, if anything, the results are far more impressive than we would have expected.

As I indicated in my prepared remarks, I think some of the numbers we are looking at are statistical noise, meaning it is just the fact that these are very difficult numbers to measure. But even extracting from that, even making all of the adjustments that you want, it is an extraordinary performance, which I must say bodes well for the longer-term outlook of this economy.

Representative Saxton. Well, thank you. That certainly sounds like good news, and we look forward to watching this factor as we move forward.

Mr. Greenspan. I just wanted to say, I just don't believe that we can continue to get the numbers published for the fourth quarter and that will be published for the first quarter indefinitely. The world does not work that well.

Representative Saxton. Yes, sir. Thank you very much.

Mr. Reed, we are glad your votes have subsided for the moment, and the floor is yours.

Senator Reed. Thank you very much, Mr. Chairman, and thank you for calling this hearing. I have a statement which I would like included in the record, with your permission.

Representative Saxton. Without objection.

[The prepared statement of Senator Reed appears in the Submissions for the Record on page 26.]

Senator Reed. Thank you for your testimony and for your colleagues' very adroit use of monetary policy over the last several months to keep us moving forward.

Let me begin with the question. A year ago, Mr. Chairman, you worried that we might be in danger of paying down the national debt too quickly. You suggested we might have to find ways to reduce the surplus, and many people took this as an endorsement to the President's tax cut. Do you still have that concern?

Mr. Greenspan. No. If you may recall, Senator, the concern I had stemmed from the Congressional Budget Office's (CBO) long-term projection of the current services budget, which exhibited a pattern of growing surpluses, which would imply that by 2006, the Federal Government would have to start to accumulate private or state and local assets because it could no longer run down the debt, in other words, no longer employ the surplus as debt repayment. In fact, the number that they showed was, as I recall, a half a trillion dollars annual surplus.

I had indicated that I thought that accumulation of private assets by the Federal Government was a very undesirable economic policy for a lot of reasons. If I held that position, which I still do, and we are looking at the data that they published, then the question was, how did you get the half-a-trillion-dollar surplus down to zero to prevent the accumulation of assets? And the answer is no matter how you do it, it would be an extraordinary expansion of fiscal policy. It would be a huge stimulus, which may be wholly inappropriate for that particular time.

So I argued that either expenditures ought to be increased, or taxes ought to be cut. I preferred tax cuts, and indeed the bills before the Congress at the time – either the President's or congressional bills, both were adequate to solve the problem of eliminating the surplus by the mid-decade, and indeed we got a significant tax cut, and the problem was solved. So I am no longer concerned about it.

Senator Reed. Might this significant tax cut cause other problems? As you noted, the previous projections were for over $5 trillion of surplus over 10 years, and now these projections have dropped to about 1.7 trillion in less than a year, over just about a year. That is a $4 trillion reduction. And, in fact, the President's recent budgetary proposal would further reduce this projected surplus to less than $500 billion. But are we in danger of running into some of the same problems that we have seen before, which is we run deficits, we put pressure on interest rates, we get back into the fiscal difficulties we had in the 1980s and the 1990s, particularly since now so much of the – of what we must spend money on is not avoidable, the war on terrorism and other major programs?

Mr. Greenspan. No. I think that we have to be very careful about going back into deficit spending, which is very easy to do, and the reason largely, obviously, is that the evidence does indicate that if you start to run substantial deficits, you will begin to move long-term interest rates, and the effect of that on the economy is clearly not favorable.

My judgment is that we have got to come up with a much longer-term focus on fiscal policy. As you know, we have the very major demographic shift that occurs at the end of the decade, and I think what we have to do is decide where we want to be in the year, say, 2013 or somewhere in that area, with respect to the level of debt, the policies of both the unified budget, and also what I would call the accrued budget, which includes the contingent liabilities of the Federal Government, and then, in a sense, having decided where it is sustainable over the longer run given our demographic changes, work back toward what type of path would be desirable to have in fiscal policy. And my judgment is that it is very unlikely that a very large protracted deficit for the rest of this decade would be where one would want to come out.

Senator Reed. Mr. Chairman, we have seen over the last several weeks and months some encouraging signs about the economy, but one area of continuing concern is the unemployment numbers, which are still hovering around 5.6 to 5.8 percent. There is a possibility that as other factors in the economy improve, we could be in a situation where unemployment lingers at those levels. And are you concerned about a jobless recovery, one in which other indexes will show progress, but unemployment will remain at high levels?

Mr. Greenspan. I am not, Senator. I think that what we have observed currently is a significant recovery underway in the context of very strong gains in output per hour. And the data show not only a rise in output, but a decline in total hours and a decline in employment, which is even more, because as you probably are aware, overtime has gone up, and the average weekly hours have gone up. So what we are observing at this particular stage is the consequence of the economy recovering in the context of very strong productivity growth, which is very favorable.

But what we also were able to observe in the latter part of the 1990s was that this very productive growth enabled the unemployment rate to be driven down quite significantly without any inflationary implications. And if that pattern is still there, it essentially says that that is likely what will happen eventually in the future.

So I am not concerned about chronically elevated levels of unemployment. I think that as this recovery takes hold, those levels will come down, as indeed they did during the latter part of the 1990s.

Senator Reed. Thank you.

One final question, if I may, Mr. Chairman. You argue very eloquently for a longer-term perspective which will take into consideration not just the combined consolidated budget, but our contingent responsibilities, particularly with an aging population. In that context, calls to make the present tax cuts permanent would seem to me to complicate further the resolution of these contingent liabilities particularly.

What is your feeling about making permanent the current temporary or least transitory tax cuts?

Mr. Greenspan. Well, Senator, I can't talk about the politics of this, because clearly the issue from an economic point of view is somewhat different. I don't know of any economist who does long-term forecasting and presumes that the tax cuts will fall off the cliff at the end of the period in which they are statutorily in place.

So my own impression is that the markets assumed that these tax cuts are permanent. In other words, the legal question is a political issue. I don't think it is an economic issue, because I don't know of anyone that seriously believes that the world works the way the legislation stipulated.

Senator Reed. But, if you believe that, that leaves us with, I would suspect, an even greater deficit potential in the future.

Mr. Greenspan. Yes. That is correct.

Senator Reed. Which further complicates the tough problems that we have right now.

Mr. Greenspan. I would agree with that. I think that were I doing a forecast for the long-term unified and, as I call it, accrued budget, I would not make the presumption that the Congress at that particular point is going to act to rescind those taxes in the way the statute now stipulates.

Senator Reed. Thank you very much, Mr. Chairman.

Representative Saxton. We are going to go to Mr. Smith.

Before we do, if I may just follow up. Senator Reed, I think appropriately, raised the question of deficit and surplus. But isn't the economic slowdown a major reason for the shift in the 2002 fiscal situation?

Mr. Greenspan. It certainly is, Mr. Chairman.

Representative Saxton. Thank you.

Mr. Smith.

Representative Smith. Mr. Chairman, thank you for holding this hearing.

And, Chairman Greenspan, thank you for being willing to testify.

My first question is about the Patent and Trademark Office, in particular the amount of time required to have a patent approved when requested by businesses today. The average time, as I understand it, is about two years, and the length of time required for patents is expected to increase rather than diminish. It seems to me that this is a real disadvantage to high-tech companies who often produce a product quickly, develop it quickly, and often the product has a short shelf life.

I wanted to ask you if you felt that the length of time required to have a patent approved is a disadvantage to high-tech companies in particular, and harmful to the economy in general?

Mr. Greenspan. Yes, Congressman, I think you are raising a very important question. But it goes beyond patents. It goes into the regulatory pattern – put it this way: It goes into the whole structure of the interface of how government regulates a wide variety of areas, including the time it takes to do a lot of things.

Since it is evident that one aspect of the economy that has emerged in the last six or seven years is a very quickened pace of response as information technology has created a tremendous amount of real-time information systems, all adjustments are happening far more quickly, including the life cycle of a particular innovation, which is the issue that you are raising.

And I am fearful that the tendency to just apply the same old time lags in everything we do is contrary to the new economy, if one wants to use that term, which I hesitate to use, but it is useful in this context.

Representative Smith. Would your comments also apply to depreciation schedules for technology products like computers?

Mr. Greenspan. I don't think so, because I think those are indeed being adjusted to the proper periodicity and the degree of obsolescence. That is handled automatically, or it should be. Obviously to the extent that there are delays in IRS certification of various different types of programs, clearly that would be an issue, but I am not aware that that is a problem.

Representative Smith. Specifically in regard to the depreciation schedule, for instance, for a computer is now five years. It seems to me, given what you have just said about technology, that that is a little too long. We all know that computers are usually out of date within a year or two, and I wanted to ask you as well if you think that those depreciation schedules should be adjusted?

Mr. Greenspan. I really can't say, because I do know that there is a continuous reevaluation of so-called economic life, which is what you are raising, versus let's say IRS or even FASB issues with respect to the depreciation charges.

I think everyone is aware that this issue is out there, and it is being addressed. I don't think that is where a major problem is. I am more concerned about the issues you raise with respect to patents and the long time that it takes, for example, to get new pharmacological innovations through FDA as well.

I mean, these are very tough issues because clearly you don't want to run through a patent evaluation and find that there is truly patent infringement involved. And it takes time to make a judgment as to whether the patent is an innovation, a true one, and obviously it takes time to examine new drugs. So I am not arguing that we should push it merely for the sake of pushing, but I think we ought to be aware of the fact that that process is negative to innovation.

Representative Smith. Thank you.

Chairman Greenspan, one last question. You refer in your testimony to the technological advances contributing to the gains in productivity. One of the most astounding figures I have read recently is that, I think, two-thirds of our economy's increase in productivity gains since 1995 are attributed to information technology, and I wanted to ask you if you think those contributions to the economy by the information technology sector will continue, and if they are as important in the future as they have been in the past.

Mr. Greenspan. Well, it is difficult to make a judgment of what part of the increase in measured output per hour, which we do reasonably well even with all of the statistical noise that is involved in the process, is attributable specifically to information technology per se. We can make reasonable judgments as to what part is attributable to aggregate capital investment input, labor input and what we call overall multifactor productivity, which is a measure of the conceptual improvements that have existed.

But most people are coming out close to the number which you suggested with respect to information technology, and as best we can judge, the overall networking effect and all of the various other aspects which relate to information technology and the broader computer technologies which are associated with it have only partially been exploited. Indeed, as I indicate in my prepared remarks, when you go out and survey purchasing managers, or indeed, corporate executives more generally, you will find that they all perceive that there is a very significant amount of as yet unexploited profits in investments in information technology and in other high-tech areas as well.

So there is no evidence of which I am aware which suggests that this big surge in technology which really starts, as far as applications are concerned, in let's say 1994, 1995, is petering out. Indeed, the productivity numbers which we observed for the last six months are very strongly supportive of the notion that there is a lot out there yet to mine.

Representative Smith. Thank you, Chairman Greenspan.

Thank you, Mr. Chairman.

Representative Saxton. This subject of productivity I find very fascinating, because it seems to me that as we increase workers' productivity, it would tend to have the effect of taking pressure off increased labor costs, which would have the effect, in turn, of taking pressure – taking away certain inflationary pressures. And so this seems to me to be a very important factor in what we have seen over the last decade or two.

Mr. Greenspan. I agree with that, Mr. Chairman.

Representative Saxton. Senator Corzine.

Senator Corzine. Thank you, Chairman Saxton, and I appreciate your holding this hearing. It is always great to get the insights of the Chairman of the Federal Reserve, who has done such an outstanding job in his tenure.

I would like to maybe go back over some of the ground that Senator Reed brought up with a little different angle. There is certainly a political debate about whether we should make permanent the tax cut; as a matter of fact, very strong arguments from the economic side of the House and the administration and others that the current recovery is being hindered because of the sunsetting of the legislation.

I take it from your response to Senator Reed you probably would not believe that anyone is really factoring in that those tax cuts wouldn't be made permanent?

Mr. Greenspan. Let me take a step back.

Every analysis of a corporate investment, as you know, endeavors to project out cash flows into the future off the investment, and part of that analysis is the tax rate you apply. My impression at this particular stage is that most people presume that the tax cut is permanent and that the tax rates will remain as they are postulated in current law.

If you rescind them, the implication for that project is that the cash flow rate of return, as you know, would go down, so that the argument really gets down to whether companies making investments have effectively assumed that these tax cuts will be permanent or not. If they assumed that they will be permanent and they turn out not to be, then clearly that would be a negative effect.

Senator Corzine. But at least at the moment it is not your assumption in how you are looking at the economy that people are—

Mr. Greenspan. My general impression is that most business investment going forward is making the judgment that those tax cuts are indeed permanent.

Senator Corzine. Okay.

Let me also reiterate if that is, in fact, the case, those tax cuts are permanent, have you or your staff done analyses of what the cost of that tax cut would be in the second 10 years after 2011, and does that really drive at the question of fiscal policy in the context of this long-running demographic challenge that we have as a society?

Mr. Greenspan. Senator, we have not. The only longer-term projections we make are in the Social Security area for purposes of trying to get some sense of what the contingent liabilities are, and, therefore, what the contingent debt obligation of the Federal Government is. I don't think that we go much beyond the next two or three years ourselves. So we rely to a very substantial extent on estimates by CBO and the Office of Management and Budget (OMB) on the grounds that those are very difficult calculations, as you know as well as I, and they have much greater insight into the detail and, I hope, better models than we. So we tend to use their data as a base from which we function.

Senator Corzine. I believe that the estimates that I have seen from those models are an additional $4 trillion of revenue decline in the second decade after 2011. And it is a concern on how our fiscal path will be as we approach that and the demographic bubble at the same time with regard to both Medicare and Social Security.

I presume I am reading that you are concerned about that coming together of similar issues?

Mr. Greenspan. I am, Senator.

Senator Corzine. Thank you.

Representative Saxton. Senator, thank you very much.

Mr. Chairman, couldn't increased uncertainty about future tax policy undermine economic and business decisions that might produce and have a result of producing a drag on the economy?

Mr. Greenspan. Well, Mr. Chairman, I think that tax policy is a crucial aspect of what the longer term is all about, and I have always argued that we probably would do better with lower corporate tax rates as a general rule. And I have argued that the capital gains tax rate has not been a particularly productive vehicle for raising revenue because these are both charges against capital accumulation, which is such a crucial aspect of the gains in productivity and economic growth, which we have just been talking about. So it is a very complex subject, as you know far better than I, having been dealing with it up here for many years.

I have nothing really much to add to the discussion.

Representative Saxton. Thank you very much.

Ms. Dunn.

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

Welcome, Mr. Chairman.

I wanted to continue that discussion about tax relief just with a couple of questions. You suggested that most economists and the business community are banking on the tax relief being a permanent change, which pleases me. I like to hear that because I think that adds momentum to our effort—

Mr. Greenspan. Congresswoman, I should say that is my impression. I have never done an actual study. I have spoken to a lot of people, and that is my general expectation.

Representative Dunn. I am happy to hear that.

There are some areas, though, that if unless we make them permanent very quickly, I think will result in no behavioral change.

I bring to your mind the death tax repeal; that if it is not made permanent, I don't see why anybody would have any incentive to change behavior, how they spend money on estate planners and life insurance to provide for an unpredictable event.

What is your thought on what we ought to be doing here with regard to permanency? Ought we to be doing this earlier? Or maybe you can get Senator Corzine's vote now that you have spoken here. But what is your thought on how this should move?

Mr. Greenspan. Well, whatever you do, Congresswoman, I think it has to be clear where the longer-term tax structure in this area is. You cannot do estate planning, as you point out, unless you have a judgment as to what these numbers are. And wherever the Congress comes out, I think it is far more important that it come out clearly and unequivocally and not have an issue pending – an issue which would create a degree of uncertainty, which would make estate planning very difficult to implement.

Representative Dunn. Yes. Thank you.

Are you an advocate or do you believe in the idea of the tax relief providing a bridge during recessionary times for typical folks at home?

Mr. Greenspan. I am sorry, I didn't quite get that.

Representative Dunn. Larry Lindsey has talked in terms of tax relief providing a bridge for people to get through a time of recession; they will have more dollars in their pockets because of tax relief. Are you a believer in that theory?

Mr. Greenspan. Well, he is basically raising the issue of using tax policy as a fiscal policy, which is standard economic procedure. It goes back many generations. And the issue of countercyclical fiscal policy in many respects had the tax lever as a crucial element in that.

Representative Dunn. And you do believe that?

Mr. Greenspan. Yes, I do.

Representative Dunn. Okay. We have a big problem with unemployment in the Pacific Northwest. Oregon and Washington, for example, continually lag two or three percent behind what is happening in the rest of the nation, and many of the jobs that have been lost – and you will recall the layoffs that are occurring right now, 30,000 layoffs in the Boeing Company alone from their commercial line.

Now that businesses are slowing the pace of the inventory liquidation, do you think that this signals that companies will begin making products again, and, therefore, begin to hire workers back?

Mr. Greenspan. Well, I certainly think that as the expansion takes hold, the answer is very clearly yes. With respect to essentially Boeing and Airbus, the two major players in the world for new commercial aircraft deliveries, the sharp fall-off in demand for airline travel, especially business travel, as you know, is still creating problems for airlines, and Boeing's schedules are reflecting that.

And indeed I would suspect that until we see a restoration of airline travel for business and a reestablishment of profitability in the airlines, it is going to be quite a significant restraint on capital investment for new equipment, and indeed I make the point in my prepared remarks. So it is quite conceivable that the pattern of airline revenue and new orders for equipment will take a somewhat different path overall because that is a special case very significantly impacted by the events of September the 11th and thereafter, whereas the rest of the economy is in somewhat of a different mode with respect to the issue of terrorism and concerns about it.

So, over the longer run, there is no doubt in my mind, as I answered earlier, that the unemployment rates will be coming down in general, and the one thing one can say about the American economy is that it is really far more a single economy than it has been at any time in my recollection. I should put it this way: There are not the significant geographic differences that we used to experience three, four and five decades ago.

Very recently, we are finding that when we survey all of the various different industries, and the various regions of the country, it is remarkable. Throughout, say, 2001, they behaved very much in sync with one another. You would almost replicate the discussions in one area with another, and that is still true to this day. And with the recovery coming back, we are seeing very much the same phenomenon. Everyone is moving together.

So I should think that while there will be differences owing to industrial differences, and the Northwest is clearly a case, over the longer run that is unlikely.

Representative Dunn. Thank you.

Representative Saxton. Thank you very much, Ms. Dunn. Thank you for emphasizing the importance of the need to provide clarity with respect to the inheritance tax. I think that is an extremely important point.

Mr. Sherwood.

Representative Sherwood. Thank you, Chairman Saxton.

Chairman Greenspan, it is always great to hear you. Thank you for coming.

As I listened this morning, if I understand, I think you told us that retail sales are holding up well, and home building is remarkably strong. But the key to the economy is productivity growth, the key that makes us being able to have a good economy without inflation, and as we hear so much about less manufacturing and more service industry in the economy, when we think of productivity, we think of productivity in manufacturing. But obviously you must mean productivity in other sectors as well. Could you chat a little bit about that for us?

Mr. Greenspan. Productivity obviously has been strongest in the manufacturing area. Our data indicate that nonmanufacturing, the whole other area, is also showing significant increases, and there is even the possibility that the gap between manufacturing on the one hand and services and trade and other areas on the other may be more a measurement issue than we realized.

In other words, it is very much more difficult to get the value added, which is the numerator of output per hour, in services than it is to have a physical good where you can see what is happening. And our price data are clearly suboptimal in making those types of calculations.

But the numbers that I have been citing are the overall productivity. In fact, the general numbers that most people use are nonfarm business sector productivity, which is a third manufacturing and about two-thirds nonmanufacturing.

Representative Sherwood. The other issue, you said that unemployment will come down, and I know that there have been – a great deal of the growth and the strength in our economy has been the fact that we had workers available, including noncitizen workers. And after September 11 with us being much more careful at our borders and people having the proper identification for all of the right reasons, is this liable to be a damper on the economy? Do you see that coming?

Mr. Greenspan. Congressman, it is a very difficult issue, because clearly securing our borders is a crucial aspect in the war on terrorism. Nonetheless, we are dealing with the fact that a third of the increase in our labor force is coming from immigrants, and it has enabled us to have a rising number of households, which has been a major factor in why home building has been so powerful a force in the economy.

So I think this is a very important trade-off question here, and it is one of the many issues which the war on terrorism has surfaced and which will have to be confronted by the Congress. There is no easy answer because clearly the extent to which you enhance one aspect of the problem, you create the potential difficulties for the other.

Representative Sherwood. Thank you.

You said we will know in the next two to four months, if I understood you correctly, what direction certain things are going to take. And if I understood you, you said that a lot of the retail sales are coming now from reducing inventories, and so are you telling us that business will have to make a decision then whether to replace these inventories. I wasn't just sure I understood your two to four month comments.

Mr. Greenspan. Well, the point I was trying to make is that when you are dealing with a situation, as we are today and have been since late last year, where production has been held down very dramatically by inventory liquidation – in other words if you think in terms of consumption as being sort of a level up here, and production being well below, the difference between the two is obviously the amount of goods that are being supplied to consumption out of inventories as distinct from newly produced goods.

But as the level of inventories goes down, clearly it can't go below zero, and so well before zero it has to slow its rate of decline, which means that if consumption is stable, production must rise and supply more of the consumption than it did previously.

And that is the process which we are now going through. As production continues to rise, and since consumption has been relatively stable, we are creating a higher level of demand for people so that you are getting higher incomes, greater employment, more purchasing power, higher profits. And the question basically is whether all of those forces cause demand to kick in at a higher level when the initial thrust coming from the impetus of a reduced rate of inventory liquidation finally dissipates.

It is like a first-stage rocket carrying you off to a certain point and then a second-stage rocket essentially carrying you further. We are in the first-stage rocket, if I may put the analogy in that respect, but we are not yet at the point where its momentum has petered out enough to where we can see significant changes. But what we will learn as the months evolve is whether the increased demand from the increased incomes and profits being created by the shift from inventory liquidation to zero change in inventory, whether that shift creates a demand for goods and services over and above what is currently in place to give us an accelerated pickup in final demand, as we put it.

That is what our forecast is, that is what tends to be the case in our history, but until you actually see it, it is still problematic. You are still not certain. As I say, there is a large degree of uncertainty with respect to this issue out there.

Representative Sherwood. Thank you.

Representative Saxton. Thank you, Mr. Sherwood.

Mr. Putnam.

Representative Putnam. Thank you, Mr. Chairman.

And welcome, Mr. Greenspan.

Over the course of the past 18 months or so, as we have come through this recession, the consumer household spending and home mortgages and auto sales have essentially carried the day. The consequences of that – and, in fact, the Fed report referred to the frenzied refinancing of mortgages. But a consequence of that has been a rise in consumer or household debt. Is that a concern of yours, and what does that bode for future abilities or future room for growth in household spending?

Mr. Greenspan. We have examined that in some detail, Congressman, and we don't sense a serious problem at this stage. We don't expect it to get worse, but even now it is not a big problem.

One of the reasons is that a goodly part of the increase in debt is mortgage debt, and mortgage debt to a very substantial extent is supported by the market value of houses. And indeed, despite the fact that there has been a very dramatic increase in mortgage debt, the equities within homes continues to rise, and this is especially the case for the lower four-fifths of households calibrated by income, because, as I point out in my prepared remarks, a goodly part of the debt increase is in the upper quintile, which is almost a half of overall consumption. So I would think that while we do see that the debt service levels, that is, the amount of amortization plus interest as a ratio to income, are up at pretty high levels, there is a significant capability in most households, especially those which own homes with equity in them, to employ home equity loans or, in cases of refinancing, so-called refinancing cashouts where you take out more cash out of the process. And what that enables a lot of households to do is pay down their installment debt, their credit card debt, and indeed they have done so.

Now, clearly there are segments of our society, however, which don't have large equity positions in homes, and we do see that in some subprime lending, in both consumer and mortgage lending, delinquencies have indeed gone up. And we are probably likely to see further erosion because these types of things tend to lag behind the economy.

And indeed, I should have mentioned earlier with respect to the discussion of unemployment, there is a tendency for unemployment itself to be a lagging indicator, which is clearly a factor in which you get delinquencies and difficulties in household debt carrying into the recovery period, into its early stages, because it takes time for that process to work its way through.

But the bottom line is that having looked at this as best we can, we don't perceive it as a significant impediment to an expansion in consumer expenditures.

Representative Putnam. A number of private economists have indicated, as has the government, that IRS refunds are up perhaps as high as 26 percent over last year. Does this give the consumer some additional breathing room, and will this have a stimulative effect, as this economist from Goldman Sachs predicts, as a high level of tax refunds to increase personal income levels by as high as three billion a month?

Mr. Greenspan. Well, remember those refunds are only up to a point, and then they fall off. It is hard to know what people expect with respect to refunds and when they spend them, but there is no question that they do have an effect. But clearly as you get to April the 15th, that begins to peter off, because a good deal of refunds have occurred prior to the April 15th date. Some of them go beyond, but a goodly part of that is already in train.

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

Representative Saxton. Mr. Chairman, we promised we would finish this hearing in a timely fashion to try to accommodate your schedule. If you have time, sir, Mr. Corzine has one final question.

Senator Corzine. Mr. Chairman, we were talking earlier about a certainty and clarity, and one of the things that I think that we have talked about before in other hearings is change of circumstances should lead or often leads to change in policy considerations, just as you suggested; that if we were going to have to have a paydown of the debt and potential investment by governmental authorities, that would imply one policy versus one where deficits might impinge on the ability of the economy to save and have productive growth.

It strikes me that we are not showing the flexibility in fiscal policy that I think I have heard you endorse with regard to changing circumstances that might be. We do have a war today, a war on terrorism that has changed our spending needs, and while there is a need for clarity with regard to tax policy, I presume there is a need for clarity with regard to spending on education, special education, or spending on cleaning up the environment, or spending with respect to – or at least building up of reserves or potential capacity to pay for our Medicare expenses in future years, or Social Security for that matter.

So I am curious whether you think we are showing enough flexibility with regard to our fiscal policy strategies, which certainly wouldn't reflect how the Federal Reserve has managed monetary policy over a few years. And clarity is a two-sided coin. It is not just with taxes. I would suppose it is also with the resources that come with expenditures. I would love to hear your comments on that.

Mr. Greenspan. In principle there is no question that we have to do it, and we have to try to do it as best we can. In practice we have very considerable difficulties.

Senator Corzine. We have to have flexibility in our policies.

Mr. Greenspan. Yes. In practice we have considerable difficulties, largely because our forecast capabilities are not up as yet to the tasks, and one of the reasons is that if you are dealing, for example, with a \$2 or \$2½ trillion budget, and you have receipts and outlays roughly the same, as you know, very small changes in the balance of these very large aggregates engender very significant swings in unified budget surpluses and deficits.

And I think that you know the fan chart that CBO shows with respect to its probabilities is a good representation of what their history has been. And it is not that they are inadequate forecasters, they are pretty good as far as the profession is concerned, but it is an inherently very difficult exercise.

And so I think as part of this flexibility question, you have got a very important question of making judgments of what the probabilities of various different outlooks are and then making judgments. But that you have to do it, there is no question. That you have to be flexible, because events are changing by their nature is no question.

I just merely raise the issue of how good our capabilities are in implementing policy. Monetary policy is easy in that regard. We only have to make judgments, technically speaking, 20 minutes in advance before we can implement a policy. But you obviously cannot do that with fiscal policy. There are very long leads and lags and very long projections.

And my impression is that we probably would be wise to spend more time thinking about this problem because it is going to become a very serious issue as the years go on, if for no other reason than one of the easiest things to forecast is the demographics which are going to hit us, and I don't get the impression that we yet have the technical capability to come at this in a manner which is as effective as I think we are going to eventually need.

Senator Corzine. Could you just comment also, though, on the clarity of expenditures, investments in education, et cetera, and contrast – or at least in comparison to clarity with regard to tax policy?

Mr. Greenspan. Clarity to tax policy, you say. Well, I don't know. Clarity to me means basically you have a long-term strategy, you know where you are going, and you have a policy of getting there.

And I think one of the interesting issues that the Congress has to confront is trying to make judgments as to, let's say for example, an education policy, which policies work and which don't. And so there is a diagnosis of the problem, which I think is still in very significant debate within the society, and until we come to a conclusion of what works and what doesn't work, it is hard to get a fiscal policy which embodies that.

So there are important issues here of a conceptual nature that have got to be resolved. Over the years we have had many such arguments. We have to a greater or lesser extent resolved them. I think that is probably one of the things which is a major strength of this country.

Senator Corzine. Thank you.

Representative Saxton. Mr. Chairman, thank you.

Mr. Chairman, you just made reference to fiscal and monetary policy and its effect on influencing economic growth.

How effective were – how effective were the implementation of fiscal and monetary policies in 2001 in offsetting the recession, in your opinion?

Mr. Greenspan. In the most recent period?

Representative Saxton. Yes.

Mr. Greenspan. Both worked probably better than they usually work. That is, of necessity, all policy implies a forecast. We like to pretend that these are mechanical procedures which one can implement without making forecasts, but that is not factually the way the world works. And I think, for better or worse, the timing of policies has largely been, in my judgment, reasonably good in this respect.

Representative Saxton. How well timed were the policy moments in 2001?

Mr. Greenspan. With respect to? How was it in 2001? I thought that both tax and monetary policy turned out to be reasonably well calibrated.

Representative Saxton. Thank you.

One final question with regard to forecasting inflation. It doesn't appear that – at least from the statistical evidence that we have available – that there is any real problem with inflation currently, nor does it appear that there is a problem in the foreseeable future. But given the current economic situation, what indicators in the coming months would tend to be the most helpful in evaluating risks of future inflation?

Mr. Greenspan. Well, all of the analysis that we make from the point of view of a central bank is to endeavor to make those judgments. You don't look at any individual indicator, because that doesn't really help you because it keeps changing. You try to understand the process. You try to understand what are the broad forces, both domestically and globally, which are making the economy move. One aspect of that analysis is an evaluation of potentially building inflationary pressure.

So I would not say that there is a single statistic which would tell us that sufficiently in advance. Obviously, the price indexes themselves are what we are measuring. But they are very lagging indicators, and you can't really make useful judgments looking in the rear view mirror, if I may put it that way.

Representative Saxton. Thank you very much.

Senator Bennett has arrived, Mr. Chairman.

The Chairman is on a kind of a tight leash, Senator, so we welcome your questions, but hope you will keep that in mind.

Senator Bennett. Thank you very much. I will try to abide by that admonition.

Mr. Chairman, it has been pointed out to me at least one body of opinion rather necessarily casting it as a fact, but one body of opinion, is that since the dollar is now the de facto reserve currency of the world, if not the dominant currency in the world, you are not only the central bank for the United States, you have become the central banker for the rest of the world. And I know you didn't sign up for that, but there are many people who give you that particular responsibility.

I would like to get your views on the question of world liquidity. Many people say Japan is in a serious deflation, there is a liquidity crisis in Europe, and that while we may have statistically enough liquidity in the economy in the United States, on a worldwide basis there is a liquidity problem, and that somehow you have to be involved in that.

And while you are pondering that one, I will pose the second and somewhat related question. As we come out of this recession, we must face the reality of world overcapacity in a number of industries. Steel is the most obvious, but there are a number of industries where there is a significant overcapacity, and, of course, overcapacity tends to dampen economic recovery when you are coming out of a recession circumstance.

So could you address those two related questions and – the amount of money available in the rest of the world, and the impact of that on our economy, and then the amount of overcapacity in the rest of the world.

Mr. Greenspan. Senator, I am not concerned about the issue of world liquidity largely because to a very substantial extent the system creates liquidity as is necessary. The central banks of the world obviously are crucial at the ultimate level of liquidity creation, and here one finds very little evidence that there is any particular problem. I mean, you can look at the European community, there's certainly no difficulty from a liquidity point of view. I trust there is none in the United States, nor do I perceive one in Japan, for example, or elsewhere. One of the reasons is that markets work to create—

Senator Bennett. If I could just – Japan is in a deflation, isn't it, from your view; is it not?

Mr. Greenspan. Well, Japan is beginning to show signs of stabilization as a consequence of the fact that the United States and Europe are beginning to firm. So to be sure there has been a very serious deflationary problem in Japan, but there are the first inklings that that is beginning to stabilize.

I don't wish to say that they don't have significant problems, which they clearly do, but I wouldn't perceive this as a particularly major issue if the rest of the world is beginning to move.

On the issue of overcapacity, that is a problem, Senator, which I think we always have one way or the other. And clearly steel has become the poster child of overcapacity, largely because it tends to become an industry which many emerging nations perceived as evidence of industrialization, and we created a very substantial amount of capacity, some of it quite obsolete and some of it extraordinarily high-cost.

And as you know, Secretary O'Neill, who was involved in endeavoring to, as a private citizen, bring down excess aluminum reduction plant capacity over the years, is trying to obtain similar sorts of adjustments in world steel capacity, and I would say that it is important that he succeed or that – I should put it more generally – that he and his colleagues who are involved in these discussions make significant headway, because it is important to rationalize the industry.

Senator Bennett. But overall you think that the overcapacity problem in the world is not going to dampen our recovery from the recession?

Mr. Greenspan. I think not. I think that it always does, but not to a great extent. A more relevant concern is obviously the communications capacity problem where a goodly part of high-tech investment is being impeded due to an endeavor to absorb a good deal of the excess which has been put in place. That will impede the recovery some, but not over the longer run. We managed to move capital from obsolescent overcapacity in industries into cutting-edge uses quite effectively.

Senator Bennett. Thank you, Mr. Chairman. I recognize that my time is up.

I would like to pursue with Chairman Greenspan the issue of data-sharing and the quality of economic statistics. Maybe we can have that dialogue in another venue. But I know that he is a leader in trying to get good economic information, and I have an interest in information-sharing, and we will pursue that at another time when we don't have the time constraints.

[The written question to Chairman Greenspan from Senator Bennett, together with the written response appears in the Submissions for the Record on page 38.]

Representative Saxton. Thank you, Senator Bennett.

Mr. Chairman, we would like to thank you and your staff for being here with us today. We appreciate it very much. We appreciate your message also that the foundation seems to have been set for an economic recovery, and that there are still, however, continuing concerns that we need to watch very carefully in terms of a number of factors that may play as a drag on economic performance.

So thank you for being with us. We appreciate it again, and we look forward to seeing you again in the future. Thank you.

Mr. Greenspan. Thank you very much, Mr. Chairman.

Representative Saxton. The hearing is adjourned.

[Whereupon, at 11:35 a.m., the hearing was adjourned.]

SUBMISSIONS FOR THE RECORD

PREPARED STATEMENT OF REPRESENTATIVE JIM SAXTON, CHAIRMAN

I am pleased to welcome Chairman Greenspan to testify before the Joint Economic Committee this morning. We appreciate your appearance today to discuss monetary policy and the improved economic situation that has emerged in recent months.

The economy appears to be recovering from the slowdown that began in the middle of 2000, and turned into a mild recession in March of 2001. The September 11 terrorist attacks inflicted further economic damage. Nonetheless, in the last quarter of 2001, real GDP increased 1.7 percent, with personal consumption spending surging at a 6.1 percent rate.

In addition, manufacturing output has stabilized and appears to be expanding, home sales have held up well, and large payroll employment declines have subsided. The liquidation of inventories last year has established the basis for inventory rebuilding later in 2002. Another positive aspect of the current outlook is that good productivity growth has been sustained through the business cycle and appears likely in the future. Economic forecasts generally anticipate a strengthening of economic growth during 2002. Leading market price indicators show no significant threat of inflation in the pipeline.

The recovery has begun, but there are potential weaknesses and vulnerabilities that could affect the breadth and sustainability of the economic rebound. As the Federal Reserve has pointed out, the declines in business profits and investment were important factors in the recession, and these remain problematic. Despite the improvement in fourth quarter GDP, investment spending fell sharply. Business and household debt levels are relatively high by historic standards and could restrain growth.

In addition, the weakness in the economies of some of our international trading partners limits overseas markets for U.S. production. Meanwhile, costs imposed by terrorism, the instability in the Middle East, and the increase in oil prices provide other potential impediments to faster U.S. growth. Unfortunately, there are a number of major risks to the U.S. economic recovery.

Given these risks, the current stance of Federal Reserve monetary policy seems appropriate. The Federal Reserve wisely has shown restraint in not tightening monetary policy as the economic rebound consolidates. With little threat of inflation, there has been no reason for a tightening of monetary policy by the Federal Reserve.

PREPARED STATEMENT OF SENATOR JACK REED, VICE CHAIRMAN

Thank you. I want to commend Chairman Saxton for holding this hearing and to welcome Federal Reserve Chairman Greenspan.

The past year and a half have proven to be quite challenging, both for economic forecasters and for policymakers. You and your colleagues at the Federal Reserve began to take aggressive action to head off economic weakness early last year and ended up cutting short-term interest rates 11 times over the course of the year. You also responded quickly to inject liquidity into the financial system at the time of the September 11 attacks. In other words, Chairman Greenspan, I think you have conducted monetary policy quite reasonably over this period.

I wish we in the Congress had been as wise in our fiscal policy decisions. In any case, the economy may be on the road to recovery, but the budget outlook was left in shambles by the tax cut, the recession, and the terrorist attacks. And, in that order, I might add. The Senate Budget Committee's analysis of CBO data show that more than 40 percent of the decline in the baseline of 2002-2011 surpluses since last January is due to the tax cut and associated debt service costs, with lesser percentages attributable to weaker economic conditions, increased spending to fight terrorism, and other technical budget adjustments.

This change in our budget outlook has important implications for our economy. As you pointed out earlier this year, Chairman Greenspan, the reduced prospects for paying down our national debt were a factor in keeping long-term interest rates from falling as much as we might have expected when the Fed cut short-term rates. And if the experience of the 1980s is any guide, a large tax cut that eats into our national saving will keep interest rates high and produce an unbalanced expansion with low rates of investment even as we climb back to full employment.

The consequences of not having surpluses to fund our national priorities are severe. I am worried, for example that even as the recovery gets underway, labor markets will remain soft for the most vulnerable in our society – less skilled and minority workers. Budgetary pressures have led the President to propose tax cuts in job training programs, which are precisely the sort of programs we will need to help less-skilled workers join in the recovery.

So Chairman Greenspan, I am encouraged with how the economy has been performing recently, at least relative to the discouraging forecasts we had been seeing. With the economy picking up while inflation remains moderate, I hope the Federal Reserve can afford to wait before it begins to unwind its year-long series of rate cuts. I will be interested in hearing your views on the short-term outlook.

But I am discouraged by the longer-term fiscal outlook. I would be interested in your views about whether the deterioration of the budget outlook is a threat to our long-term growth prospects, especially as we look beyond the current budget window to the years when the retirement of the baby boom generation will put increasing pressure on the budget.

I don't think we can just grow our way out of the current budget situation, but I wonder what you think.

Again, thank you for coming, and I look forward to your testimony.

For release on delivery
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April 17, 2002

Statement of

Alan Greenspan

Chairman

Board of Governors of the Federal Reserve System

before the

Joint Economic Committee

United States Congress

April 17, 2002

I appreciate the opportunity to appear before the Joint Economic Committee to discuss the current state of the economy.

As we noted in our statement following the Federal Open Market Committee meeting in March, "The economy, bolstered by a marked swing in inventory investment, is expanding at a significant pace. Nonetheless, the degree of strengthening in final demand over coming quarters, an essential element in sustained economic expansion, is still uncertain." Little, if anything, has happened since the FOMC meeting to alter that assessment.

This morning I would like to elaborate on some of the forces that are likely to shape activity in the months ahead.

As I just noted, the behavior of inventories currently is the driving force in the near-term outlook. Stocks of goods in many industries were drawn down significantly last year, and preliminary data suggest that the pace of liquidation tapered off markedly in the first quarter. This development is important because the reduction in the rate of inventory liquidation has induced a rise in industrial production.

The pickup in the growth of activity, however, will be short-lived unless sustained increases in final demand kick in before the positive effects of inventory investment dissipate. We have seen encouraging signs in recent months that underlying trends in final demand are strengthening, but the dimensions of the pickup are still not clear.

* * *

A number of crosscurrents are likely to influence household spending this year. Through much of last year's slowdown, housing and consumption spending held up well and proved to be a major stabilizing force. But because there was little retrenchment during the cyclical downturn, the potential for a significant acceleration in activity in the household sector is likely to be more limited than in past business cycles.

One important source of support to household spending late last year--energy prices--will likely be less favorable in the months ahead. With the rise in world crude oil prices since the middle of January, higher energy costs are again sapping the purchasing power of households. To the extent that the increase in energy prices is limited in dimension--with prices not materially exceeding the trading range of recent weeks--the negative effects on spending in the aggregate should prove to be small. However, a price hike that drove oil prices well above existing levels for an appreciable period of time would likely have more far-reaching consequences.

In assessing the possible effects of higher oil prices, the inherent uncertainty about their future path is compounded by the limitations of the statistical models available to analyze such price shocks. When simulated over periods with observed oil prices spikes, these models do *not* show oil prices consistently having been a decisive factor in depressing economic activity. Yet, coincidence or not, all economic downturns in the United States since 1973, when oil became a prominent cost factor in business, have been preceded by sharp increases in the price of oil. This pattern leads one to suspect that the responsiveness of U.S. gross domestic product to energy prices is far more complex and may be quite different when households and businesses are confronted with abnormal price hikes. Macroeconometric models typically are specified as linear relationships, and they reflect average behavior over history. These models cannot distinguish between responses to outsized spikes and normal price fluctuations and thus may not capture the effect of sudden and sizable shifts in oil prices on the economy.

Another factor likely to damp the growth of consumer spending in the period ahead, at least to some extent, is the change in overall household financial positions over the past two years. Household wealth relative to income has dropped from a peak multiple of about 6.3 at the end of 1999 to around 5.3 currently. Econometric evidence suggests that wealth is an important determinant of spending, explaining about one-fifth of the total level of consumer outlays. Indeed, about nine-tenths of the decline in the personal saving rate from 1995 to 1999 can be attributed to the rise in the ratio of wealth to income, and the subsequent decline in that ratio is doubtless restraining the growth of consumption.

Much of the movement in household net worth in recent years has been driven by changes on the asset side of the household balance sheet. But household liabilities have generally moved higher as well. Accordingly, the aggregate household debt service burden, defined as the ratio of households' required debt payments to their disposable personal income, rose considerably in recent years, returning last year to close to its previous cyclical peak of the mid-1980s, where it has remained.

Neither wealth nor the burden of debt is distributed evenly across households. Hence, the spending effects of changes in these influences also will not be evenly distributed. For example, increased debt burdens appear disproportionately attributable to higher-income households. Calculations by staff at the Federal Reserve suggest that the ratio of household liabilities to annual after-tax income for the top fifth of all households ranked by income rose from about 1.1 at the end of 1998 to 1.3 at the end of 2001. The increase for the lower four-fifths was not quite half as large

Although high-income households should not experience much strain in meeting their debt-service obligations, others might. Indeed, repayment difficulties have already increased, particularly in the subprime markets for consumer loans and mortgages. Delinquency rates may well worsen as a delayed result of the strains on household finances over the past two years. Large erosions, however, do not seem likely, and the overall levels of debt and repayment delinquencies do not, as of now, appear to pose a major impediment to a moderate expansion of consumption spending going forward.

Although the macroeconomic effects of debt burdens may be limited, we have already observed significant spending restraint among the top fifth of income earners--who accounted for around 44 percent of total after-tax household income last year--presumably owing to the drop in equity prices, on net, over the past two years. The effect of the stock market on other households' spending has been less evident. Moderate-income households have a much larger proportion of their assets in homes, and the continuing rise in the value of houses has provided greater support for their net worth. Reflecting these differences in portfolio composition, the net worth of the top fifth of income earners has dropped far more than it did for the remaining four-fifths over the two-year period.

As a consequence, excluding capital gains and losses from the calculation, as is the convention in our national income accounts, personal saving for the upper fifth, which had been negative during 1999 and 2000, turned positive in 2001. By contrast, the average saving rate for the lower four-fifths of households, by income, was generally positive during the second half of the 1990s and has fluctuated in a narrow range in the past few years. Accordingly, most of the change in consumption expenditures that resulted from the bull stock market and its demise reflected shifts in spending by upper-income households. As I noted earlier, the restraining effects from the net decline in wealth during the past two years presumably have not, as yet, fully played out and could exert some further damping effect on the overall growth of household spending relative to that of income.

Perhaps most central to the outlook for consumer spending will be developments in the labor market, which has improved some in recent months. The pace of layoffs quickened last fall, especially after September 11, and the unemployment rate rose sharply. But layoffs have diminished noticeably in 2002, and payrolls grew again in March. In typical cyclical fashion, the unemployment rate has lagged the pickup in demand somewhat, but it has remained between 5-1/2 and 5-3/4 percent of late, after rising rapidly in 2001.

Over the longer haul, incomes and spending are driven most importantly by the behavior of labor productivity. And here the most recent readings have been very encouraging. Typically, labor productivity declines when output is cut back and businesses are reluctant to proportionately reduce their workforces. However, output per hour continued to grow last year. Indeed, it rose at an annual rate of 5-1/2 percent in the fourth quarter of last year and appears to have posted another sharp advance in the first quarter. No doubt, some of the recent acceleration reflects normal statistical noise. More fundamentally, some of this pickup probably occurred because businesses have remained cautious about boosting labor input in response to the surprising strength of demand in recent months. But the magnitude of the gains in productivity over the past year provides further evidence of improvement in the underlying pace of structural labor productivity. This development augurs well for firms' ability to grant wage increases to their employees without putting upward pressure on prices.

In housing markets, low mortgage interest rates and favorable weather have provided considerable support to homebuilding in recent months. Moreover, attractive mortgage rates have bolstered the sales of existing homes and the extraction of capital gains embedded in home equity that those sales engender. Low rates have also encouraged households to take on larger mortgages when refinancing their homes. Drawing on home equity in this manner is a significant source of funding for consumption and home modernization. The pace of such extractions likely dropped along with the decline in refinancing activity that followed the backup in mortgage rates that began in early November. Mortgage rates have gone back down again in recent weeks and are at low levels. This should continue to underpin activity in housing, but with perhaps less spillover to consumption more generally.

The ongoing strength in the housing market has raised concerns about the possible emergence of a bubble in home prices. However, the analogy often made to the building and bursting of a stock price bubble is imperfect. First, unlike in the stock market, sales in the real estate market incur substantial transactions costs and, when most homes are sold, the seller must physically move out. Doing so often entails significant financial and emotional costs and is an obvious impediment to stimulating a bubble through speculative trading in homes. Thus, while stock market turnover is more than 100 percent annually, the turnover of home ownership is less than 10 percent annually--scarcely tinder for speculative conflagration. Second, arbitrage opportunities are much more limited in housing markets than in securities markets. A home in Portland, Oregon is not a close substitute for a home in Portland, Maine, and the "national" housing market is better understood as a collection of small, local housing markets. Even if a bubble were to develop in a local market, it would not necessarily have implications for the nation as a whole.

These factors certainly do not mean that bubbles cannot develop in house markets and that home prices cannot decline: Indeed, home prices fell significantly in several parts of the country in the early 1990s. But because the turnover of homes is so much smaller than that of stocks and because the underlying demand for living space tends to be revised very gradually, the speed and magnitude of price rises and declines often observed in markets for securities are more difficult to create in markets for homes.

* * *

The technological advances contributing to the gains in productivity that we have achieved over the past year should provide support not only to the household sector but also to the business sector through a recovery in corporate profits and capital investment.

The retrenchment in capital spending over the past year and a half was central to the sharp slowing in overall activity. These cutbacks in capital spending interacted with, and were reinforced by, falling profits and equity prices. Indeed, a striking feature of the current cyclical episode relative to many earlier ones has been the virtual absence of pricing power across much of American business, as increasing globalization and deregulation have enhanced competition. Business managers, with little opportunity to raise prices, have moved aggressively to stabilize cash flows by trimming workforces. These efforts have limited any rise in unit costs, attenuated the pressure on profit margins, and ultimately helped to preserve the vast majority of private-sector jobs. To the extent that businesses are successful in boosting profits and cash flow, capital spending should begin to recover more noticeably.

Part of the reduction in pricing power observed in this cycle should be reversed as firming demand enables businesses to take back large price discounts. Though such an adjustment would tend to elevate price levels, underlying inflationary cost pressures should remain contained. A lack of pressures in labor markets and increases in productivity are holding labor costs in check, resulting in rising profit margins even with inflation remaining low. Although energy-using companies will experience some profit pressures as recent increases in spot oil prices become imbedded in contracts, these effects should be limited unless oil prices increase appreciably further.

To be sure, over time, the current accommodative stance of monetary policy is not likely to be consistent with maintaining price stability. But prospects for low inflation and inflation expectations in the period ahead mean that the Federal Reserve should have ample opportunity to adjust policy to keep inflation pressures contained once sustained, solid, economic expansion is in view.

Improved profit margins over time and more assured prospects for rising final demand would likely be accompanied by a decline in risk premiums from their current elevated levels toward a more normal range. With real rates of return on high-tech equipment still attractive, the lowering of risk premiums should be an additional spur to new investment. Reports from businesses around the country suggest that the exploitation of available networking and other information technologies was only partially completed when the cyclical retrenchment of the past year began. Many business managers still hold the view, according to a recent survey of purchasing managers, that less than half of currently available new and, presumably profitable, supply-chain technologies have been put into use.

Recent evidence suggests that a recovery in at least some forms of high-tech investment is under way. Production of semiconductors, which in the past has been a leading indicator of computer production, turned up last fall. Expenditures on computers rose at a double-digit annual rate in real terms in the fourth quarter. But investment expenditures in the communications sector, where overcapacity was substantial, as yet show few signs of increasing, and business investment in some other sectors, such as aircraft, hit by the drop in air travel, will presumably remain weak in 2002. On balance, the recovery this year in overall spending on business fixed investment is likely to be gradual.

* * *

The U.S. economy has displayed a remarkable resilience over the past six months in the face of some very significant adverse shocks. But the strength of the economic expansion that is under way remains to be clarified. Some of the forces that have weighed heavily on the economy over the past year or so have begun to dissipate, but other factors, such as the sharp increase in world oil prices, have arisen that pose new challenges. As a result, the course of final demand will need to be monitored closely.

Still, there can be little doubt that prospects have brightened. Spending in the household sector has held up well, and some signs of improvement are evident in business profits and investment. Fiscal policy continues to provide stimulus to aggregate demand, and monetary policy is currently accommodative. With the growth of productivity well maintained and inflation pressures largely absent, the foundation for economic expansion has been laid.

Congress of the United States
JOINT ECONOMIC COMMITTEE
(CREATED PURSUANT TO SEC. 5(a) OF PUBLIC LAW 304, 79TH CONGRESS)
Washington, DC 20510–6602

April 25, 2002

The Honorable Alan Greenspan
Chairman
Board of Governors of the Federal Reserve System
Twentieth Street and Constitution Avenue, N.W.
Washington, DC 20551

Dear Chairman Greenspan:

It was a pleasure to speak with you at the Joint Economic Committee hearing of April 17, 2002 and to hear your thoughts on monetary policy and the state of the U.S. and world economies. Since I had only limited time to get your thoughts at the hearing, I appreciate the opportunity to follow-up with a few questions that can be included in the record.

As I briefly mentioned at the end of the hearing, I believe that opportunities exist to improve the quality of the economic statistics that federal agencies collect, process, and disseminate. As you know, these statistics – on production, income, employment, productivity, etc. – play an important role, not only in the development of economic policy, but also in the decision-making of many businesses and consumers.

It recently came to my attention that statutory constraints might be limiting the quality of economic statistics. As you know, the responsibility for economic statistics is spread across many separate agencies, most notably the Bureau of Economic Analysis (BEA), the Bureau of Labor Statistics (BLS), and the Bureau of the Census. The data gathering efforts of these agencies sometimes overlap. For example, both the BLS and the Census collect data about business establishments.

It has been suggested to me that the statistical agencies could realize significant gains – in the quality of their published data, the cost of preparing it, and the burden that data collection places on respondents in the private sector – if they could share some of their underlying data with each other. Their ability to do so, however, is greatly limited by statutory barriers that, in essence, prohibit such sharing.

These statutes have a worthy goal – protecting the confidentiality of the respondents who provide information to the government. I have been advised, however, that under reasonable statutory changes, it should be possible to maintain or even strengthen the current level of confidentiality while allowing data sharing only for statistical purposes.

Page 2
Chairman Greenspan

Given the Federal Reserve's prominent role as both a consumer and a producer of economic statistics, I would appreciate your thoughts on these issues. In particular:

- Would data sharing among the leading statistical agencies improve the quality of economic statistics?

- Would data sharing among the leading statistical agencies, and any resultant improvements in economic statistics, assist the Federal Reserve in its activities, such as:

  - o producing its own economic statistics (e.g., industrial production);

  - o analyzing and understanding trends in key economic measures, such as output, employment, prices, or productivity;

  - o conducting monetary policy; and

  - o supervising and regulating banking institutions?

- Would increased data sharing among the statistical agencies raise any concerns for the Federal Reserve about respondent confidentiality?

To the extent that you can provide specific examples in response to any of these questions, that would be very helpful.

Should you have any questions about these inquiries, please do not hesitate to contact me or Donald Marron (202-224-3922), my Principal Economist at the Joint Economic Committee.

Thank you for interest and assistance.

Sincerely,

Robert F. Bennett
United States Senator

RFB:dbm

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON, D. C. 20551

ALAN GREENSPAN
CHAIRMAN

May 8, 2002

The Honorable Robert F. Bennett
United States Senate
Washington, D.C. 20510

Dear Senator:

Thank you for your letter of April 25 in which you asked for my views on removing certain statutory barriers to the sharing of business data among the Bureau of the Census, the Bureau of Labor Statistics (BLS), and the Bureau of Economic Analysis (BEA). Under a recent proposal, data would be shared for the purpose of updating statistical sample frames, improving sample coverage, providing consistent classifications of establishments and companies into industries, and reconciling significant differences between existing data produced by the three agencies.

As I have remarked on many occasions, high quality economic statistics are an important input for decisionmaking by households, businesses, and policymakers. We are fortunate that the statistical systems in the United States, both public and private, are among the best in the world and, indeed, in many respects set the world standard. But even a world standard can be made better.

One important outcome of data sharing would be the coordination of establishment lists. Currently, the BLS and the Census Bureau maintain separate lists of establishments that they use for sampling purposes. These establishment lists are derived from two different sets of administrative records. The Census Bureau uses tax records, and the BLS uses records from the unemployment insurance system. In a dynamic economy such as ours, where new establishments are being created every day, the statistical agencies have a difficult job making sure that the lists used for their sampling frames provide an up-to-date and complete representation of the current industrial structure. If legislation allowing the sharing of business data were enacted, the Census Bureau and the BLS would be able to compare their lists in order to improve the depth and breadth of their samples. Such improved coverage would help make the data collected by agencies more representative of the economy and, accordingly, more reliable.

The Honorable Robert F. Bennett
Page Two

The establishment lists that both agencies maintain include a code that identifies the industry associated with the primary output of the establishment. These codes are based on the North American Industry Classification System (NAICS). One problem is that the two lists may identify the same establishment with different NAICS codes. As a result, for example, the detailed industry data on shipments from a Census Bureau survey may not cover the same establishments as the detailed industry data on employment collected by the BLS. To the extent that these misclassifications occur, detailed industry estimates of productivity will be invalid. My understanding is that problems of this type do, in fact, exist. Thus, another benefit of the proposed legislation is that it would allow the statistical agencies to cross-validate their establishment lists.

Improving the consistency and reliability of economic information across statistical agencies would benefit all data users. To illustrate, at the Federal Reserve we look closely at data such as shipments and employment at the detailed industry level for our economic analysis and as part of our industrial production statistical program. This work would certainly be enhanced by improvements in the quality of the underlying source data.

The American statistical system is an extremely important national resource, and I applaud efforts to improve that system.

Sincerely,

PAUL S. SARBANES
MARYLAND

309 HART SENATE OFFICE BUILDING
WASHINGTON, DC 20510
202-224-4524

United States Senate
WASHINGTON, DC 20510-2002

Dear Chairman Greenspan,

An article published on Tuesday, April 16th, in the Wall Street Journal reported that, "The U.S. may not be nearly as big an international debtor as generally thought, because official data overstate how much it owes to foreigners, a Federal Reserve study has found." Even if this is correct, it is fair to say that the U.S. external debt is extraordinarily large and growing.

Foreigners held $9.4 trillion in U.S. assets at the end of 2000 (the most recent official data). At the same time, Americans held $7.2 trillion in assets abroad. That left us with a net asset position of $2.2 trillion (market value) – 22 percent of our GDP. Even if the estimates made in the recent Fed study are correct, the net negative international position was still 16 percent of GDP and rising rapidly. In 2001, the U.S. ran another deficit of $417 billion in the current account, probably increasing U.S. external debt by another 4 percent of GDP.

With our imports running 35 percent larger than our exports, our exports must grow 35 percent faster than our imports just to keep the trade balance from widening. Trade economists tell us that, when U.S. income goes up 10 percent, our imports rise about 18 percent, but when income abroad rises 10 percent U.S. exports rise by only about 11 or 12 percent. The consensus of economists calls for U.S. growth to outpace foreign growth again this year.

All this points to the almost certain result that the trade deficit will resume going up again this year after a one year respite because of the recession.

Whether the official numbers or the Fed researchers numbers are correct about the current level of our net asset position, the ratio of our net position to GDP is rising rapidly. How long does the Federal Reserve expect the current account to be roughly 4 percent or more of GDP? How much does the Federal Reserve expect the net asset to GDP ratio to rise over the next 5 years? Over the next 10 years? What are the conditions necessary to stabilize this deteriorating situation?

Sincerely,

Paul S. Sarbanes

Paul S. Sarbanes
Senator

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON, D. C. 20551

ALAN GREENSPAN
CHAIRMAN

April 26, 2002

The Honorable Paul S. Sarbanes
United States Senate
Washington, D.C. 20510

Dear Senator:

I am pleased to enclose my response to the question you submitted following the April 17 hearing before the Joint Economic Committee. I have also forwarded a copy to the Committee for inclusion in the hearing record.

Sincerely,

Enclosure

Chairman Greenspan submitted the following in response to a written question received from Senator Sarbanes in connection with the Joint Economic Committee hearing of April 17, 2002:

Current Account Deficit

An article published on Tuesday, April 16th, in the Wall Street Journal reported that, "The U.S. may not be nearly as big an international debtor as generally thought, because official data overstate how much it owes foreigners, a Federal Reserve study has found." Even if this is correct, it is fair to say that the U.S. external debt is extraordinarily large and growing.

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Whether the official numbers or the Fed researchers numbers are correct about the level of our net asset position, the ratio of our net position to GDP is rising rapidly. How long does the Federal Reserve expect the current account to be roughly 4 percent or more of GDP? How much does the Federal Reserve expect the net asset to GDP ratio to rise over the next 5 years? Over the next 10 years? What are the conditions necessary to stabilize this deteriorating situation?

As noted in the question, our imports have exceeded our exports by a growing amount over the past several years resulting in a widening current account deficit. Our ongoing current account deficit is also, by definition, a measure of the portion of our net investment in domestic plant and equipment that is financed with foreign funds, both debt and equity. The impressive productivity performance of the U.S. economy during this period has motivated global investors (both U.S. and foreign) to place their funds disproportionately in U.S. assets because of the expectation of higher returns on these relatively more productive assets. During the past six years, about 40 percent of the total increase in our capital stock in effect has been financed, on net, by saving from abroad

It is difficult to predict how long global investors will continue to place their funds disproportionately in U.S. assets. One cannot help but be impressed with how well productivity has held up in the face of the abrupt slowing of the economy in late 2000 and in 2001. While the recovery in spending on business fixed investment is likely to be only gradual, if the recent more-favorable economic developments gather momentum, uncertainties will diminish, risk premiums will fall, and the pace of capital investment embodying new technologies will increase. To this point, the United States has had little apparent difficulty in attracting funds from abroad. The fact that the foreign exchange value of the dollar has drifted higher, on balance, during the past few years suggests that incipient net private financial inflows are at least equal to the deficit on the current account. Private foreign purchases of U.S. securities alone have either met or exceeded the entire current account deficit during the past three years. In addition, foreign direct investment into the United States has swollen in recent years.

But the current account deficit, as you acknowledge, is also a measure of the increase in the level of net claims, primarily debt claims, that foreigners have on our assets. As the stock of such claims grows, an ever-larger flow of interest payments must be provided to the foreign suppliers of this capital. Countries that have gone down this path invariably have run into trouble, and so would we. Eventually, the current account deficit will have to be restrained. The nation's economic potential will be brighter if that comes about through an increase in domestic saving rather than a reduction in domestic investment.

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THE ECONOMIC OUTLOOK

HEARING

before the

JOINT ECONOMIC COMMITTEE
CONGRESS OF THE UNITED STATES

ONE HUNDRED SEVENTH CONGRESS

SECOND SESSION

July 17, 2002

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Wednesday, July 17, 2002

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

The Committee met, pursuant to notice, at 10:05 a.m., in Room 2226, Rayburn House Office Building, the Honorable Jim Saxton, Chairman of the Committee, presiding.

Present: Representatives Saxton, Ryan, Dunn, English, Putnam and Hill; Senators Reed and Bennett.

Staff Present: Chris Frenze, Robert Keleher, Colleen Healy, Darryl Evans, Brian Higginbotham, Donald Marron, Patricia Ruggles, Chad Stone, Matthew Salomon, and Diane Rogers.

OPENING STATEMENT OF REPRESENTATIVE JIM SAXTON, CHAIRMAN

Representative Saxton. Good morning. It is a pleasure to welcome Chairman Hubbard this morning to the Joint Economic Committee (JEC) to testify on the economic outlook.

The economy continues to rebound from the slowdown that began in the middle of 2000, eventually becoming a recession. In March of 2000, the NASDAQ began a sharp decline, with spreading weakness signaled later in that year by falling factory employment and industrial production. The slowdown became a mild recession in 2001, but economic indicators suggest that a recovery was under way by late last year.

Real GDP (gross domestic product) increased 6.1 percent in the first quarter of 2002, manufacturing activity rebounded, industrial production rose, and consumption and residential real estate remained strong. However, there are signs that the pace of economic expansion has moderated more recently.

The payroll employment data indicate that many employers have held off on new hiring until the stability of the recovery becomes clear. As a result, the output of goods and services is rising, but at a faster pace than is employment. Consequently, labor productivity in the first quarter surged, and is expected to remain strong in the second quarter.

The pace of the expansion may be affected by concerns about international tensions, terrorism, and corporate accounting practices. As a result, the level of risk and uncertainty is significant, and this imposes additional costs on the economy and also is reflected in the weak stock market.

As Chairman Greenspan pointed out just yesterday, our free market economic system is based on property rights, and fraud and deception are thefts of property. Reforms are needed in accounting and corporate governance to strengthen safeguards against those who would otherwise abuse the rights of shareholders. The President and Congress are moving forward to provide these needed reforms.

However, despite these problems, the remarkable resilience of the American people and economy continues to be evident. It appears likely that business profits and investment will recover in due course, consolidating and extending the U.S. economic expansion. The Federal Reserve's actions to reduce interest rates, and congressional actions to reduce the tax burden have improved the prospects of economic expansion.

Let me yield at this time to Senator Reed for any opening statement he may wish to make.

[The prepared statement of Representative Saxton appears in the Submissions for the Record on page 31.]

PREPARED STATEMENT OF SENATOR JACK REED, VICE CHAIRMAN

Senator Reed. Thank you very much, Mr. Chairman.

I want to welcome Chairman Hubbard. He plays a critical role as Chairman of the Council of Economic Advisers (CEA). I am looking forward to hearing Chairman Hubbard's views on the state of the economy, and I wouldn't be surprised if we have some spirited discussion about the administration's latest forecast and its implications for budget and tax policy.

I have serious concerns about the economic policies that this administration is pursuing. We are very fortunate that the worst fears about how September 11th would affect the economy were not realized, but I fear that we may be experiencing the same kind of jobless recovery that we saw the last time around. When the recession ended in March of 1991, unemployment kept rising until July of 1992, and the Federal budget reached a record deficit of $290 billion. Last month the unemployment rate bumped up to 5.9 percent, and the number of unemployed people was nearly 2.4 million higher than it was when the recession started. Even though there was a small increase last month, the number of payroll jobs is lower now than it was at the beginning of the year. And, of course, every time we reestimate the budget deficit, it gets worse.

The administration seems to believe that more tax cuts are the answer. But how do budget-draining tax cuts skewed towards upper-income taxpayers address the concerns of ordinary Americans? People are worried about their jobs and their pensions; they want to be sure that Social Security is on a sound footing and that they can afford prescription drugs; they want to be assured that corporate executives are honest or that they will be caught and punished if they are not; and they want to believe that the government is on their side, working to help them improve their lives.

On another matter, I would like to commend the CEA on its role in improving the quality of Federal statistics. The proposal the administration unveiled last week to enhance data sharing among the Census Bureau, the Bureau of Labor Statistics, and the Bureau of Economic Analysis is an important step towards improving our ability to measure and understand the rapidly changing economy. The JEC, too, has had a long tradition of working to improve the quality of Federal statistics. In fact, we are having a hearing next week on the topic of measuring economic change, and I look forward to working with the CEA on efforts to create a 21st century statistical infrastructure appropriate for a 21st century economy.

Dr. Hubbard, I look forward to hearing what you have to say about the economic outlook. I hope that the CEA is taking a hard look at economic realities and can give us some constructive advice on how we can improve the employment picture while stimulating economic growth and avoiding a new round of ballooning deficits. Thank you.

[The prepared statement of Senator Reed appears in the Submissions for the Record on page 32.]

Representative Saxton. Thank you, Senator Reed.

Chairman Hubbard, thank you for being here this morning. We appreciate your participation.

Let me just announce at the outset that both the House and the Senate are expected to have votes in approximately 20 minutes. So we will get started, and unfortunately we will have a little interruption, and then we will come back to hear the rest of your testimony.

So, sir, if you would like to go lead and share your thoughts with us at this time, we would appreciate it.

PREPARED STATEMENT OF DR. R. GLENN HUBBARD, CHAIRMAN, COUNCIL OF ECONOMIC ADVISERS

Dr. Hubbard. Sure. Thank you very much, Mr. Chairman and Senator Reed and Congressman Ryan. I will be brief, because you have my full testimony.

What I really wanted to bring up for your attention were three things: One, to talk a little bit about the mechanics of the recovery that we are now seeing; second, to talk about what both of you raised in your opening statements, risks to the recovery; and, third, what kinds of public policies promote the recovery, and, frankly, what kinds of public policies might hinder it.

Our economic outlook at the administration, of course, has just been updated and released in the midsession review of the budget, which, of course, you have. In doing that revision, we took into account recent changes in economic forecasts in the private sector as well as passage of the *Job Creation and Worker Assistance Act*, which contains provisions both on the unemployment side and for investment incentives.

Over the longer term in the budget, we kept GDP growth where we had had it, and long-term GDP growth is still projected to average around 3.2 percent per year, which I would note is also the Blue Chip consensus forecast. During the last part of that period, we have the long-term growth of the country at about 3.1 percent.

What are the mechanics of recovery? Well, the star in the recovery any time is the star in the economy, which is the consumer, since consumer spending is about two thirds of the economy; and the household sector, of course, which is well known to you, was the star during the downturn and continues to hold up very prominently during the upturn. This holding up, in our view at the CEA, is quite rational and reflects expectations of greater income growth in the future, very accommodated monetary policy, and a tax policy which, while also good for the long term, provided a short-term cushion for consumers.

In order, however, to have a sustainable recovery, I think any economist will tell you that the attention must, at some point, shift to business fixed investment. It is very hard to have a sustainable recovery with the kind of job creation, for example, that Senator Reed highlighted, without much more vigorous investment. As you know, public policy shifted to provide more incentives for investment in the *Job Creation and Worker Assistance Act*. Interest rate climate for investment also remains quite favorable. And something that does not appear to be getting the attention it deserves, corporate profits as measured in our national income and product accounts, are rebounding quite strongly.

And this is a flip side, Mr. Chairman, of the points you raised about productivity. The very modest increases we are seeing in unit labor costs during the recovery have led to a profit rebound. So when most economists – and I would count myself among them – look for an investment turnaround later this year, they are highlighting those fundamentals in a turnaround in profits as well as effects of lower interest rates and investment stimulus.

I think we will continue to see evidence of the investment recovery in coming months. Toward this end, I would point out that most recently the data we got on industrial production are very encouraging, as we had news beyond market expectations.

Now, I said I also wanted to talk with you about risks to the recovery. I think there is too much of a tendency for economists to give you a number and then walk away, and I want to have a very candid discussion with you where I think risks are. And a key risk that I am sure is on your mind, as is it on mine, has to do with the stock market. For example, the stock market has declined about 13 percent since the end of May, and my judgment is that reflects shifts in the equity risk premium and concerns over, among other things, profitability that I mentioned before, and, frankly, concerns over the quality of financial and accounting data.

The upshot of that is a story all too familiar to you that household wealth has fallen by about $1.3 trillion. This manifests itself most obviously to all of us when we look at our pension values, or 401(k) plans or retirement plans, but it has raised concerns in some quarters about the durability of the recovery. So I just want to put a calculation on the table to try to frame how much or how not much of a worry the debt is.

If one were to suppose that the decline in the stock market value that we have seen since May were to be permanent, that is, we just take it forever out of the level of stock prices, we estimate at the Council that the level of real GDP would be lower by between 4/10 to 7/10 of a percentage point after a year. That is a noticeable hit. It by no means would derail the recovery. And that, of course, is assuming the worst, a permanent hit. It is also important to note that while equity values have fallen, that has been cushioned in part for households by a rise in housing equity, though by no means cushioned as much as a decline in equity.

On the investment side, I would also note as a risk the modest rise we have been seeing in risk spreads, which doubtless contributes to lower equity valuations. In terms of the cost of capital for investment, those risk premium increases have been offset in part by a decline in riskless rate; that is, around the world we are seeing a flight to quality, in economist terms, as people are selling equities and buying bonds.

A part of all this in talking about the risks to the recovery, though, is to ask ourselves about the quality of the data, and I very much appreciate Senator Reed bringing this up. The intense focus we are seeing on monthly or sometimes weekly data releases during the recovery is really focusing the attention, I think, on the quality of economic data. And as the Senator mentioned, the Council unveiled the President's initiative last week to raise the quality of economic statistics. This isn't a parlor game issue among economists; it is about having real-time data that are of use to the private economy in making saving and investment plans, and to you and us in the administration in formulating and thinking about economic policy. We have initiatives for the coordination of data across the statistical agencies that would still protect the confidentiality of taxpayers and firms. I believe this is an initiative that deserves very serious consideration, and hope that it comes to fruition very soon.

Now, I said that I would also spend a few minutes with you on issues about policies for recovery, good policies and bad, and I think one of the issues that has come to the fore in the recovery is the notion of uncertainty. Now, partly, this uncertainty is real. It reflects terrorism risks that perhaps are acknowledged as being larger than they once were or perhaps even new. These are real risks to our economy that one does not easily wave away in the short term.

There are also, however, risks to our economy, both for the long run and the recovery, that come from public policies. Now, we have abundant lessons over the past two decades that testify to the energy and innovation of the private sector. That came up, of course, in the opening statements as well. And I find it somewhat remarkable that some have suggested the growth-oriented tax policy might be making matters worse in urging repeal of the tax cut. I submit to you that is not only bad long-term tax policy, uncertainty surrounding such a discussion weighs on the minds of savers and investors and contributes to an atmosphere of uncertainty in markets.

I will give you a number if that helps. Professor Harvey Rosen at Princeton recently did a calculation that doing a U-turn by taking away the balance of the President's tax cut and looking forward would ultimately reduce GDP growth by just under 2/10 of a percentage point per year. Now, that may not sound like a lot to you, but after 10 years that is about $1,000 in extra output for every man, woman, and child in the country. The message there, I think, is straightforward: One doesn't want to place the future pro-growth tax policy at risk.

The second pro-growth policy that I worry about is in the trade area. I think we all share generally, if not specifically – and hopefully all specifically – the President's interest in trade promotion authority and open markets and gains from trade. I will spare you the homily on free trade, although I will stipulate that it is true, just to remind you that the institutions for trade are important, and uncertainty about conditions being attached to trade promotion authority is not good business.

The final element of a general uncertainty, before I get to the newer area of corporate governance in the market, has to do with spending. There is often a concern, as, of course, there should be, over deficits and surpluses. But I would submit to you, that is the top layer of the concern. The real issue is overspending and the size of government; that is what determines the current and future tax burdens. Being wary of spending patterns is critical for you and for us.

The final new element I wanted to raise with you is uncertainty over corporate governance. We cannot have the most efficient capital markets in the world, which we have historically had in this country, without trust, and that trust is of two kinds at least. One is faith in the numbers that we see, that they recognize the true state of a company or set of companies. And second is trust that the management of companies will act in the interest of the shareholders in whose trust they serve.

The President, of course, put out in March a 10-point plan focused on two primary areas. One is transparency, that is, improving the quality of information we get as investors or policymakers; and the other is accountability, so that abuses of trust are punished financially, or in some cases in a criminal setting.

The Securities and Exchange Commission, of course, has already made substantial strides here and has asked for several new rulemakings, and, as you know well, has asked for a recertification of statements of the top 1,000 companies. More recently the President called for a new ethic of responsibility in the corporate community, and in the administration we are very pleased with the progress in the Congress in getting both the Senate bill and the House bill out. The President would like to get something soon that he can sign. This is an uncertainty over our economy that we need to resolve, and I commend those in the Congress who have been working very strenuously on this.

Before I finish, I would like to close with one area about which there is no uncertainty. It is, of course, always easy and exciting to look at the events that are in the pages of the newspaper before us, but the truth about our economy's long-term growth today is the same as it always has been. Our standard of living is determined by productivity growth. As we think about policies, be they tax policies, be they regulatory policies, be they the way we approach corporate America, we need to make sure we emphasize growth and innovation.

Thank you, Mr. Chairman. I am delighted to have this opportunity, and I look forward to your questions or any questions Members of the Committee might have.

[The prepared statement of Dr. Hubbard appears in the Submissions for the Record on page 35.]

Representative Saxton. Well, thank you very much, Mr. Hubbard, for sharing those thoughts with us.

Let me begin with kind of a paradoxical question. We here at the JEC constantly monitor a variety of economic indicators, and, frankly, most of those indicators look pretty good. And yet I found myself yesterday sitting in my office talking with some of my staff reaching for the television clicker to turn off the news because it didn't look good. And I thought to myself, why do I need to watch this and put my stomach through arduous kinds of conditions?

When we monitor, for example, growth of domestic product during the first quarter of the year was over 6 percent growth, and in the second quarter it looks like it is going to be about half that, but still significant growth in the economy. Consumption, as you pointed out in your statement, during the first quarter was over 6 percent, and in the second quarter again it looks like it will be – I'm sorry, the last quarter of last year was over 6 percent, and in the first quarter of this year, it was something like 3.3 percent. As you pointed out also, retail sales continue to trend upward. This is good economic news. Home sales continue to be very strong. Business investment, while weak, is not as weak as perhaps it was several months ago. New orders in capital goods are trending up. The Industrial Production Index has been on the positive side for the last six or seven months. The Purchasing Managers Index, which is a measure of the percentage of businesses that are growing, just a few months ago, perhaps at the end of the third quarter of last year, showed there were only 40 percent of the businesses in the country that we measured as growing. Today 56 percent are growing, or thereabouts.

And so there is a lot of good news in the economy, and yet we see obvious signs of other weaknesses. Is this totally because of the accountability and uncertainty factors that you mentioned vis-a-vis terrorism and problems with our accounting processes and uncertainty that develop because of those two issues?

Dr. Hubbard. I don't think so, Mr. Chairman. After September 11th, I started having fairly regular telephone conversations with samples of executives around the country precisely because I felt they needed information faster than the data releases would give it to them. The areas that worried people at the time and worry people still have to do with the timing of an investment recovery. You probably know, CEOs generally have been more pessimistic in that regard than have most economists – not just myself, but many in the private sector. I think that is a source of uncertainty and a wild card that certainly predated the corporate governance issues. I think the corporate governance problem has made things worse because it has added the complication of stock market valuations and probably complicated the investment recovery.

The other issue I would raise, I should follow up on something that Senator Reed had mentioned in the beginning. I think one reason in many people's minds that recovery doesn't feel as good is that we haven't seen job creation at the same pace as we have seen output creation. That will come, but it has been slower and, I think, has slowed down people's perceptions of the times.

Representative Saxton. Well, thank you. As I indicated at the outset, we are going to have some votes around 10:30 both in the House and the Senate. So I am going to have some more questions later, but let me turn to Senator Reed to give him an opportunity before he has to run off.

Senator Reed. Thank you very much, Mr. Chairman. And, as you indicated, the Senate has a vote at 10:30, and I will leave, and I hope my colleagues will return here after the vote.

Again, Chairman Hubbard, thank you for your testimony. There has been some discussion about the results of the first quarter the President pointed to that were very impressive, about 6.1 percent growth in GDP. But wasn't much of the growth in the first quarter based on one-time inventory adjustments rather than underlying strength and sales?

Dr. Hubbard. Certainly a very large factor in the first quarter was inventory adjustments. I expect inventory adjustments will also figure in the second quarter's growth as well. But, yes, they are not final demand changes.

Senator Reed. And so we still haven't seen – well, let me put it another way. That 6.1 percent doesn't reflect a surge in the consumer demand; it is more or less reduction in inventories?

Dr. Hubbard. Consumer demand held up very well in the first quarter; but I don't think any economist will tell you that 6.1 percent is a normal rate.

Senator Reed. Dr. Hubbard, in your testimony, in your remarks, you cited a study by Professor Rosen that estimates that the tax cut reduces the dead weight loss of the tax system by about 2/10 of a percent of GDP annually. Does this calculation take into account the economic effects of the revenue loss and loss of national savings associated with tax cuts? Other studies, I am told, one by Professor Auerbach, found that there is a net loss from the tax cut if national savings goes down. Would you comment?

Dr. Hubbard. I will answer both parts of that. The calculation that Harvey Rosen does was just as I described: It was simply of a tax change. The effects of the tax change through interest rates on the economy are very modest. The best study that I am familiar with was done at the Federal Reserve Board, Elmendorf & Mankiw study. I have a number of very deep technical concerns with the Auerbach paper. I am not sure if this is the right venue to have them. But I do not accept the paper's conclusions.

Senator Reed. Well, we on the Senate side had a hearing on the Banking Committee, and Professor Solow and Professor Stiglitz joined us. And paraphrasing – and awkwardly paraphrasing – their comments, the suggestion was that national savings will be decreased because of the budget surplus going down, and is unlikely to be made up by private savings given the history of private savings in the country. And without national savings, we don't have the resources for the investment that you think is going to be the leading edge of our recovery. And proposals today to further cut taxes would, I tend to think, further erode national savings in terms of simply decreasing in a more dramatic way the surplus, which is already exhausted through the deficit. Can you comment?

Dr. Hubbard. Sure. The three points you raise: One, I think the base line in that experiment is one that I think is somewhat odd, which is the notion that if you ran surpluses without the tax cut, those would not be spent. I think that, history tells us, is not perhaps the most apt.

The second, on interest rates. While I will skip the general technical differences in the model, in the Auerbach paper, it is built in to have the largest possible interest rate effects; in fact, far larger than any empirical evidence would suggest.

And on the notion of further cutting taxes, I think what I referred to in my testimony was carrying out the tax cut that you have already passed. I wasn't asking you for your consideration for yet another round of tax cuts.

Senator Reed. Well, I seem to hear the President at every possible moment talking about extending and making permanent the estate tax repeal, and making permanent tax cuts that will sunset in 10 years or so. So, is he doing something that you would advise him not to do?

Dr. Hubbard. No. Absolutely not. I think we do want the tax cut that you passed made permanent – good long-term tax cuts.

Senator Reed. Well, so you would want the estate tax cut permanently?

Dr. Hubbard. Everything that you enacted in the tax bill, yes, we would like to make it permanent.

Senator Reed. Well, we already have reached a point where we have a significant deficit of $165 billion, and it keeps going up with every estimate.

In the midsession review, OMB Director Daniels did a preview, and he suggested that the 10-year surplus was significantly caused by the recession, and only 15 percent of the change was the result of the tax changes made last year, the tax cuts. Yet as I look at your report -- the midsession review, actually -- it suggests on page 6 that over the 10-year period almost 40 percent of the change is a result of the tax cuts. Is it 15 or is it 40? And if we cut taxes further or, in fact, increase or make permanent the taxes, will that 40 percent grow even more, particularly, obviously, after the 10-year period?

Dr. Hubbard. Well, I, of course, wasn't here for your conversation with Mitch, so I don't want to talk about his number. But, yes, the tax cut is one of the contributing factors in the decline in the surplus there on page 6. And over the long term, the static costs of the tax cut are very high. Absolutely true.

Our advocacy, as an administration, for the tax cut and your advocacy in the Congress in passing it, was the belief that it was the right program policy for the country.

Senator Reed. Well, at least in the short run we haven't seen that take hold yet; is that correct?

Dr. Hubbard. I would disagree with that, Senator, respectfully. I think that we have seen support from the tax cut in both the downturn and at the beginning of the recovery. And, of course, the real purpose for tax cuts of the sort that you pass, marginal-rate cuts, is for long-term economic growth.

Senator Reed. Let me just conclude. One of the other issues that was motivating the proposals last year for the tax cut was the notion that it was important to reduce the deficit, and we could do that. That we could, in fact retire Federal debt. It seems now that this is getting more and more difficult. How much debt do you think we can retire now by 2007? I think some of the components of the tax cut would suggest one reason we could cut taxes is because the surplus would grow so large that we couldn't handle it.

Dr. Hubbard. Well, the surplus, of course, is much smaller than at that time. As you know, the unified budget surpluses reappear in the midsession forecasts in the fiscal year 2005 budget, and that is when the period of more aggressive debt reduction begins.

Senator Reed. Thank you, Mr. Chairman.

Representative Saxton. Thank you.

Mr. Ryan.

Representative Ryan. Thank you, Mr. Chairman.

Mr. Hubbard, it is nice to see you here. I have been going through your testimony and listening to your oral testimony, and I just have a few observations and just a couple quick questions.

It is very important that we now look at the threats facing our economy as we try to pull out of the bad news and the problems we have had. And in looking at the President's recent comments, looking at some of the comments from Ken Dam, from the administration, over at the Treasury Department, I have a few concerns.

One concern that I completely agree with you is that the sunset of these tax cuts is producing uncertainty in the economy, when 24 percent of our equity markets are owned by pensions, are owned by people's retirement portfolios, and yet the tax treatment of those pensions from the tax law we passed, for instance, bringing the cap on 401(k)s down by a third, bringing the cap on IRAs down by half, those kinds of uncertainties expiring in eight years put a lot of uncertainty into the equity markets. And we need to fix that and make these tax policies permanent so the market's pension holders in the equity markets know on the income horizon that the tax treatment is certain.

But on the trade issue, you mention we need to go to free trade and pass TPA, I couldn't agree with that more, but I worry that the market see conflicting signals coming from the administration. I reference the steel action, and the lumber action. And also I think that the earnings stripping policy coming from the Treasury Department also has a problem in that it could trigger off a new round of tax treatment against our companies competing overseas. And I worry that the earnings stripping policy that the Treasury has put out may have the unintended consequence of just raising taxes on people who aren't seeking to avoid paying U.S. taxation.

So, I would like to get your comments on the Treasury earnings stripping policy. We in Ways and Means – a few of us here serve on that Committee as well – are trying to clean that up and trying to fix that so we don't trigger another round of perceived protectionism with respect to tax policy.

Spending is also something that I think we need the administration to weigh in on. The President has said a couple of times, we need to hold the line on spending; we need to hit the House target. But we don't hear anything from the administration in specifics and we here in Congress deal in specifics. We break the total spending total down into 13 different bills. We are in a little fight right now on the floor on the first domestic discretionary bill, but we haven't heard anything from the administration on how to get out of this fiscal year with some kind of spending discipline. And if we don't have any partnership or any detailed direction from the administration, my fear – and I think I can share this with a lot of people in this Congress – is that we are going to leave this fiscal year with blowing the cap, which is a Presidential veto threat, and the only budget resolution that exists, which is the House-passed that has been deemed.

On corporate governance – I also would like to get your comments on some of the bills that we have had around here. And I think the markets are worried: Are we going to do overkill and have government and Washington take over the accounting industry, approve the balance sheets and the accounting standards of our corporations; or are we going to pass confidence-building measures that allow transparency, honestly, truthfulness in our records? And is that going to then bring the rule of law back into capitalism, which is what we are trying to accomplish?

And so these are things that are taking place right now. I think the administration, Ken Dam, in particular, his comments that the stock market is still overvalued references that the 1990s were a binge. I think those are hurtful comments to the markets, and I think that they have contributed to a weak dollar policy, whether or not that is the intended policy of the administration. And I also think that some of the policy coming from the administration, probably in an unintended way, gives the impression that our policy shift is away from free trade and toward protectionism, is away from a strong dollar and toward a weak dollar, and is away from spending discipline toward spending more money. And I would like it if you can comment on those.

Dr. Hubbard. You give me quite a list. I will try to go through them.

Let me start with the issue of steel. As you know, the issue in the steel question isn't just whether or not one ought to have a tariff on steel. As a narrowly put economic question, I think the answer to that is obvious. The question is, is this part of the right structural adjustment policy. The President's judgment is that it is, that that is part of what we need to help the steel industry restructure and to pursue the broader trade agenda.

On earnings stripping, we can probably have a longer discussion later, but just to give you a sense of where the Treasury is coming from, is to attempt to go after the source of problems in so-called inversions; rather than banning inversions and meddling in corporate affairs, trying to ask: What is the incentive for this kind of activity? That will inevitably require leveling the playing field, and whenever you level the playing field, there will be winners and losers. And I would very much welcome a chance to talk with you on your concerns.

On spending, this is something where I think the administration has and will continue to provide guidance. For example, on the supplemental, I think the President has been quite blunt as it is on what he would like to see.

On corporate governance, I think in the administration we salute the efforts both that Chairman Oxley has made in the House and Chairman Sarbanes has made in the Senate. And I think we have bills that have very good elements and need to be reconciled quickly. As I said in my opening remarks, this is an uncertainty hanging over the market, and the President would like to sign this soon.

Representative Saxton. Mr. Chairman, unfortunately we have got about 5 minutes left in this vote, so we are going to have to run off. So in fairness to Mr. Ryan—

Representative Ryan. I think he is finishing up.

Dr. Hubbard. Can I give you one last one, and then I will let you sprint? Or I can do it later.

But on the issue of the stock market and binging, I don't think any economist can tell you with perfect certainty whether the market is overvalued or undervalued. What I can tell you is that the fundamentals of the economy are very, very good, and that it is very difficult to see anyplace other than the U.S. to be the best place to invest.

I would advise you not to carry the binge analogy too far in the sense that what we have left over from the 1990s is an economy that has wonderful technological innovation and productivity growth. It is the engine and envy of the world's growth.

Representative Saxton. Thank you, Mr. Chairman. We will go get this vote out of the way and be back as soon as possible, and when we return, we will go to Mr. English.

[Recess.]

Representative Saxton. Mr. Chairman, hopefully we won't be interrupted again for some time. Let's go to Mr. English at this point.

Representative English. Thank you, Mr. Chairman.

Chairman Hubbard, it is a privilege to have you here. I must say, when I am in Erie, Pennsylvania, I get a much less optimistic view of the economy than I do when I am here within the Washington Beltway. Our concern there is the things that we specialize in, which are particularly manufacturing; Erie County, Pennsylvania, has the biggest concentration of manufacturing jobs and export-related jobs in our entire State. We see our local economy very much tied to the manufacturing cycle, so I am going to concentrate the focus of my questions on that.

In your testimony, you say that the key to transforming recovery and robust growth is the pace of business-fixed investment. And then you reference what we were able to do in the very limited stimulus package that the Senate permitted us. That makes a great deal of sense to me. And then you also note: For the economy as a whole, business investment slowed its decline during the first quarter. Investment in nonresidential structures continues to decline, but purchases of equipment and software have shown some signs of firming.

In a second, I wonder if you could respond to that, and also respond to the question I – one of the hats I wear is Chairman of the Real Estate Caucus. Should we also be looking long term to incentives to encourage investment into nonresidential property as something that will add – value added to the economy?

I would like you, though, specifically to comment: Do you foresee a sustained rebound in manufacturing? Do you feel that the recent decline in the value of the dollar will have a significant positive effect on manufacturing and its competitive position in the United States?

And, finally, as Chairman of the Steel Caucus, I may have a little different view than you and some of my colleagues on the President's steel policy, which I think is revolutionary and shows the courage of being willing to think outside of the box. But I wonder if you would comment on what trends you see in steel prices, and how that is going to affect not only steel companies, but the manufacturing sector as a whole.

Dr. Hubbard. Thank you very much. A number of very good questions.

First, let me set the record straight. I absolutely support the President's steel decision.

Representative English. I got that.

Dr. Hubbard. I think it is an excellent example of corporate restructuring.

On the questions that you asked, I think that we do have a manufacturing recovery under way. The National Association of Manufacturers, I think, would agree to that in terms of surveys of its members. And we are starting to see more robust upturns in industrial production.

Yes, I do think a decline in the dollar is part of the story for manufacturing, just as it was part of the story for manufacturing's decline.

On the question about nonresidential property incentives, I think this is really a topic for discussion under tax reform. I would prefer, at least, to see a general discussion of how we tax capital and investment in the country, rather than doing it in a run-off way. One of the things I thought that was particularly good about the investment incentives that the Congress had passed before, was that they were a move toward a more neutral tax system, the business investment. I certainly salute that.

Representative English. And on that point, Chairman, if I might interrupt, one of my concerns was that our focus, because it was a narrow, limited bill, and because the Senate constrained Congress's approach to a stimulus package, we did not provide a similar series of incentives to encourage investment in business structures, in business property. And I wonder if you see that as an imbalance that we should address long term?

Dr. Hubbard. Well, I think the first and most important short-term consideration there will be the recovery of the economy itself, because the lumpiness of structures are naturally going to be slower to recover than equipment. I would urge you to think again in terms of bigger tax reform issues rather than focusing on it as a stimulus per se.

You asked the question about steel prices. Of course, steel prices will track very closely the economic recovery, as steel is a basic input.

Representative English. So would it be fair to say that, in your view, one of the critical things in the President's policy on steel is that by encouraging the economy overall to recover, essentially that is going to help the steel sector, which is closely tied to the performance of the overall economy? There is a tendency for many to break out the 2001 action as a freestanding, comprehensive policy. In fact, I see the President's approach to steel as being much more nuanced and much broader. And, in fact, the recovery of the manufacturing sector is likely to be the most effective way of providing recovery to the steel sector. Is that a fair summary?

Dr. Hubbard. That is absolutely true. The best policy for industries tends to be a policy that helps the economy as a whole. The piece of nuance I think that you were referring to, is the President wanted to use this action as a way to encourage restructuring in the steel industry, and we await that restructure.

Representative English. I thank the Chairman.

Representative Saxton. Thank you very much, Mr. English.

Ms. Dunn?

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

And welcome to you, Chairman Hubbard. I enjoyed and appreciated your answers to Mr. Reed's questions on the tax relief proposal that the President signed last year. And we need to go ahead to create permanency in some of these items. I think that, especially when it comes to the permanent repeal of the death tax, when people do have that sense of certainty, it is at that point where they change their behavior. And so, I think that that is very important to make sure that the dollars that continue to have to be put into life insurance coverage and estate planning be allowed to be put back into the companies. And I think that will help and boost our recovery to a much greater degree.

I was very interested in your conversation with Mr. English on steel, and I will hope at some future point that you will be able to tell us that the industry actually has begun to restructure. That will be the question I look at when I analyze whether that is proper policy, since it is going to be in effect for 3 years. I hope that we will see some examples of how that is occurring in the way that the President would like it to.

I did have an opportunity, Dr. Hubbard, last spring, to listen to your testimony on the Ways and Means Oversight Committee, and you talked about the effect of dynamics. That is of great interest to me, and I supported your candor – or appreciated your candor, I guess, in talking about how difficult it is to try to bring reality into the scoring process. And you suggested that that would be possible and practical on large-scale tax bills.

In your opinion, when Congress evaluates the merits of large tax changes, do you believe it would be beneficial to Members to see maybe more than one, maybe several different economic models being used to evaluate those tax changes?

Dr. Hubbard. I do, absolutely. I think that when you make your deliberation over tax policy, what, of course, you are concerned about, is effects on the economy and distribution of the tax benefits and costs of what you are considering. And I think you implicitly look at models or effects on the economy in your deliberation.

What I would like to see done is to provide more systematic help, and I don't think it has to be a single answer. A range of answers would help inform the debate. And I am not sure it is a great analogy, but the way I think of it is more like an impact statement, to give you the kind of information as a policymaker, that you need to figure it out. So absolutely, I think it is important for large tax bills.

Representative Dunn. And I also see the need to create that broad perspective and knowledge when it comes to trade legislation. I think we penalize ourselves often by requiring a revenue statement on what a change in trade policy is going to bring about, when so often the effect of free trade is to increase revenues, and so it becomes almost a false statement. And I come from the State of Washington, which we just learned has finally dropped in its unemployment numbers a bit. They have continued to be number 2 in – among all states in the Nation – after Oregon, Washington State is. And I am very hopeful that as we work together with the administration, that we can come up with those tweaks that need to be done to assist us in moving forward economically, to make that turnaround of the economy happen sooner rather than later. And so I appreciated very much your summary of what the uncertainty elements were, because it has given me some thoughts on what needs to be done. Thank you, Chairman Hubbard.

Dr. Hubbard. Thank you.

Representative Saxton. Thank you.

The gentleman from Florida, Mr. Putnam.

Representative Putnam. Thank you, Mr. Chairman.

Good morning, Dr. Hubbard. I want to briefly address the issues of consumption of household debt. As has been noted by people a whole lot smarter than I, the household consumption in housing buoyed us through the recent slowdown. The consequence being that, as we are poised for recovery, there is a lack of pent-up demand. Does this give you any concerns?

And also, as a result of the consumption continuing throughout the slowdown, much of that was done on credit. And I would like for you, if you would, to address household debt and its impact on being a drag on recovery.

Dr. Hubbard. Well, to take the question, at least start actually on where you ended up, on the recovery, I don't think it is the case that you need an acceleration of consumer spending to have a decent recovery. As you noted, consumer spending was robust during the downturn and continues to be so. What is needed for more sustainable recovery is the recovery in investment. And I want to come back to that in just a second.

On your issues of whether households are strained, like many things in looking at these ratios, it depends on what you look at. I think people tend to focus on changes in balance sheet variables, in looking at households taking on more debt. And you are correct that that has happened, but debt serviceability of households has actually held up very well. In part, this is a statement of the low interest rate climate in which we find ourselves.

Now, is this a wise thing for households to do? And here I will come back to the investment point. Households are making a bet, if you will, that the economic growth forecasts that are, say, in the administration's documents or in the private sector forecasts, will come to pass. It is income growth that is the largest determinative of consumer spending. I think that is a very reasonable bet. Are there wild cards in the risks? Yes. And they are the ones that I mentioned in my testimony particularly having to do with the value of equities. But I think at the moment, households have a very reasonable bet, and I see nothing in what has happened to suggest that we are likely to see a fall in consumption.

Representative Putnam. The issues – the consumer confidence from the University of Michigan last week showed a dip. In your conversations with executives, and particularly retailers, as they are making their purchasing decisions for the Christmas season now, what are you hearing out there in terms of their expectations for the holiday season?

Dr. Hubbard. Well, first, on the confidence, what appears to have happened, the dip isn't so much an impression about current conditions, but in questions have talked about the situation going forward, which is a code word for worrying about the stock market, since it is really coming down to the same wild card that I mentioned before.

Among retailers, perhaps the most brisk positions are retailers at the middle and lower price points for products. But I expect this should be a relatively good retail season, given the aggregate of consumption forecasts we have seen.

So, yes, there is reason to worry at some level about the confidence factors you mentioned, but, again, I think this is all back to the question of the market.

Representative Putnam. In the Daniels mid-session review, one of the things that came out was that at its high, somewhere along the line of $600 billion of government revenues were generated by the capital gains tax. It raises some interesting questions about the dependence on that particular tax for government revenues. Obviously, that is not going to be the case now or in the near future, and there will be a lagging effect on revenues as a result of the low market. So, comment on that, please, if you would, our new-found dependence on capital gains as a source of federal government revenues.

Dr. Hubbard. Well, I think the pattern that Mitch was referring to and that you raised is actually part of a more general story in the tax system of how dependent we are on the decisions and incomes of very high-income taxpayers. In the capital gains story, it is really two stories. One is a story about just investors realizing gains; another is the compensation of very high-income folks in corporations. And I think what we saw in the 1990s, as you would expect in a big boon for the economy, is an increase in that compensation, and we are now beginning to see and probably will see a decline in that compensation. A tax system that tries to load up its principal burden on high-income taxpayers will be very sensitive to the income movements of those taxpayers. Capital gains would be an element, but I think it will also show up in individual income taxes generally.

Representative Putnam. Does the imbalance of the tax base and its disproportionate burden, if you will, on those high-income ratepayers, is that troubling to you as an economist in terms of when you have a setback in the markets, as we appear to be in now, it has a disproportionate effect on revenues? What are your thoughts on that?

Dr. Hubbard. Well, I think it is actually a little more complicated. We, of course, have a progressive tax system, so the general pattern you mention wouldn't be a surprise. I think what was a surprise to at least us in the administration, and I think to many private sector forecasters, was just how much the revenues depend on that.

Let me give you a quick example. You probably know between the budget and the midsession, the actual forecast for economic growth was increased. And so typically you would say, well, then we should be bringing before you an increase in revenues. Of course, that was not the case. And that change in economic growth was more than offset by these yet unexplained changes on the tax side. So, it is an area that we are still just really coming to grips with.

Representative Putnam. I certainly agree with you, we have a progressive-rate structure, but it has almost reached a point of being super-progressive in the sense that you have a huge percentage of people who pay nothing and a very small percentage of people who pay a majority. And that is troubling when you get into situations like we are in now, where you have a tremendous fall-off in capital gains and in those upper income, those margins, and it has a disproportionate effect on revenues.

Dr. Hubbard. I would agree with you about that. I think the principal troubling factor for me is simply that high marginal tax rates generally are bad for our economy. And I think any continuing discussion of tax reform that would push us toward a broader-based lower-rate tax system is absolutely a good thing.

Representative Putnam. Thank you, Mr. Chairman.

Representative Saxton. Mr. Hill.

Representative Hill. Dr. Hubbard, thank you for being here this morning. I appreciate your comments.

I guess the question I have got in the back of my mind is, you have got statistics here showing that this economy is going to be growing at 6.1 percent. If that is the case, then why are we running deficits? If the economy is blazing along at 6.1 percent, why aren't we getting the revenue in to create surpluses rather than deficits?

Dr. Hubbard. Well, I guess the first part of the answer I would give is, of course, we are not projecting 6.1 percent. That is a statement of what happened, not what will happen. I think the potential growth rate of our economy, which is obviously a debate among economists, is a little over 3 percent per year. That is the sustainable GDP growth rate for our economy. That is what we have in the budget. I think it is actually higher than that, but we try to be conservative.

Your question about revenues gets back to the previous discussion I was having with Mr. Putnam, which is that while we have forecasted higher growth, to be as straightforward as possible, the effective tax rate on income appears to have gone down, and that is in part due to lower capital gains realization and the decline in income among very high-income households. So I think that is part of the puzzle. And I don't think anyone would suggest the economy is likely to be growing at 6 percent.

Representative Hill. Well, what does this mean then? In early February – I am reading from the Joint Economic Committee Democratic staff. It says: In early February, most analysts expected that the real growth domestic product would grow at 1.6 percent annual rate in the first quarter. In fact, GDP grew at 6.1 percent. Does that not – is that not right?

Dr. Hubbard. That is what I am saying. In the past, in the first quarter, GDP did grow at 6.1 percent. I would count myself as among those who were surprised by the strength largely having to do with, as Senator Reed had pointed out earlier, the strength of the inventory cycle at that point. The projections for the rest of the year in the Blue Chip would be, I believe, for the second quarter something like 2.6 percent and 3.3 in the remaining two quarters of the year.

Representative Hill. Why are we running deficits then if we are growing this strongly?

Dr. Hubbard. Well, the sources of deficits are many, having to do with weaker receipts from the past, i.e., the downturn, having to do with increases in spending and with, frankly, the needed build-up in some areas of spending in defense and homeland security. As you know, from the midsession document, the administration's forecast is for unified budget surpluses commencing in the 2005 fiscal year budget, which would be the last budget the President would submit in his first term.

Representative Hill. Well, let me ask you a different question then. Do you believe that paying down the national debt can make an important contribution to national savings and economic growth?

Dr. Hubbard. I think paying down the national debt will be an excellent contribution to national savings.

Representative Hill. But we are not going to be paying down the national debt; we are going to be increasing it.

Dr. Hubbard. Well, the forecasts show that after the 2005 budget, we continue to have the unified budget surpluses, which would be used for debt reduction, unless the Congress decides either to change taxes or spending policy.

Representative Hill. Well, 2005 is a long way off; and as we know, a little more than a year ago we had a discussion about whether or not we should do tax cuts or not. And I remember part of that discussion was whether or not it was going to generate deficits if the economy went south. Well, the economy did go south. We had September 11th; we are now experiencing huge deficits. You are telling me that, in terms of economic growth and vitality of our economy, that paying down the debt is a good thing. In this year we are running approximately $320 billion deficits. We are not -- we are not following your advice. You are saying that paying down the debt is a good thing that we should be doing; that in the foreseeable future we are not going to be doing that.

Dr. Hubbard. Well, if I might take your question in two parts. In the short term, in the budget forecast in the midsession review, the tax cut plays decidedly a bit player's role in the deficit. In fact, for the first deficit reported there, the tax cut is actually a relatively small component, because, as you know, the size of the tax cut gets larger as you go out. So it simply isn't the story. The story there is rather the weaker economy and spending.

When you asked should we pay down national debt as to whether that would increase savings, I, of course, said, yes, that would be automatically true. But the question for policy isn't that arithmetic question; it is relative to, what? If you wanted to start with this midsession and decided you wanted to run larger surpluses, you must do one of two things: raise taxes or cut spending. And so the question would be, do you think economic growth for the country would be greater if you pursued that policy to raise surpluses? I think not. But that would be the question to ask.

Representative Hill. Okay. Well, I see my time has run out.

Representative Saxton. Thank you, Mr. Hill.

Senator Bennett, welcome to the House side.

Senator Bennett. Thank you, Mr. Chairman. We had a vote. I see Senator Reed got here before I did. I apologize, but the vote prevented me from getting here before this.

First, very quickly, over the Fourth of July holiday I went with the Leader, Senator Lott, and some other Senators to a number of places, among them Ireland, which is now called the Celtic Tiger of the European Union. And we visited with the Prime Minister of Ireland and said, how have you gotten your economy turned around from being the sick man of Europe with unemployment in the high teens, if not low 20s, now to the strongest economy in Europe? And he said, three things. We had a stack -- he held up his hand. He said, we had a stack of business regulations this high, and we shrunk it down to this. Number two, we cut the corporate income tax rate to 10 percent. And, number three, we cut the capital gains tax rate in half. And now here we are.

Now, I am not sure it is that simple, but those were interesting comments.

Now, let us get back to this whole question that we have been discussing here. I have always held that paying down the debt in numerical terms was the wrong holy grail to chase; that the significant number we should look at is the size of the debt compared to the size of the economy. And I agree with your numbers. Chairman Greenspan yesterday forecast growth this year of about 3-3/4 percent. Coming off the very strong first quarter of 6.1, that means relatively anemic growth for the other three quarters to come out at the end of the year 3.5 or 3-3/4. Nonetheless, if the economy is growing at – to keep the numbers simple – let's say 3 percent, and the national debt is growing at 2.9 percent, doesn't that mean we are moving in the right direction, even though the debt is going up in numerical terms?

Dr. Hubbard. Absolutely. And I would just add one qualification to that, Senator, if I might. A corollary point to that is what is really important is the size of government and the spending that is giving you that debt in the first place. But, yes, your analysis is right on.

Senator Bennett. And the other thing the Prime Minister of Ireland said when he was talking about the corporate tax rate of 10 percent, he said, I am less concerned about tax rate than I am with tax take. And we have found that our tax take has over time gone up as we cut our tax rate down. Now, we are talking about raising taxes.

I agree with your point that the tax increase that we passed last year had virtually no significant impact on where we are right now in terms of deficits, because it was a relatively small percentage of the shortfall, and, in fact, all of that was programmed into our forecast. Isn't that true, that we forecasted the shortfall by virtue of the tax—

Dr. Hubbard. That is true.

Senator Bennett. So all of the shortfall, in addition to the tax cut, has come from one of three things: the slowdown of the economy, the increased defense spending, and the increased spending for homeland security. Is that fair to say?

Dr. Hubbard. That is correct.

Senator Bennett. Now, let's try to look ahead. And I understand there is nothing more difficult than an accurate forecast. Indeed, I have come to the conclusion since I have been here, there is no such thing as an accurate forecast, and I have never seen one. We all end up either high or low. We think we are heroes if it is higher, but, in fact, we are just as big chumps if it comes out that we get more money than we thought, as we are if it comes out that we get less money than we thought.

Assume that this recovery goes along the lines Chairman Greenspan outlined yesterday in his testimony, and that we are about 3-3/4 this year and 4 percent next year, and then project from that forward. Is the tax cut that then starts to kick in going to have a significant impact on slowing down the economy in those outyears?

Dr. Hubbard. I don't think it will, Senator. In fact, quite the opposite. I think that in our forecasts – and I certainly, again, can't speak for the Chairman – you would have to ask him. But I also believe in forecast, the impact of tax policy is present in measuring economic growth. So the effect is, if anything, positive.

Senator Bennett. So you think perhaps the economic growth will be higher by virtue of the tax cut kicking in that period?

Dr. Hubbard. Absolutely, Senator.

Senator Bennett. So you would agree with the Prime Minister of Ireland then.

Dr. Hubbard. Well, I certainly agree that any policy that reduces marginal tax rates, broadens the tax base, and lowers the tax rate is good tax policy.

Senator Bennett. So even if the deficits persist into 2005, if the economy is growing at a faster rate than the debt over that period, in terms of the legacy we are leaving our children, we are making progress?

Dr. Hubbard. That is correct. And we are certainly improving not just the legacy for our children, but the lives of people in the here and now, because we will have better economic growth and better employment.

Senator Bennett. Well, we are in the process of debating in the Senate a prescription drug benefit that has not been scored, so we don't know how much it will add to spending, but the estimates have been made by the people that have looked at it that if we were to take the most expensive one, it would add a trillion dollars to the deficit over the next

10 years, and the next 10 years are the easy ones. That is, the impact of that kind of an entitlement over the next 20 years will be much greater, but we are not allowed to score beyond 10 years, so we have to stop at 10 years. But the 10 years is ramping up like this, and then it starts to take off. If we can do prescription drugs for substantially less than a trillion dollars, wouldn't that have a very significant benefit for the economy long term?

Dr. Hubbard. Well, the key, of course, in the Medicare prescription drug debate is, first, what is the right policy for people, for seniors? We believe in the administration it is possible to focus on lower-income households, and with programs with competition and choice, it would be substantially less.

Senator Bennett. But let us leave the policy aside for a minute and just talk about economics. If we were to choose between policy A -- let's assume the policy is defensible in both cases. Policy A that costs us 400 billion over the next 10 years, and then the base thereafter from that level, or a trillion over the next 10 years with the base from that level, which would be the most damaging to the economy?

Dr. Hubbard. Well, from the pure spending effect, obviously the larger one. The only caution I would leave you with is, of course, you want to decide on the merits of the policy and trade that off against that cost. But, yes, the larger one would be more costly.

Senator Bennett. As I say, let's assume for the sake of the argument that either one is a defensible benefit in terms of what you are trying to accomplish. Well, I lay that down because that is a very significant economic circumstance that we are debating right now. The House's prescription drug benefit is, as I recall, 350 billion over the next 10 years.

Representative Ryan. That is right.

Senator Bennett. The proposal that would have come out of the Finance Committee, if the Majority Leader had allowed the Finance Committee to meet, would have been 370 billion. And I understand the proposal that the Majority Leader is in favor of would be a trillion dollars, but we don't know because it has not been scored. And we will have that debate. Senator Reed and I will undoubtedly have a lot to say about that as that goes forward, and I am sure his view will be somewhat different than mine.

Dr. Hubbard. If I might, on that very point, Senator, I think the costs that you are trying to get at for the economy aren't simply the fact that government debt is higher; you borrow more, and there will be an interest rate effect. That is really the tail, not the dog, that is wagging. The dog that it is wagging is that future taxes have to be raised, and that means crowding out productive activities. I think you put your finger on a very good concern.

Senator Bennett. Thank you, Mr. Chairman.

Representative Saxton. Senator, thank you.

Senator Reed and I were just chatting. There is a lot of interest here in hearing further from Dr. Hubbard. Perhaps we could have another second round, but maybe we could limit our questions to a minute or two, and we will go along those lines.

Let me just begin with something that I am very curious about to see, and to see if the administration has focused on this. We experienced two decades of really robust economic growth with a very short interruption in the short recession we had in the early 1990s. And one of the things that JEC does is to try and identify the things that government is doing right and some of the things we are doing wrong. And we have identified four or five factors that we think played a strong part in that long period of growth. One is, obviously, monetary policy, which the Congress doesn't have a whole lot to do with. Another is tax policy, which we do have a lot to do with. A third is promoting international trade, which we hope that we have something to do with. A fourth is spending policy, which, beginning in the middle 1990s, we began to slow its growth.

But the fifth is the subject of my question. We discovered, and I was surprised – maybe I shouldn't have been – but I was surprised to see the effects of American productivity based on investment in technology during the two decades of the 1980s and the 1990s. And my question is this: Has the administration focused on this last factor, productivity and investment in technology, and the effect of the diversion of resources to the necessary expenditures and activities involved in protecting our country and our citizens against terrorism?

It seems to me that we are diverting large amounts of resources for this very necessary purpose. Has the administration focused on what this means and the potential effect on economic growth?

Dr. Hubbard. Yes, we have, Mr. Chairman. In the most recent economic report of the President – there has been a long version, and the short version I will give you now.

If you imagine doubling private sector security expenditures and an increase in the security expenditures that is being done in the public sector, we estimate that productivity growth could fall by about a tenth of a percentage point per year for a few years. That is noticeable. It is not a killing. It does suggest the need to keep that number as small as possible, as your question suggested, by making sure that we give the right incentives for the private sector to innovate ways to meet those security requirements as opposed to being overly regulatory.

I would say, in terms of productivity in the country, if I might, that the biggest component probably for American productivity comes from the institutions in our economy. We are often quick to jump to technology investment, but the truth is American productivity growth has been very high relative to Japan and Europe, two areas which, of course, have access to the same technologies that we have.

So I think there is a complicated story there, and I certainly salute the Committee's longstanding interest in that.

Representative Saxton. I guess my only other thought on this subject that I will get into here is that it seems to me that our tendency in dealing with terrorism is to deal with it in a very broad spectrum. And maybe one of the things that we need to do is to try to do a better job in identifying where the threat really exists, because we can't protect everything, and I think we are trying to do that at the moment. And it is just a concern that I have about the wisest uses of our resources.

Dr. Hubbard. I certainly agree with that; good cost/benefit analysis is needed here as in other things. And that, of course, would be a good chunk of what the management of the new Homeland Security Department would be doing.

Representative Saxton. Thank you.

Mr. Reed.

Senator Reed. Thank you very much, Mr. Chairman.

And, again, thank you, Dr. Hubbard, for your testimony.

I have listened, and I think you have said quite clearly several times that the key to our recovery economically is stimulating investments. That is why I am still a bit puzzled why the administration would take such a strong position with respect to the estate tax repeal, making it permanent. It seems to me that it affects very few people so that the cumulative contribution to investment would be very small.

And also, I think you have got some tricky timing issues. Most people don't die on the advice of their accountant; so, as a result, when you go out and speak to groups and the President speaks to groups, I think there is disconnect because I think particularly sophisticated financial advisors can understand investment is important, but when you trot out the estate tax and essentially the same speech that was given a year and a half ago before 9/11, before this recovery, I think the perception is, one, you don't get it; or, even if you get it, you are not going to do the things that are necessary to do to really move the economy forward. But particularly troubling to me is the case of the estate tax. Could you comment?

Dr. Hubbard. Sure, on actually the multiple parts of your question. I think the principal reason to oppose the estate tax is not so much the investment effect -- I am going to get to that in a second -- but just a question of whether it is appropriate in society to add yet another layer of capital taxation on top of multiple layers that have occurred before. I think it is an issue of tax fairness.

On the issue of investment --

Senator Reed. It exists already. We are not adding it.

Dr. Hubbard. But if you are not going to make it permanent, you are indeed putting it back on.

Senator Reed. Now we are getting into linguistics. Go ahead.

Dr. Hubbard. But your question was about investment. In there, I think economists see the estate tax for what it is, which is a tax on saving and capital accumulation. It feeds definitely into the required rate of return on capital in the economy. I can't imagine anyone who could argue that the estate tax, that is somehow a tax that in and of itself would promote investment. There are reasons to have a debate over size of the estate tax, but I don't think that is important.

Senator Reed. Just not to belabor the point, but if you are here – and I think you are – saying we had better get investment stimulated dramatically, and in the short run we will see the economy recover, but in the repertoire of approaches that you and the President continually urge, there are provisions that will have very little, if no, effect in the short run, in the medium run on investment. And it just seems to be a disconnect. And when you speak to financial markets, I think they understand that. Most of the brokers there would love to see the estate tax repealed because it would be personally beneficial, but they understand it is not going to move the economy. That is one reason I think you see the President speaking and the market diving simultaneously.

Dr. Hubbard. I don't agree with that, with due respect, Senator. I don't think there is a disconnect at all. The dominant factors in the investment recovery are likely to be what I laid out in my testimony to the recovery of the economy itself: low interest rates, the investment stimulus package which you enacted. Making the tax cut as a whole permanent is not only good tax policy; it does remove a sense of uncertainty about the collection of fiscal policies in the country that I believe, for what it is worth, does weigh on the minds of the market.

Senator Reed. Thank you, Mr. Chairman.

Representative Saxton. Mr. Ryan.

Representative Ryan. One thing that I think ought to be added to the answer to Senator Reed is that the estate tax itself is the single greatest destroyer of the transfer of businesses from one generation to the next, and so it is a job killer. And that is also an issue that I think needs to be dealt with in that debate.

What I wanted to ask you about is this whole idea that seems to be dominating the discussion up here on the separation of the corporate managers with the interests of the shareholders, and the debate is a very important debate. And now we are trying to find ideas to connect the interests of the managers with the interest of the shareholders.

The answer inevitably always comes up to more regulation. And I wanted to ask you about an alternative to that, which is directed at reforming, repealing, or amending the Williams Act and other laws like that, which, over the last couple of – last decades, have made it much more difficult for takeovers of corporations, particularly hostile takeovers. We have had a lot of different laws passed in States, different laws that have been passed in the Federal Government, that make it virtually impossible for tender offers to be offered and to be received, which puts pressure on corporate managers to perform well and to perform in a way that the shareholders would like them to perform. And it is a system that, prior to preventing these kind of takeovers, basically you had the shareholders in the driver's seat. The shareholders, if they thought they could bring in better management, improve their stock price, had a way to do it; they had a vehicle to go to.

And I just wanted to know if you had any comments on that, any opinions on that, and is the administration at all looking at maybe revising some of these laws so that shareholders can have a chance at better management if the management that they had in place is, you know, running the company into the ground?

Dr. Hubbard. Well, of course, you raise what corporate finance specialists would call the key problem in corporate finance, the agency problem. The shareholders own the firm, but it is the managers who carry out the decision.

I think government does have a very strong role to play there. In particular, getting information out helps the shareholders understand what management is doing, and in setting the rules of the game for accountability for management. I think that has been the theme of both what the President asked for and what the House and Senate are doing.

I think, however, what we know in corporate finance also is that additional good effects can come from the empowerment of large shareholders. Much of our shareholdings, of course, are concentrated in institutional investors, and making sure that institutional investors have the incentive and ability to carry out their monitoring role is important, and making sure that the market for corporate control works very well is very important. That is where, as you suggested, the rubber meets the road.

I don't want to comment on any specific pieces of legislation, but I think that is an area that deserves emphasis.

Representative Ryan. Thank you.

Representative Saxton. Thank you very much.

Mr. Putnam?

Representative Putnam. Thank you, Mr. Chairman. I want to also echo Mr. Ryan's remarks on the estate tax, and point out that Mr. Hubbard's own testimony says that while entrepreneurs constitute a minority of the people, they are three times more likely to be subject to the estate taxes, making the tax drag on asset accumulation in a risk-taking economy, reinforcing the point about the hyper progressivity of our Tax Code, and that it is confiscatory, and mostly impacts people who tend to be, as we say at home, land rich and cash poor.

And as a segue, a lot of those people are in rural America, and a lot of them are brokers in the Northeast and all, but a lot of them are in rural America dealing in agriculture where they have a high level of assets, but not a whole lot of cash. And even in the most robust of times in the past decade, it has been pointed out by everyone, including Mr. Greenspan, that the one sector of the economy that has been left behind is agriculture in rural America.

And my question to you: Is this a painful but necessary restructuring of market forces, where we have towns disappearing, and we have a tremendous depression in rural America, or is it something that can be corrected by some policy changes to effectuate a balance to have a sustainable rural economy in this country?

Dr. Hubbard. Well, I think, starting at the beginning of your question on the estate tax, I think interest in the estate tax is not so much whether it affects rural Americans or urban Americans, but that it is just bad tax policy. It violates simple norms of tax, and it is grossly inefficient. It is as bad for the urbanite as it is for the farmer, even though the farmer might appear to some more sympathetic.

On the issue of agriculture communities, there, of course, isn't a policy magic wand to wave, but I think there is work that we can do in place-based aid in farming, and in supporting environmental and conservation programs, which, of course, is part of the recent farm law.

Representative Saxton. Thank you very much.

Mr. Hill.

Representative Hill. Dr. Hubbard, the economy is growing, but the stock market is going south. What is this all about?

Dr. Hubbard. Well, of course, the first honest disclaimer I would have to give you is no economist could give you the absolute perfect answer to that, at least speaking for myself. I will give you my impression as to what is going on.

What economic data are telling you is about the performance of the economy in real-time. The stock market tells you several things. It tells you, first, what expectations are for future profits of companies, and then what the right way to discount those is, what do you think the uncertainty surrounding performance is.

To get to your question, what the stock market, I think, is telling us is not that future profits are likely to be low. Everything we know about the profit turnaround and what we are seeing suggests that is not the case. But there is uncertainty about the accounting data, the corporate governance issues, and, frankly, there is also real uncertainty having to do with terrorists and risks and general responses to those.

Representative Hill. So what should we be doing to restore confidence in the market then?

Dr. Hubbard. Well, I think that the Congress and the President have been taking the right steps in trying to focus on transparency and accountability in the corporate sector to make sure that accounting data have real meaning to investors as well as to managers, and that people who abuse the public trust are punished.

Representative Hill. So you think this decline in the stock market is entirely due to corporate misgivings?

Dr. Hubbard. No, I do not. I think that we have seen a decline in stock markets around the world and in regions with different accounting systems and a flight to quality, if you will, moving from equities to bonds, treasury equivalents in different countries. So I think the story is more complicated than simple corporate governance.

Representative Hill. Do you recognize a recovery soon?

Dr. Hubbard. In the stock market or—

Representative Hill. In the stock market.

Dr. Hubbard. Well, the stock market is pricing fundamentals. I think when the fundamentals of the economy become very clear, as they will when profit reports come out, it becomes much easier for the market to react.

Representative Hill. One last question. Earlier I asked you a question if paying down the national debt could make an important contribution to economic growth, and you agreed with that. We should be paying down the national debt, correct?

Dr. Hubbard. I think what I agreed with was the first part of that, which was national savings.

Representative Hill. But do you believe that paying down the debt can contribute, as Alan Greenspan believes, to economic growth?

Dr. Hubbard. Modestly. I think the empirical effect there is actually quite small, to be honest with you, based on studies done at the Federal Reserve and elsewhere.

Representative Hill. All right. We all have our propaganda, and I have got mine in front of me here. I want to ask you a question relating to this propaganda that I have in front of me here. It says that – what I have here is Director Daniels issued a one-page preview of the midsession review. This document includes the claim that the recession erased two-thirds of the projected 10-year surplus, and the tax cut generated less than 15 percent. On page 6 of the midsession review, there is a table showing that the tax cut was responsible for almost 40 percent of the deterioration. What is your view? Is it 40 percent, or is it 15 percent?

Dr. Hubbard. Well, I don't know, of course, the precise document you are talking about. From OMB, our numbers in the administration are as printed in the midsession. My guess is there must be confusion about talking about a single year, which that sounds to me about right, versus a very long period of time. There is no question over the long period of time that the tax cut contributes to economic growth and revenues.

Representative Hill. Well, I didn't ask you that question. The question I asked you, is it 15 percent or 40 percent of debts?

Dr. Hubbard. As I said, Congressman, it depends on the horizon. Without knowing what you are talking about from an OMB document, in the first year, the 15 percent sounds about right. A very small component, as I said earlier, of the deficit comes from the tax cut. Over the longer period of time, the 40 percent number sounds about right.

Representative Hill. Okay. The Chairman says my time is up, so—

Representative Saxton. Thank you very much. Senator Bennett.

Senator Bennett. Thank you, Mr. Chairman. And thank you for the second round. I think this has been a worthwhile dialogue.

I come back again to the fact that there are no certainties in this business. There are no hard and fast forecasts. I have never seen a forecast that turned out to be correct more than maybe 15 days after it is made. You go out to six months or to a year, whatever forecast, whatever percentages that are quoted, on either side of the ideological debate, they always prove out to be wrong. And the reason is – as difficult as it is for those of us in Congress to understand – we don't control what happens in the economy.

There were some yesterday that said gleefully during our hearing with Chairman Greenspan, "Mr. Chairman, since you started testifying – when you started testifying, the market was down 166 points, and now it is only down 40." And, of course, it ended up down something like 170 after he left the stand. And we could tell ourselves that if we could just keep him on the stand filibustering, somehow the market would go up. But the market doesn't pay nearly as much attention to what we say on Capitol Hill as we do. And, before coming here I checked, and the market is up – at least as of the time I left, the market is up over 170 points, and nobody said anything.

The fact is the market is responding to fundamentals and analysis of where we are and has nothing – not nothing, but very little to do with what people in government have to say. All we can do is—

Representative Saxton. Would the gentleman yield?

Senator Bennett. Yes.

Representative Saxton. Maybe that 170 may have something to do with Chairman Hubbard's testimony.

Senator Bennett. I will stipulate to that.

Now, my own sense – and I will just give it to you and get a quick comment. A large part of the stock market tumble has to do with the fact that we were in tulip time. You understand what that means, the Holland tulip bulb and so on, that there were many stocks that clearly had a market cap that was totally unjustified. And people got carried away. And, like every bull market that finally explodes into tulip time, there had to be a correction, and there would have been a correction regardless of what Congress did, regardless of what the President did, regardless of who the President might have been. We would have seen the obscene market caps of some of the dot-com stocks come down to what they were really worth.

And, in the process, the market has overreacted in some areas. It has been exacerbated by the crisis of confidence coming out of the accounting reports so that there is uncertainty about what the numbers mean, but that as soon as that uncertainty passes and the water has been squeezed out of the tulips, the stock market will then begin to respond to the underlying strength and stability of the economy and come back.

Now, is that a Pollyanna view, or is there an economic basis to support that view?

Dr. Hubbard. I don't think it is a Pollyanna view. It is indeed a restatement of market efficiency that we expect stocks to respond to fundamentals.

I would like to quibble respectfully, if I might, with the tulip analogy. I think there are some areas of the market where there may have been some froth, but, broadly speaking, we have seen declines in sectors that were not as subject to that froth.

Senator Bennett. I will accept that.

Dr. Hubbard. So we may be seeing things that are more fundamental having to do with the shifts in equity, risk premia, and the uncertainty to which you refer. But I certainly agree with your summary.

The one caution I would make on policy is there is more that policymakers can do to hurt than to help, in the sense that discussions that generate an atmosphere of uncertainty I think can hang over the market. I don't think policymakers can talk up the market, but I think it can hurt.

Senator Bennett. I accept both your correction and your last comment, that the one thing the market wants more than anything else is a sense of certainty, and they always flee from uncertainty, whether it is caused by a war, or a crazy President, or an out-of-control Congress, or an incompetent Federal Reserve Chair. And hopefully we don't have most of those things. Thank you.

Representative Saxton. Senator, thank you.

Dr. Hubbard, thank you very much for being with us and your time this morning.

Dr. Hubbard. Sure. It is my pleasure.

Representative Saxton. We appreciate it very much. We have not only enjoyed having you here, but we feel we always benefit from hearing your perspective. So, thank you for being with us.

Dr. Hubbard. Thank you. And likewise.

Representative Saxton. We look forward to seeing you in the future. The hearing is adjourned.

[Whereupon, at 11:55 a.m., the joint Committee was adjourned.]

SUBMISSIONS FOR THE RECORD

PREPARED STATEMENT OF REPRESENTATIVE JIM SAXTON, CHAIRMAN

It is a pleasure to welcome Chairman Hubbard this morning before the Joint Economic Committee to testify on the economic outlook.

The economy continues to rebound from the slowdown that began in the middle of 2000, eventually becoming a recession. In March of 2000 the NASDAQ began a sharp decline, with spreading weakness signaled later in that year by falling factory employment and industrial production. The slowdown became a mild recession early in 2001, but economic indicators suggest that a recovery was underway by late last year.

Real GDP increased 6.1 percent in the first quarter of 2002, manufacturing activity rebounded, industrial production rose, and consumption and residential real estate remain strong. However, there are signs that the pace of the economic expansion has moderated recently.

The payroll employment data indicate that many employers have held off new hiring until the sustainability of the recovery becomes clearer. As a result, the output of goods and services is rising, but at a faster pace than is employment. Consequently, labor productivity in the first quarter surged, and is expected to remain strong in the second quarter.

The pace of the expansion may be affected by concerns about international tensions, terrorism and corporate accounting practices. As a result, the level of risk and uncertainty is significant, and this imposes additional costs on the economy and also is reflected in the weak stock market.

As Chairman Greenspan pointed out yesterday, our free market economic system is based on property rights, and "fraud and deception are thefts of property." Reforms are needed in accounting and corporate governance to strengthen safeguards against those who would otherwise abuse the rights of shareholders. The President and Congress are moving forward to provide these needed reforms.

However, despite these problems, the remarkable resilience of the American people and economy continues to be evident. It appears likely that business profits and investment will recover in due course, consolidating and extending the U.S. economic expansion. The Federal Reserve's actions to reduce interest rates, and Congressional actions to reduce the tax burden, have improved the prospect of sustained economic expansion.

PREPARED STATEMENT OF SENATOR JACK REED, VICE CHAIRMAN

Thank you, Mr. Chairman. It is a pleasure to welcome Chairman Hubbard of the Council of Economic Advisers. The CEA has a critically important role to play in economic policy. It shouldn't be blind to politics, but it should be above politics in providing the President with the best and most objective economic advice it can.

I am looking forward to hearing Chairman Hubbard's views on the state of the economy, and I wouldn't be surprised if we have some spirited discussion about the Administration's latest forecast and its implications for budget and tax policy.

I have serious concerns about the economic policies that this Administration is pursuing. We are very fortunate that the worst fears about how September 11th would affect the economy were not realized. But I fear that we may be experiencing the same kind of jobless recovery that we saw the last time around, when the recession ended in March of 1991 yet unemployment kept rising until July of 1992 and the federal budget reached a record deficit of $290 billion. Last month the unemployment rate bumped up to 5.9 percent and the number of unemployed people was nearly 2.4 million higher than it was when the recession started. Even though there was a small increase last month, the number of payroll jobs is lower now than it was at the beginning of the year. And, of course, every time we re-estimate the budget deficit it gets worse.

The Administration seems to believe that more tax cuts are the answer. But how do budget-draining tax cuts skewed toward upper-income taxpayers address the concerns of ordinary Americans? People are worried about their jobs and their pensions; they want to be sure that Social Security is on a sound footing and that they can afford prescription drugs; they want to be assured that corporate executives are honest or that they will be caught and punished if they are not; and they want to believe that the government is on their side, working to help them improve their lives.

On another matter, I would like to commend the CEA on its role in improving the quality of Federal statistics. The proposal the Administration unveiled last week to enhance data sharing among the Census Bureau, the Bureau of Labor Statistics, and the Bureau of Economic Analysis is an important step toward improving our ability to measure and understand a rapidly changing economy. The JEC too has had a long tradition of working to improve the quality of federal statistics. In fact, we are having a hearing next week on the topic of measuring economic change, and I look forward to working with the CEA on efforts to create a 21st century statistical infrastructure appropriate to a 21st century economy.

Dr. Hubbard, I look forward to hearing what you have to say about the economic outlook. I hope that the CEA is taking a hard look at economic realities, and can give us some constructive advice on how we can improve the employment picture while stimulating economic growth and avoiding a new round of ballooning deficits.

PREPARED STATEMENT OF REPRESENTATIVE ADAM H. PUTNAM

Thank you Mr. Chairman for convening this important hearing on America's Economic Outlook and thank you Chairman Hubbard for appearing before this Committee to answer our questions.

I am encouraged by some of the positive economic data that has been released. Real GDP growth is now expected to be 6.1 percent, which is higher than previously predicted. This indicator can provide a boost for our economy because it reaffirms America's fundamental economic soundness.

Nevertheless, risks do appear when one examines the U.S.'s economic outlook for the coming months. For instance, we have all witnessed the massive decline of the stock market and the consequential rapid decline of household equity wealth. Since the end of May of this year we have witnessed the loss of nearly thirteen trillion dollars worth of household equity wealth. This equity has simply vanished. Stability will return when ordinary investors begin to trust the markets and when credibility has been restored to America's financial institutions.

Prospects and risks are present in the current economic outlook but judging by the fundamental indicators such as consumption growth, business fixed investment, productivity growth and GDP among others, economic revitalization can be achieved.

In the past year, the U.S. economy has taken on many difficult hurdles and prevailed. The nagging recession and the economic realties of the war on terrorism has put an extra strain on the U.S economy. Due to the fundamental strength of the U.S. economy an economic rebound will occur. The only question is when and what can Congress do to assist.

PREPARED STATEMENT OF DR. R. GLENN HUBBARD, CHAIRMAN, COUNCIL OF ECONOMIC ADVISERS

Chairman Saxton, Vice Chairman Reed, and members of the Committee, it is a pleasure to appear before you today to discuss the economic outlook and policies that will advance the recovery and promote economic growth.

The Economic Outlook

The Administration's economic outlook is contained in detail in the recently released *Mid-Session Review of the Budget*. In these remarks, I will focus only on the main features of that *Review*. The economic assumptions were revised from those used in the Administration's 2003 Budget to incorporate the unanticipated strength and timing of the recovery, as well as the passage of the Job Creation and Worker Assistance Act (JCWAA). Real GDP growth this year is now expected to be considerably higher than anticipated in the Budget, a revision that reflects broad consensus among private sector forecasters.

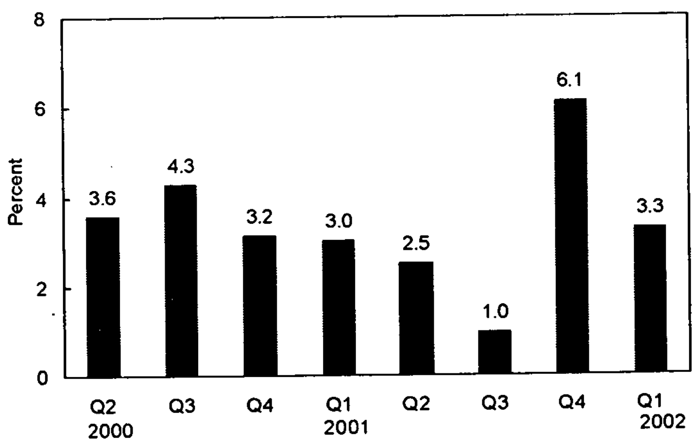
The rates of GDP growth and unemployment during the second half of the projection period are the same as in the Budget; inflation and interest rate projections are nearly identical to those in the Budget. Specifically, year-over-year GDP growth in 2002 is projected to be 2.6 percent, compared with 0.7 percent in the Budget. Growth during 2002-12 is projected to average 3.2 percent per year – the same rate as in the most recent Blue Chip consensus long-run forecast. During the latter years of the forecast (2008-2012), growth is projected to proceed at the potential rate of 3.1 percent per year.

Consistent with the FY2003 Budget assumptions, the unemployment rate is projected to decline during the next few years to 4.9 percent in 2007 and then remain at that low level. That rate is the Administration's estimate (and matches the Blue Chip consensus long-run estimate) of the long-run unemployment rate that is consistent with stable inflation. With regard to inflation, in the near term, the CPI measure of inflation is projected to be 1.7 percent, slightly below the budget projection, while over 2003-2012 the inflation projection is slightly less than 2.5 percent.

The Mechanics of Economic Recovery

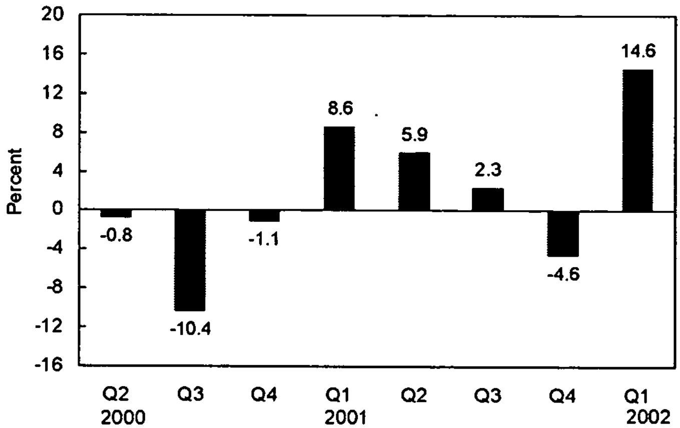
The basic mechanics of the present economic recovery are familiar. Solid consumption growth forms the foundation of continued strength in the growth of final demand. Indeed, as is well known, the household sector has been a source of strength in final demand over the course of the recession and recovery. In addition to enhancing long-term economic efficiency, the tax cut proposed by the President and passed by Congress last spring provided valuable support for disposable incomes. Substantial cuts in the target federal funds rate by the Federal Reserve have translated into lower mortgage interest rates, supporting housing starts and mortgage refinancing. The upshot has been solid growth in personal consumption expenditures and residential investment that will support the recovery.

Real PCE Growth



Source: Bureau of Economic Analysis, Department of Commerce

Real Residential Investment Growth



Source: Bureau of Economic Analysis, Department of Commerce

In addition, growth in GDP has benefited from government purchases associated with enhanced homeland security and short-run inventory dynamics; the latter are estimated to have contributed 3.4 percentage points to GDP growth during the first quarter. These factors are likely to continue to contribute a bit in the near term, while there is little basis for expectation of aggregate demand growth stemming from the international sector.

Inventory investment contributed to the economic slowdown, but by early in 2002, the pace of inventory decline slowed, and business efforts to reduce further decline provided a significant fillip to production. In some sectors of the economy,

evidence suggests that inventory restocking is underway. Over the next several quarters, as inventory and sales growth come together, inventory investment's role in real GDP growth should provide momentum. Attention on fixed investment decisions is therefore important.

The key to transforming recovery into robust growth is the pace of business fixed investment. Only with robust business investment will labor markets firm and the economy return to robust job creation. The recently passed "Job Creation and Worker Assistance Act of 2002" (more widely known as the "stimulus package") reduces disincentives to investment – technically 30 percent expensing. Businesses are permitted to deduct immediately 30 percent of the cost of new qualifying business investments undertaken in the three years starting on September 11, 2001.

These provisions provide valuable policy support for an investment recovery. In addition, the interest rate environment remains favorable and the corporate profitability appear to be improving. As reported in the National Income and Product Accounts, profits from domestic operations have increased 26 percent (not annualized) during the past two quarters. The gain in profits is partly accounted for by very modest growth of unit labor costs. Productivity grew 4.2 percent during the past four quarters (a period that includes recession and recovery) – and quite rapidly during the first quarter. The Employment Cost Index measure of hourly compensation growth was stable at about 4 percent, allowing profit margins to expand. Given the stronger fundamentals, one would expect investment to recover.

Indeed, most private forecasters envision a rebound this year. In its May 2002 *Economic Outlook*, Macroeconomic Advisers reported that it expects a recovery in investment in 2002, with nonresidential business fixed investment forecast to rise 0.8 percent this year and 12.1 percent in 2003.

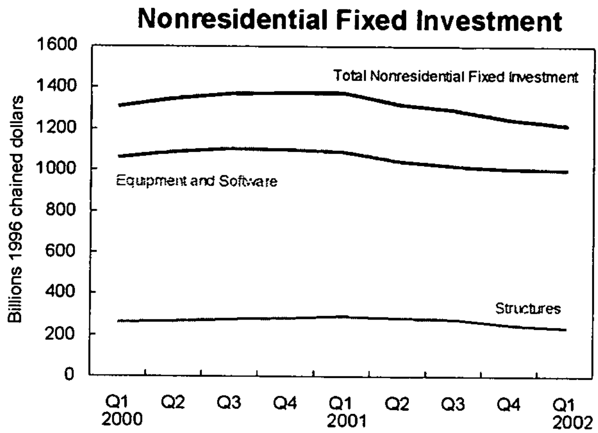
Macroeconomic Advisers June 2002 Investment Forecast
(Q4/Q4 Real Growth)

	2002	2003
Nonresidential Fixed Investment	**0.8%**	**12.1%**
➢ Structures	-8.7%	1.9%
➢ Equipment and Software	4.1%	15.3%
-- Computers and Software	8.5%	25.5%
-- Other Equipment	2.2%	11.0%

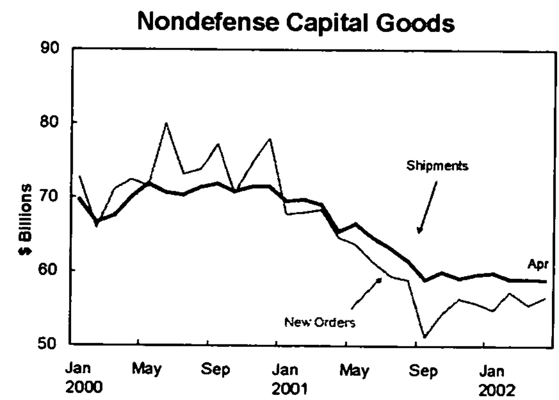
Source: Macroeconomic Advisers June 2002 Economic Outlook

In building its forecast, Macroeconomic Advisers argues that there is little cause to worry about investment drag related to a high-tech overhang, as any capital overhang in the economy has been largely eliminated. These conclusions mirror analysis done at the Council of Economic Advisers.

For the economy as a whole business investment slowed its decline during the first quarter. Investment in nonresidential structures continues to decline, but purchases of equipment and software have shown some signs of firming.



The most recent data are consistent with flat to modest growth in investment during the second quarter thus far. For example, the Commerce Department announced that new orders for manufactured durable goods excluding semiconductors increased 0.7 percent in May, after rising the same amount in April. New orders for nondefense capital goods (which give an indication of future investment spending) grew 4.3 percent in May, following a 1.1 percent increase in April. In contrast, shipments of nondefense capital goods (which give an indication of current business investment) rose a more modest 1.2 percent in May, compared with 0.1 percent in April.



On balance, then, while forecasts and surveys are promising, we await firm evidence of a rebound in business investment strong enough to sustain rapid rates of job growth. Such evidence is likely in the coming months, as firms respond to improved sales and profits, investment tax incentives, and enhancements in productivity made possible by advances in technology. Toward this end the most recent data on industrial production – which rose by 0.8 percent in June – are heartening, as they showed stronger growth in industrial production in a broad cross-section of industries.

Of course, there are risks to this outlook. For example, the stock market has declined about 13 percent since the end of May, reflecting shifts in the equity risk premium and concerns over among other things, profitability and financial data, with the result that household equity wealth has fallen about $1.3 trillion. While this represents a clear loss to households through direct holdings and 401(k) and retirement plans, it has also raised concerns over the durability of the recovery. To get a sense for the potential magnitudes involved, however, begin by noting that consumption tends to fall three to five cents for every dollar of lost equity wealth. In addition, investment also falls because of the higher cost of capital. Combining these effects, a *permanent* loss of 13 percent in stock-market value – together with other macroeconomic interactions in a standard model, including any offsetting action by the Federal Reserve – would reduce the level of real GDP by roughly 0.4 to 0.7 percentage point after one year. While this is a significant impact, but it would not overwhelm the upward path of the recovery. Moreover, the reduction in GDP would be a transitory event, with GDP returning to its former path after three years or so.

Moreover, such an effect would require a substantial (and, as I noted, permanent) loss in wealth and investment incentives. In this respect, it is useful to note that declines in equity values have been offset in part – though certainly not entirely – by increases in housing wealth, lessening the impact on consumption. These recent increases in home prices reflect effects on the demand for housing of low interest rates and demographic factors and have bolstered household balance sheets or, through mortgage refinancing, provided extra funds to finance consumption and debt service. In part due to refinancing, some measures of household debt service burdens have risen;

excluding mortgage interest reveals no significant rise in the fraction of household income devoted to interest costs.

On the investment side, it is interesting to note that there has been a modest rise in risk spreads recently – a factor that could contribute to lower equity valuations – but these have been offset by a shrinkage in the yield spread between long-term and short-term Treasury securities. Also, in the past month, the rise in risk premia appears concentrated in Baa corporate bonds, as these yields have risen relative to high-grade corporate bonds.

Data Sharing Initiative

The intense focus on monthly – or even weekly – data releases during the recovery thus far has focused attention on the importance of improving our economic data. Last week, the Council of Economic Advisers unveiled the President's initiative to raise further the quality of economic statistics. This initiative would remove statutory barriers to the sharing of business data among the Bureau of the Census, the Bureau of Economic Analysis, and the Bureau of Labor Statistics. In addition, it would strengthen the safeguards that protect the confidentiality of the public's statistical information through a clear and consistent set of minimum statutory safeguards and stiff penalties for violators. Enhanced data sharing would improve the reliability and accuracy of key business statistics such as GDP, employment, productivity, and industrial production and would permit the statistical agencies to resolve existing and growing data anomalies that raise questions about the accuracy of economic statistics. For example, GDP has experienced an historically high measurement error approaching $200 billion. At the same time, nearly 30 percent of single-establishment businesses had inconsistent four-digit standardized industry classification codes in the separate business lists maintained at the Census Bureau and at the Bureau of Labor Statistics. This seemingly minor classification issue brings into question the ability to track accurately industry output, employment, and productivity trends.

Improving the quality of these data is central to maintaining the foundation for our understanding of the economy and economic policies. The President looks forward to working with Congress so that the American people can benefit from higher-quality economic statistics for public and private decisionmaking.

Enhancing Economic Growth

Focusing on the "real economy" my reading of the basic mechanics of recovery and the data thus far indicate a recovery that is roughly on track, with the possible exception of business investment. Of course, it is subject to the standard economic uncertainty regarding fundamentals. However, as you are doubtless aware, there are many news reports focusing on an

uncertain state of economic recovery. To some degree this is surprising in light of my reading of the fundamentals of the economic recovery. Although there are always questions about "when" a particular phase of recovery will transpire, or how strongly a particular component of aggregate purchases may grow, the uncertainty evinced in the public discourse is seemingly far deeper.

To the extent that additional uncertainty stems from the outlook for economic policies that support growth, it is unfortunate. Two of the key lessons of the past two decades at home and abroad is the centrality of private firms and markets in generating superior economic performance through their ability to drive innovation and growth, and the importance of maintaining vigilance against impaired market incentives.

The deregulation of our economy beginning in the 1970s and 1980s was and is a tremendous source of economic flexibility and success in generating resources for our economy. Deregulation of several key sectors of our economy brought substantial benefits to consumers and workers. One study estimates the combined economic benefit of deregulating airlines, motor carriers, and railroads to be about 0.5 percent of GDP per year.

Deregulation, reductions in marginal tax rates, and victory in the Cold War fueled a long boom in the United States that was interrupted only briefly during the early 1990s. The post-1995 boom in productivity growth in the United States stands out from other industrial economies. Productivity growth does not arrive from the heavens, and businesses around the world can all buy the same technology – the U.S. advantage must be elsewhere. New technologies, process innovations, and other aspects of entrepreneurial, private-sector productivity gains are the result of investment and risk-taking.

Despite the economy's success during the long boom, during the 1990s, a new orthodoxy took root in Washington. While ostensibly adherent to market principles, this view placed the government at the center of good economic performance. A recent manifestation of this orientation has been the focus on accumulating government budget surpluses as the key. Despite essentially no evidence that surpluses are related to long-term interest rates, proponents of this view argue that increasing the budget surplus is the key to faster growth through its effects on long-term interest rates. In reality, these concepts are linked. However, the prevailing orthodoxy has the tail wagging the dog – a stronger economy produces higher revenue and larger surpluses, not the other way around.

It is remarkable that some suggest that growth-oriented tax policy might be making matters worse, and some urge its repeal. Economic growth is a direct consequence of millions of individual decisions to produce, save, invest, innovate, create, and bear risks. Any added tax burden today would be a step in the wrong direction. Entrepreneurs are at the heart of this equation. Recent research shows that cutting marginal tax rates allows entrepreneurial businesses to grow faster, invest more, and hire faster.

Marginal rate reductions also improve access to capital and the vitality of the entrepreneurial sector. These impacts are not confined to the income tax. The estate tax acts as a brake on entrepreneurial activity. While entrepreneurs constitute a minority of people, they are three times more likely to be subject to the estate tax, making the tax a drag on asset accumulation and risk-taking in the economy.

Thus one source of uncertainty facing the economy is the specter of failing to make the tax cut permanent, and facing the diminished growth opportunities that would follow. Of course, it is not just an issue of the level of taxes. It is the potential loss of a pro-growth tax policy. Princeton University economist Harvey Rosen has estimated that the marginal tax rate reductions passed in 2001 will lower the efficiency cost – the "deadweight loss" or pure drag on the economy – by roughly $40 billion in 2010. To

put this figure in perspective, note that it is about the same size as last year's tax rebate of $36 billion – and it would happen every year. A manifestation of returning to a less efficient tax system is reduced growth. Professor Rosen's results suggest that doing a U-turn on taxes would reduce growth by 0.15 percent annually. The basic message is straightforward: Placing the future of pro-growth tax policy at risk raises the level of uncertainty and mitigates against rapid recovery and growth.

Another perspective on the threat to pro-growth tax policies comes from examining the recent, rapid growth in Federal spending. Over the long term, increased growth in Federal spending will necessarily be financed by higher levels of taxation. Thus one threat to lower tax rates and rapid retirement of Federal debt is an absence of fiscal discipline. Moreover, to the extent that debt service burdens and retirement are ultimately linked to tax revenues, the failure to control the growth of Federal spending places upward pressure on distortionary taxes.

A second feature of the new orthodoxy revolves around an economy of guarantees. Even when pursing one of the fundamental policies central to better growth – expanding global free markets – proponents of this view demand "guarantees" to insulate the economy from the very source of its dynamics and growth. The recent debate over an ever-widening Trade Adjustment Assistance Program and its threat to Trade Promotion Authority is a second troubling source of uncertainty over the outlook for growth.

In short, the clash between policies to provide an environment for faster sustained growth and the new orthodoxy has given rise to uncertainty over the future course of policy. Sadly, this clash translates immediately into reduced incentives for growth. In each case, simple action by the Senate – passing TPA or making the tax cut permanent – would remove the lingering uncertainty and raise incentives for growth.

At some level, however, it is "normal" for the private sector to face conflicting messages on economic policy. However, there are special features raising uncertainty as well. Terrorism has raised the need to harden the economy against the risk of terrorist events. In the aftermath of the events of September 11, the President immediately began a campaign to strike at terrorism's roots, and to secure the United States against the risk of terrorist events. These efforts have beneficial economic effects, raising consumer confidence and reducing the need for private-sector security expenditures.

An important part of the President's response was a proposal to provide a catastrophic backstop for terrorism risk insurance. The terrorist attacks indicated that the probability of catastrophic property and casualty losses was higher than

anticipated. This situation called for a new policy to encourage private market incentives so that insurers would expand their capacity to absorb and diversify risk—an approach that the Administration proposed.

A part of the debate over terrorism risk insurance has been proposals for litigation procedures for mass tort terrorism cases. Another possible source of uncertainty hanging over the growth outlook is the tort system as a whole. While business concerns over the impacts of frivolous lawsuits are not new, it may be the case that the events of September 11 have produced heightened awareness of the potential for a substantial "tort tax" in the future, impeding growth.

The final "new" element of uncertainty in the economic environment is the increased concern over corporate governance that has emerged in the aftermath of accounting failures and related events. The corporate governance question has raised concerns over investor protection and has impeded the efficient functioning of capital markets. A key underpinning of productivity growth is the flexibility with which capital is allocated in the United States. This efficacy is made possible by timely and accurate judgments in the marketplace, which in turn reflect timely and accurate information in a complex web of relationships among corporate leaders, boards, auditors, analysts, institutional investors, and ultimately investors.

The President recognizes that the quality of our economic performance would be enhanced by prompt improvements in corporate disclosure, greater accountability of corporate leaders, and the strengthening of audit systems. On March 7, he announced a ten-point plan to strengthen the quality of the information underlying investment decisions. The President's plan focused on the key issues of financial transparency and corporate accountability. It began with proposals to improve the timeliness and quantity of crucial information disseminated to investors, turned to incentives for CEOs to provide high-quality information, and then addressed steps to strengthen the auditing function. This approach focused attention on the underlying sources of information shortcomings in financial accounting, and rapid implementation of its recommendations will serve to reduce the uncertainty stemming from issues of corporate governance.

In the weeks following the President's diagnosis, the Securities and Exchange Commission has initiated rulemakings regarding the content of quarterly informational reports and ensured that CEOs and other officers will not profit from financial misstatements. It has initiated a rulemaking to ensure that corporate leaders provide prompt disclosure of trades in their companies' stock.

The SEC efforts continued by requiring CEOs and CFOs to certify the contents of the company's quarterly and annual reports, meeting the President's directive that corporate leaders should personally vouch for the veracity, timeliness, and fairness of their companies' public disclosures, including financial statements. In addition, the SEC proposed amendments to disclosure rules – Form 8-K rules to be precise – regarding extraordinary corporate events. The proposals would add eleven new disclosure items, move two items from annual and quarterly reports to Form 8-K, shorten the Form 8-K filing deadline to two business days, and make other changes.

More recently, the President called for a new ethic of responsibility in America's corporate community. He signed an Executive Order creating a Corporate Fraud Task Force to provide direction for investigations and prosecutions of criminal activity, requested the funds necessary to beef up SEC enforcement, and proposed toughening criminal sanctions for corporate financial fraud. The Administration looks forward to working with Congress on these important issues.

The private sector has also been active. As noted by Federal Reserve Board Chairman Alan Greenspan, "Corporate governance has doubtless already measurably improved as a result of this greater market discipline in the wake of recent events." One piece of evidence in this regard is the recent

corporate governance rule changes announced by the NASDAQ. Likewise, a committee of the New York Stock Exchange has emphasized the need for reforms of corporate governance.

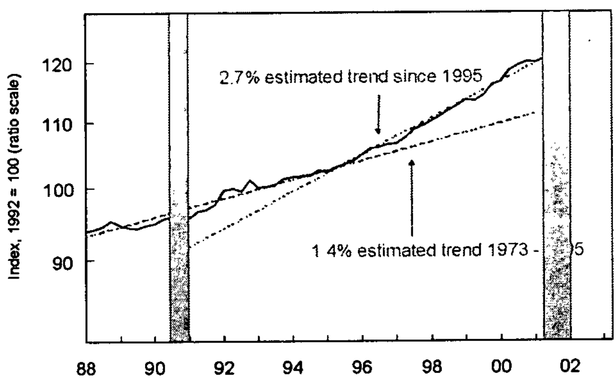
Given the inherent informational advantage of corporate insiders over outside investors, private sector and regulatory reform will hopefully lead to progress, in the spirit of the President's plan, in improving transparency and accountability. As an example, in their proposals on corporate governance reform, both the NASDAQ and the NYSE include provisions to ensure that shareholders approve all stock options plans. While the final resolution remains a matter of study and debate, initiatives of this type aim to improve the accountability within our existing system. This could be paired with matching provisions to improve transparency.

Regardless of the specifics, there will be an advantage to a rapid resolution of the future path of corporate governance reforms. The SEC has done an excellent job of turning the President's ten-point plan into better disclosure. The rulemaking process includes necessary deliberation and time for public comment. Nevertheless, the actions to date represent a swift response to the revelation of the need to enhance the information available to investors.

Innovation and Long-Term Productivity Growth

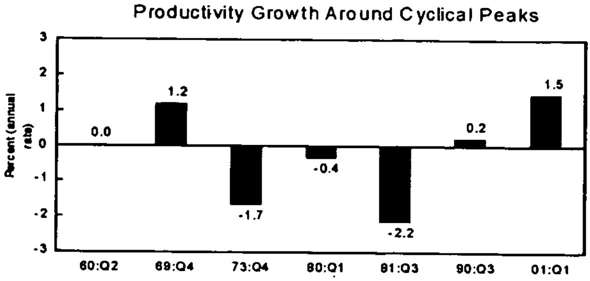
Thus far, I have focused primarily on the near-term recovery and the degree to which uncertainty has impeded the pace of acceleration. Before finishing, let me turn to an area without any uncertainty: Over the long term, the increase in the United States' standard of living is determined by productivity growth. Put differently, the underlying rate of productivity growth is the single most important indicator of long-term economic success, international competitiveness, and our ability to meet myriad future demands in both the private and public sectors. As is by now widely recognized, the United States experienced an acceleration of productivity in the years following 1995.

Nonfarm Labor Productivity



Source: CEA calculations.

The economic downturn has raised the specter of less robust productivity growth. Thus, the strength of productivity growth on the recent business cycle turning point is important evidence in support of the idea that U.S. structural productivity growth rate remains robust.



Source: CEA calculations

Productivity growth depends heavily on the policy environment for innovation. The United States must foster incentives to ensure continued growth in innovation and new technologies. We must invest in basic research, ensure that the intellectual property of innovators is secure at home and abroad, as well as invest in the skills and abilities of all our people. In part to support the private sector in these areas, the President signed into law an economic security package that will accelerate investment. Deploying advanced technologies can be capital intensive. Faster capital cost recovery is both good tax policy and makes companies more likely to make important investments.

The Administration has a commitment to promote basic research and development. The President signed into law the largest federal R&D budget in history and proposed broadening and making permanent the Research and Experimentation Tax Credit. The Administration has proposed broadening access to the research and experimentation tax credit to make it easier for companies to deduct many costs associated with developing new technologies and drugs.

Conclusion

Mr. Chairman, I am delighted to have had the opportunity to discuss the pace of the economic recovery and the long-term economic outlook. I look forward to our discussion and would be happy to answer your questions.

1753

S. Hrg. 107-716

REFORM OF THE IMF AND WORLD BANK

HEARING

before the

JOINT ECONOMIC COMMITTEE
CONGRESS OF THE UNITED STATES

ONE HUNDRED SEVENTH CONGRESS

SECOND SESSION

February 14, 2002

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JOINT ECONOMIC COMMITTEE

[Created pursuant to Sec. 5(a) of Public Law 304, 79th Congress]

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REFORM OF THE IMF AND WORLD BANK

Thursday, February 14, 2002

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

The Committee met, pursuant to notice, at 10:15 a.m., in Room 2318, Rayburn House Office Building, the Honorable Jim Saxton, Chairman of the Committee, presiding.

Present: Representatives Saxton, Ryan, English, and Putnam.

Staff Present: Chris Frenze, Robert Keleher, Colleen J. Healy, Darryl Evans, Brian Higginbotham, Matthew Salomon, Diane Rogers, and Frank Sammartino.

OPENING STATEMENT OF REPRESENTATIVE JIM SAXTON, CHAIRMAN

Representative Saxton. It is a pleasure to welcome Under Secretary of Treasury John Taylor before the Joint Economic Committee (JEC) this morning. Let me just say there is a vote on, and I suspect there will be some members coming in as we proceed through the early parts of this hearing. So we will get started and as they come in, we will welcome them to our ranks.

Dr. Taylor enjoys a fine reputation as a distinguished academic economist from Stanford University and has previously served as a member of the Council on Economic Advisers and held a number of other government positions. In his current position, Dr. Taylor deals with some of the most challenging issues of international economic policy. A number of these issues relate to the proposals for reform of the International Monetary Fund (IMF), an issue I have been involved in since the debate over the 1998 IMF quota increase legislation.

In preparation for the 1998 debate, the JEC conducted an extensive research program on the IMF resulting in a series of studies and hearings. The outcome of this research concluded that the IMF was not financially transparent, that it provided below-market subsidized interest rates and promoted moral hazard. In addition, we found IMF mission creep was reflected in its drift into lending for development and structural reform often involving longer loan maturities and rollovers of existing loans.

Committee research also found that there was a lack of IMF accounting controls and lending safeguards that could result in misuse of taxpayer money. A number of other findings involve the IMF's heavy reliance on the G10 for resources and the lack of meaningful financial support for the IMF by most of its members.

The research led to an introduction of the IMF Transparency and Efficiency act, a version of which later became law as a condition attached to the IMF appropriation. This reform mandated much more

IMF transparency and the use of risk adjusted interest rates in IMF bailouts. In the last few years, International Monetary Fund operations have become more transparent, although its financial statements still lack transparency. Although the IMF has made some limited progress in the area of financial transparency, a former IMF research director has also noted, "the need to improve the financial structure of the fund in terms of transparency, efficiency, and equity."

I would also like to note the President's Council of Economic Advisers (CEA) statements endorsing reform of the International Monetary Fund. According to the recent CEA report, IMF liquidity loan "programs would appropriately involve short-term lending at penalty rates of interest to encourage and facilitate the borrowers quick return to private capital markets." This is very consistent with the finding of the Meltzer Commission as well as the congressional mandates for IMF reform developed by this Committee in 1998. A version of these transparency and lending reforms became law in 1998 as conditions attached to the IMF quota increase legislation. Thus, congressional actions already taken strongly support the administration's position on needed reform of IMF lending programs.

The administration's support for significant grant financing of some World Bank activities is also very significant. This reform would offer the best approach to improving living standards and reducing poverty in the world's poorest nations. The traditional World Bank/IMF approach of saddling poor countries with loans they cannot repay has failed. Moreover the high failure rate of World Bank projects reflects a waste of resources that could have better been used to alleviate poverty.

Finally we now have an administration that is serious about needed reforms of the IMF and World Bank. Although change in these institutions will not occur overnight, consistent and steady advocacy of responsible reform will produce results that will limit moral hazard, curb international financial instability and reduce the waste of resources to the benefit of many millions of people around the world.

Mr. Secretary, thank you for being with us this morning. We have been joined by my good friend from Erie, Phil English. We thank the gentleman for being here in a timely fashion. Mr. Secretary, we are anxious to hear your testimony this morning and welcome you to the Committee. The floor is yours.

[The prepared statement of Representative Saxton appears in the Submissions for the Record on page 18.]

OPENING STATEMENT OF DR. JOHN B. TAYLOR, UNDER SECRETARY OF THE TREASURY FOR INTERNATIONAL AFFAIRS

Dr. Taylor. Thank you very much, Mr. Chairman and thank you and Mr. English for inviting me to this hearing to discuss reform of the international financial institutions. I know that reform has been a high priority for you and for this Committee for a long time, and I know that many of the ideas that have come forth in these hearings in the

Committee such as greater transparency, higher interest rates, longer maturities, have already had an impact on the International Monetary Fund, so they have been very constructive. Reform of these institutions is also a very high priority for President Bush's administration.

President Bush himself has given two speeches where he has drawn attention to some of the ways that the World Bank and the multilateral development banks could be improved, and Secretary O'Neill, on numerous occasions, has pointed out the need for reform in these institutions and the IMF. The goals of reform proposals that we have been thinking about are fundamentally to raise economic growth in the world and to try to create a greater degree of economic stability.

We hold those goals out all the time as guiding lights for our approach. We agree with you that there is still room for improvement, and therefore have made it a high priority. In this testimony, which I would like to put in the record, Mr. Chairman, I focus primarily on two reform initiatives which I think are very important for our overall reform effort. Those two reform efforts are more grants at the World Bank and the other multilateral development banks and the creation of a better sovereign debt restructuring mechanism, which would apply to emerging market debt and the activities of the International Monetary Fund. So I would like to focus on those two issues primarily in my oral remarks here, and of course I will be happy to answer any questions about what we are doing or what you are doing in this area.

Last summer President Bush made an important speech at the World Bank where he called for increased assistance in the form of grants from the World Bank and the other multilateral development banks to the poorest countries in the world. He just reiterated this proposal last month in another speech and I will quote, "he is urging the World Bank to provide up to 50 percent of its assistance to the world's poorest nations in the form of grants rather than loans, grants for education, for health, for nutrition, for water supplies and for sanitation."

Why is this grants proposal so important as part of our efforts to encourage reform at the World Bank and the other multilateral development banks? There are a number of reasons. The first one I would mention is, as you referred to in your opening remarks, Mr. Chairman, is that it creates a greater degree of transparency. The loans that IDA (the International Development Association), the branch of the World Bank that provides loans to the poorest countries, makes are at highly favorable terms at this point. Their maturity is 40 years. The interest rate is 75 basis points, sometimes called a service charge, and there is a 10-year grace period.

So by any measure, these loans have an enormous degree of grant element anyway. We feel that since they have this element of grants in them already, it would be much more straightforward and transparent to basically make them grants in the first place rather than to call them loans. So transparency is the first advantage I would mention for converting at least some of the loans into grants.

A second advantage is that the loans are now being given to the poorest countries, many of which we are effectively writing down through the Highly Indebted Poor Country (HIPC) program. There are many people supporting this effective write down in the debt to enable these poor countries to get into a more sustainable situation. We feel that loans from IDA, or wherever, increase this debt again and go counter to the direction of reducing the debt.

So rather than put more loans on countries where the debt burden is high and therefore we are reducing the debt, we think it is important to try to stop the debt if you like, to try to give grants whenever possible instead to these very poor, highly indebted countries.

A third reason is that grants are really much more suited for many kinds of social spending, spending for disadvantaged people and sectors in particular, for raising the enrollment rate for girls, say, in Afghanistan, which is only 3 percent, or to try to help HIV/AIDS patients and fight communicable disease in general. Giving loans for these kinds of activities doesn't make a lot of sense. Grants are the more appropriate form of support because the returns on these are not economic, they are largely social.

The fourth reason which I have emphasized a lot, Mr. Chairman, is that the grants can be tied to measurable performance I think in a way which can make them even more effective than other forms of support. Measurable performance is a theme which the administration has stressed a lot in the international financial institutions. The hope here is that grants can be tied to actual results. So, for example, if the grant is used to provide assistance to education, then the performance would be measured in how much enrollment is increased or how much test scores are increased.

If the grant is to provide for health, for HIV/AIDS assistance, then it would be measured in terms of how much patients are actually being treated. And if the treatments are not up or the enrollment rates are not up, then the grants would be shifted to other providers. This provides accountability and enforcement of the purposes of the grants, which we think could make them much more effective as a development tool.

I would mention that there are two objections which countries have pointed to in this proposal, and then I would like to discuss where we are in terms of international negotiations. Some people have pointed out that by converting loans into grants, the reflows would diminish over time. Reflows refer to the fact that eventually the loans are paid off at least when they are not written down, and those reflows are again then used to make loans to poor countries. So if there were a transition from loans to grants, the reflows would diminish.

However those reflows are effectively payments by some poor countries to other countries. So by reducing those reflows as grants would do, of course, you are actually providing more assistance from the donor countries and less assistance from poor countries themselves. So the worry about reflows is simply a worry about poor countries financing other poor countries, and we think it is more appropriate to have the grants rather than the loans for that purpose.

A second objection that some people point out is a feeling that the grants are a proposal that really would mean less funding from the United States. The United States is pushing this proposal, and the suggestion or the worry, perhaps from some, is that means there is going to be less support for these kinds of activities. I would say that that is completely contrary to our intention, as evidenced most recently by President Bush's budget submitted last week where he has asked for and proposed an increase by a substantial amount to IDA under the condition that IDA's performance deliver results.

If that funding all goes through, it would amount to a 30 percent increase from last year to the third year of the IDA replenishment. So there is no intention here to reduce funding, the objective is to make the funding more effective. If I could just say for a minute something about the international negotiations, we have found a lot of support for this proposal from NGOs and from other countries, and there is a move now to have grants as part of IDA. There are differences of opinion about how much grants there should be, and so we still need to work out an agreement or a compromise amongst the U.S. and the other donor countries. But the good news is that there will be a move towards grants of some amount and the question is how much.

The U.S. has shown flexibility. For example, we have said that the 50 percent grant assistance could go to countries whose per capita income is less than $1 a day. That seems like a reasonable definition of poor countries, but some of our other donor partners would like a more exclusive definition of what it means to be poor. So we are going to work these out. It's not settled yet, but think we are moving in the right direction.

Let me switch now to the other major reform issue, and that is looking for a better sovereign debt restructuring process for emerging markets. We have been working in the administration to develop an overall strategy for emerging markets and for the IMF. A sovereign debt restructuring mechanism would be part of that strategy. The overall strategy is already focused on crisis prevention, which is described in my written testimony; on narrowing the focus of the IMF, as this Committee has argued in the past, narrowing the focus in terms of the conditions and its work; to try to limit official sector support, especially in situations where debt becomes unsustainable in countries; and finally, trying to find ways to keep the contagion low, the contagion that occurs in crises.

And even if we are successful, and I think we have been in these four areas, there is still something missing in the sovereign debt market, and that is a more predictable approach to resolving situations when debt does become unsustainable. We see the need for some more predictable sovereign restructuring mechanism or a workout strategy, if you like, for countries that reach an unsustainable debt position. Ideally such a mechanism would never have to be used, but simply having it in place would create a great degree of certainty and predictability.

There are several alternatives that have been suggested, and the United States is in consultations with other governments, with the IMF, with the private sector, legal experts, financial experts, traders, investors, academics, to look for and ultimately propose a constructive approach that could be put through in a consensus basis in the international community.

At this point, one of the most practical and promising proposals on the table is a decentralized approach to this problem. It would encourage borrowers and lenders to put certain clauses in their debt so that when a country needs to restructure, there is a more orderly process. Many existing bonds do not have such clauses at this point in time, and we feel if there were more clauses, the workout process could be more predictable.

We feel it is important to provide additional incentives to countries to use these kinds of bonds. One approach is to say that a country that is in an IMF program, or is about to begin one, would be required that any newly-issued bonds have these kinds of clauses. So we think it is a promising approach and we will be working with our colleagues in other countries to discuss more details about this. There are other approaches that have been put forward.

One proposal that has been suggested by the IMF would have the IMF step in situations where they view debt as unsustainable and impose a stay on legal actions when they feel it is appropriate. We feel the decentralized approach has advantages and want to give it emphasis, but even with this decentralized market-oriented approach, there will be a role for the IMF in assessing sustainability and deciding how sustainable a new IMF program would be, at least for countries that are beginning IMF programs.

So let me stop with that, Mr. Chairman, and again, welcome questions on those two issues or anything else on reform.

[The prepared statement of Dr. Taylor appears in the Submission for the Record on page 21.]

Representative Saxton. Dr. Taylor, thank you very much. That was great testimony, and obviously very informative. With regard to the World Bank, the reasons for changing from loans to grants involve transparency, the fact that they write down the debt anyway, the fact that grants are more suitable for disadvantaged spending, and finally, fourth, that grants would be tied to measurable performance. These are all, I think, very logical reasons to pursue such a grant program.

In addition to that, there has been some discussion about providing grants directly to private contractors to carry out programs rather than to provide grants through government entities, and it seems to me that that approach would provide for a more specific target and a more trackable record. It would involve a specific target, an entity that would be responsible, and which would have the responsibility of justifying a program, and it seems to me that that might provide for more transparency than to funnel the money, if you will, through a government entity.

Would you talk about that a little bit?

Dr. Taylor. I agree very much with the notion of tying the grant to actual performance, and I think that is true no matter who the provider is. If the -- as you know, the World Bank now works its assistance through governments, but the provision of services can frequently be assigned by the government to other providers, and in that case, it is important that those providers, whether it is a public enterprise or a private enterprise, do exactly what you are saying. I think it is useful to look for ways in which individual providers or the private sector in general could be getting more encouragement and assistance through the World Bank and the other multilateral development banks.

I really applaud your suggestions. More generally, one of the things which I think would be important is to try to find ways to do the kind of things that the European Bank for Reconstruction and Development does, and that is to provide support for small businesses in the private sector, and that is a very successful operation. We are also looking for ways that that could be extended to some of the other multilateral development banks. I know it is not exactly what you are referring to, but it is related, Mr. Chairman.

Representative Saxton. Thank you. Let me turn to the IMF for just a moment and ask a couple of questions with regard to how – in a general sense –the reforms that we made in the late 1990s as a result of some requirements that were attached to the $18 billion appropriation that we passed in the Congress are performing. Can you respond in a general or even specific way about how those reforms are working and how you see that process moving forward as a result of that legislation?

Dr. Taylor. I think the request that there be more transparency is working well. As I see it, there is more release of information about programs, there are more requirements that countries provide data. I actually think that greater transparency has had important impacts on the markets themselves. One of the reasons I think that contagion seems to have diminished, or at least be more based on fundamentals, is that there are more facts out there, more transparency about what countries are doing. So I think that is effective. I think we could do more. I think the institutions could do a lot more.

One of the things that I note probably because of my background and education, is that there is still a lot of confusion if you like, complexity is a better word, to the way the information is presented, especially with respect to the IMF and the way that the loan activity is described as purchasing or exchanges of currency. It is confusing to all but the experts, and I think we could do a better job trying to explain that and that would create transparency itself.

Another example of reforms that have come out of this Committee's discussions and others are that there would be higher interest rates on loans which were provided for short-term liquidity purposes, and that has occurred in two ways at least. The supplemental reserve facility (SRF) has a higher interest rate and a shorter maturity, and that has been used. There is also a contingent credit line, CCL, with tougher up-front eligibility criteria, short maturities, and interest rates below the SFR but above the IMF's normal lending rate. That has not been adopted yet, but it is there for countries that want to meet the necessary prequalifications. I think this is also important to have happen, but I think it is still very small relative to the total in practice.

So these new instruments are there, but they are not used very much at this point in time, and I think that means they need to be reconsidered, or we need to understand why they are not being used the way they are. I think it comes back to the incentives that face the countries and to the official sector.

Representative Saxton. Let me ask about two things, and I will do it in one question. The notion that the IMF producing a situation in which bad economic practices are encouraged known as moral hazard persisted, and I suspect, to a large degree, continues to persist, and that, of course, is enhanced by – let me refer to the second subject of the question, and that is enhanced by subsidized interest rates that the IMF has used as a standard practice. In other words, on a smaller scale, if I were an investor and I had a rich uncle who said to me, Jimmy, you go out and make your investments, and you know you can make some riskier investments than maybe you otherwise would because I am going to be there to bail you out with a low interest rate if you fail.

Are moral hazard and low subsidized interest rates still problems with the IMF, or have there been some progress made?

Dr. Taylor. I think we are trying to make some progress on both of those by limiting official support or endeavoring to limit it to situations, which are more like liquidity problems rather than sustainability problems. That is very difficult to do in practice. I noted that the Council of Economic Advisers report paid a great deal of attention to that distinction. So, if we are able to do that, it will reduce the moral hazard. Of course the interest rate is related to limiting official support because if there were higher interest rates on these loans, then they would be much less attractive to the government.

Now the interest rates on the IMF loans are, of course, much lower than what the country has to pay in the markets, and if it were higher, they would use it less; but, of course, then it would be something that would be less desirable for the countries to use and they may not use it.

So I think what we have tried to do is give reasons why it is not good to provide support in those situations, to limit it more to liquidity situations. In the process of making decisions, many factors come into play, so it's difficult to make that judgment, but I think that is what we are trying to do and that will ultimately limit the moral hazard problem that you raised.

Representative Saxton. Thank you. I think that is an extremely important objective. Mr. English.

Representative English. Thank you, Mr. Chairman and Dr. Taylor. It is great having an appointment of your academic eminence in a position like this, and I am not setting you up for anything. I do have a couple of questions, though, and as someone who in a previous life wore a green eyeshade, I am particularly curious to know what is the status of internal controls in the IMF and what kinds of corruption safeguards are currently in place?

Dr. Taylor. I think there have been some improvements in that area, too. At this point in time, there is a requirement that borrowing countries publish audits of central bank financial statements, and that is meant to be a safeguard of IMF resources.

Representative English. On that point, and I am curious, what is typically the scope of those audits, and are they available outside of the IMF management?

Dr. Taylor. Well, the scope of the required audits is the central bank's financial statement and the central bank is to provide the information that is necessary. In terms of the availability, I don't know, and I will have to find out how available those audits are or in what form or what detail, but I will be very happy to get back to you on that. There is a requirement that the audits be published.

Representative English. Very good. Proceed. And then what else have you done to implement, what else has the IMF done to implement corruption safeguards in recent years?

Dr. Taylor. In addition to the publication of audited central banks financial statements, all countries must undergo an assessment of their central banks' control, accounting, reporting, and auditing systems to ensure they are adequate to protect central bank resources, including IMF disbursements. Any critical vulnerabilities identified must be remedied before additional Fund resources are disbursed. At some point, of course, money is fungible, so there is only a limit of what you can do of this kind, but my sense is they are moving in the right direction. But as shareholders and representatives of the taxpayers, we need to continue to look at it carefully.

Representative English. Within the IMF, is there any ongoing process for evaluating those internal controls and corruption safeguards?

Dr. Taylor. They have created an evaluation office and recently have begun staffing that. I think that is a very good idea. It is just underway, and we will have to see how it works. We are very interested in it and its evaluating that and IMF programs in general, but they have appointed a person and they are staffing it up at this point, this new evaluation office. I hope that works effectively.

Representative English. Building on the line of inquiry that the Chairman developed, when we are talking about moral hazard, one of the obvious criticisms of the IMF in the past is that IMF loans are offered, and the whole risk premium is not necessarily included within the loan itself. How currently is risk handled under IMF loans?

Dr. Taylor. Well, the interest rate on the IMF loans is very close to the interest on the bonds of the donor countries -- United States, European countries, Japan, et cetera. So it doesn't reflect the risk that is imbedded in the interest rates that the borrowing countries have to pay.

Representative English. Right.

Dr. Taylor. So sometimes those interest rates are called risk free. Economists sometimes refer to these Treasury rates as nearly risk free. Treasury bill rates are the classic risk-free interest rate. So the extent that that interest rate or something close to it, it hovers around that, is charged on the loans then there is a subsidy because the country would otherwise have to pay a higher interest rate.

Representative English. In terms of the candidates for IMF support, in the past, there has been a very strong focus in terms of all aid programs on LDC's, trying to help those countries that are at the absolute bottom of the heap, that have the most desperate human needs. How do you evaluate the policy currently as far as loans to those sorts of countries, the so-called basket cases, versus loans to countries that are perceived as having the potential for near-term take-off in their economies are putting in place pro-growth policies and have the potential of developing a middle class and showing signs of entering the international trading system? How would you evaluate those two kinds of countries as candidates for IMF loans under current policy?

Dr. Taylor. The IMF has a loan program, called the poverty reduction growth facility (PRGF), which is aimed at the very poor countries. This program has actually suffered from much of the other activity that the IMF does. It is funded out of individual countries, not the United States for the most part. Those loans are always put in the context of advice the IMF is giving on the macroeconomic side.

So it focuses on good monetary policy, good fiscal policy, good exchange rate policy, and good financial markets in general. Those are, if put in place, all good pro-growth things to do, keep, in other words, the inflation rate low, the exchange rate stable, transparency in the markets so these loans target promotion of pro-growth strategies. However, not all the things necessary to promote growth are part of IMF lending conditions; the World Bank has to do things which are more pure development to try to get pro-growth activity going. We believe it is important to try to distinguish that activity from the IMF.

The other IMF activity through their normal windows is more for emerging markets, and those are countries which are a much higher level of income per capita and already beyond the very basics of development. My sense is that that is the area where the IMF's long-term specialty has been, in these emerging market countries, and they are only more recently going into the very poor and very underdeveloped countries. That requires skills and knowledge which frequently are different from what the IMF has had in the past.

So to the extent they continue to do that, and many shareholders want them to do it, they need to develop the skills to do that, which has traditionally been in the World Bank area. But your question had to do with being able to pick the countries that are going to do well and take the right policies, and I think what we have argued, and I think what the institutions would like to do, is to favor countries who are doing the right policies. That is, have a performance-based allocation. This refers more to the World Bank than to the IMF to be sure at this point, and therefore encourage countries who are taking serious pro-growth policies and to discourage countries who are not.

Representative English. Thank you, Dr. Taylor, and again, it is a privilege to see someone of your stature taking on such a difficult and thorny assignment, and we look forward to hearing from you again, and I thank you, Mr. Chairman for your indulgence.

Representative Saxton. Mr. English, thank you for the very thoughtful questions. We will now move to a new member of the Committee, Mr. Putnam. Thank you for being here.

Representative Putnam. Thank you, Mr. Chairman.

Representative Saxton. It was a short night, a long night followed by a short night.

Representative Putnam. For those of us fresh out of college, it is no big deal.

Representative Saxton. But the activities are different.

Representative Putnam. One of the advantages of being young in this process; isn't that right, Mr. Ryan.

Representative Ryan. Right.

Representative Putnam. The United States has been under substantial criticism over the years for the perception of its withdrawal from the international stage on aid programs as well as monetary funds and other developmental assistance. What percentage of the IMF funding comes from the G8 nations, and how many nations benefit from that through the IMF?

Dr. Taylor. The G7 provides 51 percent of the IMF's non-concessional lending resources. And the countries that benefit, well, ultimately there are 183 members of the IMF, so they are all – anyone is potentially able to benefit; but, of course, there are many fewer countries at any one point in time. There are now approximately18 countries with concessional arrangements. In addition, the IMF has concessional programs under the PRGF, which are funded separately, as I just indicated to Mr. English. Those are very poor countries, their levels of —

Representative Putnam. Are those the ones he referred to as the basket cases?

Dr. Taylor. I didn't refer to them as the basket cases, but that term was used here and there are also loans to emerging markets, which is actually a lot larger in terms of its magnitude. So those are Brazil, Turkey, Argentina, Indonesia – those countries receive a large part of the support.

Representative Putnam. What percentage of the usable quota comes from the United States?

Dr. Taylor. It's about 25 percent right now.

Representative Putnam. Now, in identifying other nations who can help us implement the President's new strategy on grants over loans and things of that sort, how many other nations have we identified that could be pulling a little bit more of the load than they have in the past, in other words, spreading some of the responsibility beyond the G8? How many other nations out there are in a position to be helpful?

Dr. Taylor. The grants are more for the World Bank and any other multilateral development banks. In the case of the U.S. support to the World Bank to the IDA program, that is around 20 percent; so the numbers are less than what I just gave for the IMF current available funds. And in terms of getting more support from those countries for our grants proposal, as I indicated before you came in, and I am sorry, Mr. Putnam, we are getting some support, but we need more and they are moving towards the President's proposal by moving a larger fraction of grants, but we need more support from the large donors, the British and the French and the Germans, in particular.

Representative Putnam. Let me change gears one second and talk a little about mission creep, which has been an issue. The President's Council of Economic Advisers report noted that in recent years, the missions of IMF and MDBs have sometimes overlapped with the IMF providing some non-emergency financing for developing economies and the MDBs contributing to crisis financing packages.

What efforts are ongoing in the administration to clean up some of the mission creep, and shouldn't these missions be more refined and more focused than they have been in the past?

Dr. Taylor. I think they should be more focused and we have argued that – as a shareholder argued in favor of that. Other shareholders, such as the G7, have argued for it, and I think in the last year or so, we are beginning to see more of that. The managing director of the IMF has made an effort to have the conditions of the loans more narrowly focused, more targeted on the so-called core responsibilities of the IMF: monetary, fiscal policy, and exchange rate policy. So I think that is moving in the right direction in terms of its scope. We put a great deal of emphasis on crisis prevention, and crisis prevention means having a greater specialty in the IMF on crises, which means narrowing the focus to these particular issues as well, so I think it's moving in the right direction.

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

Representative Saxton. Mr. Ryan.

Representative Ryan. Thank you, Mr. Chairman. Thank you for holding this hearing too, I appreciate it. Dr. Taylor, I wanted to focus a little bit on Argentina. Specifically, I wanted to get into dollarization, but first, I wanted to ask you about the recent actions in Argentina, and I don't think that the Chairman asked this question, but do the recent actions in Argentina's government, in your opinion, qualify as triggering Title XXII, section 2370 (a) of the U.S. Code, which says that the President shall instruct the United States executive directors of each multilateral development bank and international financial institution to vote against any loan or other utilization of the funds of such bank or institution for the benefit of any country that has expropriated the property of any U.S. person or nullified any contract with any U.S. person? So has the fallout from Argentina and the expropriation of funds, and basically the violation of property rights of international investors led you to believe that you must invoke this code?

Dr. Taylor. What we are doing now is trying to indicate to Argentina, and the IMF is working with Argentina, that they need to treat all investors fairly as foreign investors, domestic investors, so that there is no discrimination in any of these matters which would call forth, the kind of law you are referring to. Right now Argentina is making changes. There is a "pesification" they call it in some of these accounts, financial transactions, which basically are trying to deal with the adjustment that the devaluation of the currency has created, and what they are trying to do there is do something that they see is the right way to make this adjustment. And what we have been doing is listening to all the private sector firms, not just from the United States, by the way, but other countries who are investors, and trying to be sure that whatever is done is done fairly, and doesn't involve the kind of activities you are referring to, so that we won't have to call into play that particular law. But we are aware of it and our legal experts will be evaluating it—

Representative Ryan. But if you had to make a decision today, the answer would be no?

Dr. Taylor. That is correct. It would be no.

Representative Ryan. I think you testified over at the Financial Services Committee on January the 6th, and you said that in your personal opinion, the better answer for Argentina would be to dollarize, and I don't know if you are aware of this or not, but this is my second term, and I have authored a dollarization bill called the International Monetary Stability Act I had authored with Senator Connie Mack last term, which would share the profits from seigniorage with the countries who choose to dollarize and to make sure that countries do not put firewalls against any expectations that countries would have any say so in the conduct of our monetary policy.

The Canadians are now talking about it very, very seriously; the Mexicans have talked about it for many years; Latin America, Panamanians have already dollarized. It's spreading through the hemisphere possibly. What is your personal opinion and professional opinion on the need for Argentinians to dollarize and to share the profits of seigniorage, given that we can clearly state that we would not allow any influence in our monetary policy?

Dr. Taylor. I think the latter part is very important to keep stressing. I know that is certainly the position of the United States and the Federal Reserve Board members. With respect to my personal opinion about

Argentina, I did testify that I thought dollarization would have been useful in a particular time last year. That is my personal opinion, because I was asked for my personal opinion.

The United States opinion has always been that the exchange rate is an issue that is best left to the country. It involves political issues, historical issues. It is the classic issue in which country ownership should be stressed.

So this administration, I think, very wisely has taken the position that an exchange rate decision is the country's, and we are not going to take a position one way or the other. So if a country chooses to dollarize, that is fine. If a country chooses to have a flexible exchange rate, that is fine. We hope in either case, it's done in a sound Way. Obviously, I know about your bill and others. I think it's something that needs to be continued to be discussed.

But again I say, with respect to my personal opinion, I refer to a different period than we are now in, in Argentina.

Representative Ryan. Let me ask you this: If the Canadians get behind the idea, would you entertain a sharing of seigniorage with the Canadian central government if they decide to convert? For a lot of countries, that is a lot of money and in many of these Latin American countries it would be a substantial amount of revenue that they would have otherwise lost if we don't share the seigniorage, and it would be a revenue raiser for our Federal Government as well, because we would retain a percentage of the profits of seigniorage. Do you believe that if one of these countries were to approach you, that that would be something you would entertain?

Dr. Taylor. Right now the position of the administration is that that would not be something—

Representative Ryan. The administration officially is opposed to sharing seigniorage right now?

Dr. Taylor. Right now there are questions of appropriation and funds for this that need to be worked out. I don't think I have seen all the work that has been done on that, and I can't say there is a policy that applies uniformly across every country. But it is not something that has, to put it this way, been put on the table for us directly to consider.

So the answer must be it is a case-by-case situation but I would say at this point there are appropriation issues, there are budget issues that are serious and need to be worked out before we would consider—

Representative Ryan. We had problems with scorekeepers on this around here, and for some reason, they think that it costs money, the profits from seigniorage. I don't know if you looked at our bill very closely or not, but do you believe that if we were to engage in a seigniorage-sharing agreement, that we would actually raise money, that there would be an inflow of capital, of dollars to the Federal Government?

Dr. Taylor. With an economic perspective, Mr. Ryan, it certainly represents an increase in revenue.

Representative Ryan. Right. I think we have some problems with the scorekeepers on that. Do I still have one more – Mr. Chairman?

We have Euro now. It's fairly new. There aren't many in bank reserves around the world, but as bank reserves of Euros grow and as some of the Eurocentric African countries become accustomed to Euros and grow in bank reserves, do you believe that there is a growing trend of the spread of Euro through that region of the world, and then do you believe that it may be in our best interest to promote the use of dollars, even more so around the world and more importantly in our hemisphere, to promote dollarization more aggressively than we are right now, which is no promotion whatsoever? What is your take in the long haul, on the future long term?

Dr. Taylor. That is a good question. I think the position now where we would like countries to make their choice and take ownership is a good one. We should continue with that. With respect to providing competition, if you like, with the Euro, I think that countries that would like to Euroize rather than dollarize, I think that should also be their decision—

Representative Ryan. Sure.

Dr. Taylor. They are located close to Europe and it would make a lot more sense than dollarization, and again, ownership is very important on that. I don't think there is a problem if Euros become more useful for people. I think there is no reason why it shouldn't only be the dollar. I think for many, many years in the future, the dollar will be the chosen asset for people to hold in countries which have high inflation or are unstable for other reasons, so the dollar will be used in many countries. And I think it's just fine if some countries choose to dollarize with Euros if you like.

Representative Ryan. In Quebec, it is my understanding that the issue of currency stability was not really a top issue at the G7 meeting. Is this an issue that the administration is going to take more of an in-depth hands-on approach with the other industrialized nations? Will currency stability, which has always been more the dominant discussion of these meetings – do you believe that given the problems in Argentina, the problems still moving around Central and South America, do you believe that the administration is going to take more of a hands-on approach, more of a leadership role in promoting currency stability, and sound money across the world as opposed to just this last meeting.

Dr. Taylor. Well, I think there has been an emphasis at these meetings, and certainly this administration, that sound money, keeping inflation low, keeping interest rates low thereby is a good policy for countries to follow. We think it's an important part of pro-growth strategy for the world to have low inflation, stable interest rates and good monetary policy. So that is something that we have no problem talking about positively, but with respect to exchange rates per se, that is something that it is the Secretary of the Treasury who should speak about it when you have a chance to have him testify.

Representative Ryan. I would suggest that they are looking to us and leadership—

Dr. Taylor. I think the leadership is there on the importance of a good sound monetary policy. If a flexible exchange rate is chosen, then to have a policy that keeps that exchange rate stable, and that is a good inflation policy, and if dollarization is chosen that is fine to. We will make every effort to make that smooth, and I know the Federal Reserve will be willing to do that as well.

Representative Ryan. Thank you.

Representative Saxton. Thank you very much, Mr. Ryan. Dr. Taylor, let me turn to two final questions on the International Monetary Fund. One of the issues that we found interesting as we began to search through the information that we could get our hands on relative to the IMF, and as we worked through that process in the late 1990s, we came to the conclusion without any difficulty that there were inadequate accounting controls and corruption standards at least at that time.

One of the things that stunned me and the Committee was finding several years ago that no effective procedures or safeguards were established by the IMF to verify information and monitor funds of disbursements through the IMF. And inasmuch as we noted at that time that a large percentage of the usable quotas were provided by the United States taxpayers. We felt some kind of a special obligation to look into this. And right after the Russian debacle, I led a delegation of Members of Congress to Moscow to see what we could find out in a direct way about what happened to the funds, and of course, the Russian officials that we talked with weren't forthcoming about what happened to the funds or we suspected that they were used in inappropriate ways. As a matter of fact, in some discussions with the Russian members, particularly Russian members of the Duma, particularly Communist members of the Russian Duma, we were told, in no uncertain terms, that those funds were stolen by American banks. It wasn't humorous at the time, but looking back, you have to grin at the charade that the Russians, or some Russians, were able to pull off at that time.

So my question is, have we made any progress in putting in place better accounting controls and corruption safeguards? And I guess the second part of the question is do you have any recommendations as to how we can be helpful to kind of move this ball forward?

Dr. Taylor. I think it is a very, very important issue, and there have been efforts put in place to have more audits. That is underway. The IMF has had experts in to help set this up. It is difficult, and I think in terms of what you can do is to continue to speak out on its importance. We are going to do that as well. There are problems that arise with respect to misreporting of data and information. When that occurs, we want to know about it and take actions. Ultimately, it seems to me if problems like that persist, there shouldn't be programs, there shouldn't be loans going into situations where you can't verify and can't audit. So I want to work very hard on that and think your support is helpful, Mr. Chairman.

Representative Saxton. Thank you and let me just say that I think we can make a good team on many of these issues, and what I would like to suggest is that as we move through this process, and as you see items that need to be changed by the IMF, I think we have shown that we can be helpful in making that happen, and if, as you see needs develop as to changes that the administration would like to see made in the way the IMF operates, we would more than appreciate hearing about that with an eye toward developing, perhaps, some statutory or suggest statutory changes as to how United States funds might be used in the IMF as we did before.

Last time the door to the IMF was completely shut, closed when we started. Frankly, the previous administration was not particularly forthcoming and helpful in helping us to pry the door open, but we got it open a little bit and with your help, as you move forward, you begin to see things that we can be teammates and help you move forward, we would very much appreciate hearing about them.

Transparency and interest rates and lengths of loans and accounting standards and all those things, we and our staff have a pretty good understanding of and we can certainly help you bring pressure to bear on the folks who can change these inside the IMF.

So thank you for being here this morning. We appreciate it very much. We are going to have a vote here for shortly and so we will draw this hearing to a close by thanking you for coming here and being as forthright and as revealing as you have with us and we look forward to working with you.

Dr. Taylor. Thank you very much, Mr. Chairman.

Representative Saxton. Thank you.

[Whereupon, at 11:14 a.m., the hearing was adjourned.]

SUBMISSIONS FOR THE RECORD

PREPARED STATEMENT OF REPRESENTATIVE JIM SAXTON, CHAIRMAN

It is a pleasure to welcome Under Secretary of the Treasury John Taylor before the Joint Economic Committee this morning. Dr. Taylor enjoys a fine reputation as a distinguished academic economist from Stanford University, and has previously served as a member of the Council of Economic Advisers and held a number of other government positions. In his current position, Dr. Taylor deals with some of the most challenging issues of international economic policy.

A number of these issues relate to proposals for reform of the International Monetary Fund (IMF), an issue I have been involved in since the debate over the 1998 IMF quota increase legislation. In preparation for the 1998 debate, the JEC conducted an extensive research program on the IMF, resulting in a series of studies and hearings. This research concluded that the IMF was not financially transparent, it provided below market subsidized interest rates, and promoted moral hazard.

In addition, we found that IMF mission creep was reflected in its drift into lending for development and structural reform, often involving longer loan maturities or rollovers of existing loans. Committee research also found there was a lack of IMF accounting controls and lending safeguards that could result in misuse of taxpayer money. A number of other findings involved the IMF's heavy reliance on the G10 for resources, and the lack of meaningful financial support for the IMF by most of its members.

This research led to the introduction of the *IMF Transparency and Efficiency Act*, a version of which later became law as conditions attached to the IMF appropriation. This reform mandated much more IMF transparency and the use of risk adjusted interest rates in IMF bailouts. In the last few years, IMF operations have become more transparent, although its financial statements still lack transparency. Although the IMF has made some limited progress in the area of financial transparency, a former IMF research director has also noted "the need to improve the financial structure of the Fund in terms of transparency, efficiency and equity."

I would also like to note the President's Council of Economic Advisers' (CEA) statements endorsing reform of the International Monetary Fund (IMF). According to the recent CEA report, IMF liquidity loan "programs would appropriately involve short-term lending at penalty interest rates, to encourage and facilitate the borrower's quick return to private capital markets." This is very consistent with the findings of the Meltzer Commission as well as the Congressional mandates for IMF reform developed by this committee in 1998. A version of these transparency and lending reforms became law in 1998 as conditions attached to the IMF quota increase legislation. Thus Congressional actions already taken strongly support the Administration's position on needed reform of IMF lending programs.

The Administration's support for substantial grant financing of some World Bank activities is also very significant. This reform would offer the best approach to improving living standards and reducing poverty in the world's poorest nations. The traditional World Bank/IMF approach of saddling poor countries with loans they often cannot repay has failed. Moreover, the high failure rate of World Bank projects reflects a waste of resources that could have better been used to alleviate poverty.

In conclusion, we now have an Administration that is serious about needed reforms of the IMF and World Bank. Although change in these institutions will not occur overnight, consistent and steady advocacy of responsible reform will produce results that will limit moral hazard, curb international financial instability, and reduce the waste of resources to the benefit of many millions of people around the world.

PREPARED STATEMENT OF SENATOR JACK REED, VICE CHAIRMAN

Thank you, Chairman Saxton, for calling this hearing on reform of the IMF and World Bank. And I'd like to thank Undersecretary Taylor for taking the time to testify before us today.

The IMF and World Bank were created as a response to World War II and the recognition that supporting global economic stability and prosperity would be an effective means of ensuring global peace. Today the economies of the world are even more interconnected. In the wake of September 11th and our ongoing war on terrorism, we are reminded that these institutions continue to serve a crucial role in our national, as well as economic, security.

Unfortunately, the recent economic crisis in Argentina suggests that the effectiveness of these organizations is sometimes insufficient. Economists and policymakers continue to debate over whether that is due to fundamental problems in the missions of these organizations, misguided policies, or simply mismanagement of well-intended policies.

Today's hearing should shed some light on what can be done to make the IMF and World Bank stronger players in our efforts to support global economic and national security.

PREPARED STATEMENT OF DR. JOHN TAYLOR, UNDER SECRETARY OF THE TREASURY FOR INTERNATIONAL AFFAIRS

Thank you Chairman Saxton, Vice-Chairman Reed, and other members of the Committee for inviting me to participate in this hearing on the international financial institutions. I know that reform of these institutions has been a high priority for this Committee. Indeed, many ideas coming out of the Committee's hearings—including calls for greater transparency and better accounting of costs—are already having a positive impact on these institutions.

Reform of the international financial institutions has also been a high priority of the Bush Administration. Our fundamental goals in this reform effort are to raise economic growth and improve economic stability in the world economy. The international financial institutions can help us achieve these goals, but there is room for improvement.

The Bush Administration—in a series of speeches by President Bush and Secretary O'Neill—has put forth a substantial reform agenda for the World Bank and the International Monetary Fund. In my written testimony today, I would like to discuss two key parts of that reform agenda —the use of grants rather than loans and the creation of an improved sovereign debt restructuring process. Both reforms are now a major focus of international discussion and negotiations.

Higher Economic Growth Through World Bank Grants

Clearly there is too much poverty in the world. We know that the key to reducing poverty is higher productivity growth. But productivity growth is far below its potential in many poor countries. We know that we can raise productivity growth by improving education and by increasing private investment. But educational achievement remains low as do private capital flows to developing countries and emerging markets in general.

So, in order to achieve our goals of raising standards of living around the world, the World Bank and other multilateral development banks must address the problems of productivity growth. That is why we have chosen productivity growth as a major theme of our reform effort. And to be sure that the actions taken actually increase productivity growth, we have emphasized the importance of measuring results of all actions taken, so we can see what works and what doesn't. Achieving measurable results and raising productivity growth are the rationales behind the proposal to shift from loans toward grants at the multilateral development banks.

Last summer in a speech at the World Bank, President Bush first put forth this grant proposal for the World Bank and the other multilateral development banks. And last month in a speech to the World Affairs Council at the Organization of American States, he forcefully reiterated that proposal. He "urged the World Bank to provide up to 50 percent of its assistance to the world's poorest nations in the form of grants rather than loans—grants for education, for health, for nutrition, for water supplies and for sanitation." Why is this grants proposal so important? Why is moving from loans to grants a major element of our reform effort? How does it relate to the theme of measurable results?

The Advantages of Grants

The part of the World Bank that provides assistance to the poorest countries is the International Development Association, or IDA. Funds for IDA are replenished at three-year intervals by the United States and other donor countries, and U.S. contributions to IDA must be appropriated each year by Congress. Virtually all of the IDA assistance to poor countries is now in the form of loans (these loans are sometimes called IDA credits). The terms on these loans are highly favorable to the borrowing country—far more favorable than the government of the country could obtain in private capital markets. The loans have a 40-year maturity; the interest rate (referred to a "service charge") is 0.75 percent; and there is a 10-year grace period.

Because the terms on these IDA loans are so favorable, they are really not loans in the everyday sense of the word. The total interest and principal that must be paid back is much less, in present value terms, than the amount loaned. For example, the present discounted value of all future payments on a $1,000,000 IDA loan at a 6 percent discount rate is only $337,671. Most developing countries, however, face interest rates much higher than this: if the discount rate were 15 percent, then the present discounted value would be only $97,569. Moreover, because the grace period is so long, a finance minister of a borrowing country could be out of office long before any principal has to be paid back on such a loan; and while in office there is only the small 75 basis point interest payment. It is misleading to call such assistance "lending." Such terminology is not consistent with basic goals of transparency in government. Thus, one reason that grants are better than IDA-type loans is simply that they are more straightforward and transparent.

Another reason to prefer grants to loans as a form of IDA assistance is that many of the countries now borrowing from IDA are part of the Heavily Indebted Poor Country (HIPC) initiative. HIPCs are poor countries that have unsustainable amounts of debt. As many have argued, by forgiving this debt the hope is that these countries can achieve a more sustainable debt situation. Through the HIPC initiative, the international financial institutions, in effect, write off their loans to these poor countries and relieve the countries' debt burden. However, at the same time we are writing off loans to these poor countries, by creating more loans from IDA—even at favorable terms—we are adding to their debt burden. This approach seems counter productive. Grants, on the other hand, are better than loans because they do not add to the debt burden of these countries.

Grants are particularly advantageous in cases where it is unrealistic to assume that the activity being supported will generate enough direct economic returns to pay back IDA loans. The use of grants thus removes a disincentive for governments to focus on the most disadvantaged people and sectors, e.g., rural poor, girls, indigenous people, and AIDs orphans. For example, issuing a loan rather than a grant for humanitarian assistance or major social crises—for instance, to provide assistance to HIV/AIDS patients—seems particularly inappropriate. That is why President Bush emphasized that grants should be used in certain social sectors—for "education, for health, for nutrition, for water supplies and for sanitation."

Yet another advantage of grants is that they can easily be tied to measurable performance or results. Some people think that the President's proposal is for "free" grants. That is certainly not the case; on the contrary, the grants are to be tied to specific performance. For example, if there is a grant for education, then the grant would not continue unless there are results—unless enrollment rises, for example. If the grant is designed to assist HIV/AIDS patients, for example, then the grant will continue as long as the assistance is being provided. If the assistance becomes inadequate, then the grant funds should go to another provider. Month by month, quarter by quarter, the group receiving the grant has to keep delivering the service or the grant stops.

International Differences and Negotiations

Since the President made the grants proposal last summer, we have been working and negotiating with other IDA donors to move from loans toward more grants. Of course, the World Bank is an international institution, so to implement any reform a coalition of support must be developed. A number of non-governmental organizations and developing countries have expressed strong support for the proposal, but for the proposal to be implemented it is necessary to garner the support of major donors to IDA. The current international negotiations are taking place in the context of the current three-year replenishment of IDA, which we hope to settle soon. An important and extensive discussion on this subject took place among the G-7 Finance Ministers and Central Bank Governors in Ottawa last weekend.

There is now widespread agreement among G-7 donor countries that a larger proportion of IDA assistance should be given in the form of grants, as the President proposed. However, there are still differences of opinion among donor countries about the details and ultimately about how much should go to grants. For example, the President called for 50 percent grant assistance for the "world's poorest nations." But exactly how poor countries should be before they qualify for this percentage of grants rather than loans is still an unsettled question.

The United States has shown flexibility in the negotiations, stating that it would be acceptable to provide 50 percent grant assistance to those countries with annual per capita incomes less than $365, that is, less than $1 per day. But some donor countries would like a more exclusive definition of "poor"; some would exclude those countries with annual per capita incomes above $250. Another difference of opinion is how to define the categories of assistance that would qualify for grants. Some donor countries would like to exclude education, in contrast to the President's proposal.

One of the more strongly voiced objections to increasing the proportion of grant assistance beyond a certain level is that it would reduce the "re-flows" to IDA. Re-flows are primarily the funds that are paid back into IDA by countries with IDA loans. These payments can then be lent again to poor countries. But, of course, poor countries themselves pay these re-flows. In other words, under the current IDA program the poor are supporting the poor. So reduced re-flows through the grants really means more support for poor countries.

Significant Increase in U.S. Support for IDA, Based On Results

Another objection to moving further toward grants is the argument that U.S. assistance to IDA will decline under a grants program. The facts say otherwise. Indeed, the United States is offering a significant increase in its contribution to IDA. The United States in the last six years has been bringing down its contributions to IDA in real terms. The President intends to reverse this trend. He proposes to increase our contributions to IDA, as long as the contributions result in better performance. In the budget he submitted to Congress last week, he is proposing that the U.S. IDA contribution increase—from previous years' annual total of $803 million—to $850 million in the first year, to $950 million the second year, and to $1,050 million in the third year. These step-ups will only occur if there is an improvement in performance at the World Bank, but they would bring the annual U.S. contribution to a level 30 percent above what it was last year. That is a clear demonstration of support for economic development, tied to the idea that we want that support to create measurable improvements in peoples' lives.

A Better Sovereign Debt Restructuring Process

The second major reform initiative that I would like to discuss today is sovereign debt restructuring. It is part of our overall approach to emerging markets and the International Monetary Fund. The truth is that emerging markets have not been performing very well in the last four years. The flow of investments going through these markets has declined sharply. We would like more funds to go to the emerging markets and at lower interest rates. A more predictable sovereign debt restructuring mechanism can help achieve that goal.

An Emerging Markets/IMF Reform Strategy

Our sovereign debt restructuring initiatives are part of a multifaceted strategy toward emerging markets and the IMF. That strategy starts with a greater focus on crisis prevention, asking the IMF to look more closely at countries where economic trends appear unsustainable, giving more ownership to countries so that they can make the decisions before the crises get out of hand, and encouraging more transparency both on the part of countries and the IMF itself.

A related part of the strategy is to narrow the focus of the IMF—both its work and the conditions it imposes on borrowers. By narrowing the focus to core responsibilities—exchange rate regimes, monetary policy, fiscal policy, and the financial sector—the IMF will be able to concentrate more on preventing crises and give countries more ownership of policy.

Limiting official sector support to countries when they reach unsustainable debt situations is another key element of our emerging markets strategy. Large official sector support packages can distort incentives for countries and for investors. And, of course, such packages effectively bailout private sector investors who have already received high rates of return. I think it is becoming clearer that the official sector support in such cases is now being limited to a significant degree.

Keeping contagion low is another part of the overall strategy and is a major reason why official sector support can be limited in many cases. Clearly contagion was an important characteristic of the Asian crisis in the late 1990s. However, coming into the Bush Administration, we re-examined this contagion issue and saw that important trends were developing. People in the markets were paying more attention to economic fundamentals, differentiating between countries and events. Countries were being more transparent in their policies. Market research was more thorough. We commented favorably on this change, noting that contagion is not automatic. This communication with the markets was meant to build on and encourage the changes in the markets by emphasizing that policy decisions would not be based on unfounded claims of contagion. In fact, contagion has come down dramatically over the course of the last year. This is illustrated by the fact that the terrible economic situation in Argentina has not spread to other countries in the world, let alone the region.

A Decentralized Contract-Based Approach

But even if we are successful in all parts of the strategy mentioned above there is still something that is missing. Currently, when countries get close to a situation where debt is unsustainable, it is like approaching a black hole: no one knows exactly what will happen next. This leads to uncertainty on the part of public officials and market participants alike. It leads to pressures for IMF bailouts even in situations where debt becomes unsustainable.

A more predictable sovereign debt restructuring mechanism—a workout strategy—for countries that reach an unsustainable debt position would therefore be useful. Of course, ideally such a mechanism would never have to be used, but simply having it in place would greatly reduce uncertainty. There are several alternatives now being considered. We at the U.S. Treasury have been in close contact with people in the private sector—market participants, lawyers, and academics—as well as people at the IMF and other governments, especially finance ministries and central banks.

The most practical and promising proposal now on the table is a decentralized approach that creates debtor and creditor ownership of, and participation in, the process. This proposal would encourage borrowers and lenders to put certain clauses in their debt so that when a country needs to restructure, there is a more orderly process. For example, now in many bonds, 100 percent of bondholders must agree to restructure the financial terms of the bonds. This makes it possible for a small minority to stand in the way of a restructuring that the majority of bondholders feel is in their best interests. Majority action clauses in bonds would allow a specified majority to agree to restructuring terms. The decision of this majority would be binding on the minority. The clauses would also provide for the process and timing through which debtors and creditors come together

There are several possible ways to create incentives for countries to use such clauses, and encourage them to overcome the urge to cut a few basis points from their interest rate by avoiding such clauses. For example, the official sector could require that these clauses be utilized by any country with an IMF program. Or the IMF could make it a condition of exceptional access to its funds that countries utilize these clauses in their debt contracts. A range of ways to implement this proposal is possible. Of course, introducing new clauses is something one can only do for new bonds. Consequently, we are also exploring options that would facilitate more predictable workout processes under existing bond provisions.

Another possible approach to sovereign debt restructuring that is receiving wide attention is an IMF proposal, in which the IMF would step in and impose a stay on legal actions in certain circumstances. This proposal obviously calls for a larger role for the IMF than the more decentralized market-oriented approach described here. But even with the market-oriented approach there will be a role for the IMF in assessing sustainability and deciding on a new IMF program, at least for countries that choose to work with the IMF on a program.

As with the grants proposal, it will be necessary to work with other governments to come to a common agreement on a sovereign debt restructuring proposal. It will also be important to consult regularly with the private sector and with Congress. And as these discussions proceed we should never lose sight of the overall objective: to increase predictability and reduce uncertainty in the emerging markets so that more funds flow through them at lower interest rate spreads.

Concluding Remarks

In conclusion, there is one final point I would like to make about our reform efforts with the international financial institutions. A high priority with us is to make our own work with the institutions more effective and efficient. Currently, we are required to implement a very large number of mandates legislated by the Congress. These mandates including requirements for directed voting at the institutions, certifications, notifications, and reports. Our effectiveness in carrying our responsibilities with the IMF and the development banks could be strengthened if we are able to reduce and better rationalize these mandates. Some mandates go back 50 years. Some provisions overlap, or are inconsistent. We have 32 directed vote mandates, over 100 policy mandates, plus numerous reports, certifications, and notifications. We want the Congress to be fully informed, but numerous reporting requirements have increased the amount of time staff spends on these reports to levels that warrant serious concern. We would like to work with you to rationalize and focus our mandated requirements and reports.

Thank you very much. I would be pleased to answer any questions that you may have about the reform issues I discussed here, about our overall reform strategy, or about any other issues relating to the international financial institutions.

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MONETARY POLICY AND THE ECONOMIC OUTLOOK

HEARING

before the

JOINT ECONOMIC COMMITTEE CONGRESS OF THE UNITED STATES

ONE HUNDRED SEVENTH CONGRESS

FIRST SESSION

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Wednesday, October 17, 2001

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

The Committee met, pursuant to notice, at 10:00 a.m., in Room 311, Cannon House Office Building, Honorable Jim Saxton, Chairman of the Committee, presiding.

Present: Representatives Saxton, Smith, Dunn, English, Putnam, Stark, Maloney, and Watt. Senators Reed, Bingaman, and Corzine.

Also Present: Representative Don Sherwood.

Staff Present: Chris Frenze, Robert Keleher, Colleen J. Healy, Stephen Thompson, Darryl Evans, Brian Higginbotham, Pat Ruggles, Matthew Salomon, and Diane Rogers.

OPENINGS STATEMENT OF REPRESENTATIVE JIM SAXTON, CHAIRMAN

Representative Saxton. Good morning. I would like to welcome Chairman Greenspan before the Committee to testify on monetary policy and the economic outlook. We appreciate your being with us today, Mr. Chairman. We always look forward to the days when you come and visit with us, and so we look forward to your testimony.

I would also like to take this opportunity to thank Chairman Greenspan for his leadership and the Federal Reserve for the actions undertaken to cushion the effects of the September 11 terrorist attacks. The Federal Reserve's ability to deal with such an unspeakable crime has served the country well, and we are in your debt. It is also encouraging that the American people and the economy have demonstrated amazing resilience in the face of these attacks.

Even before the events of September 11, the available economic data indicated that the economic slowdown that began in the middle of 2000 continued. The weight of real gross domestic product (GDP) growth has slowed quite sharply since the second quarter of 2000, barely remaining positive in the second quarter of this year.

The manufacturing sector has been hard hit, losing over a million jobs since July of 2000. Investment growth has fallen over the last several quarters, and corporate profits are weak.

On the other hand, housing and consumer spending have held up fairly well. In addition, since last January, the Fed has reduced interest rates nine times. Congress has lowered the tax drag on the economy and energy prices are finally declining. Economists expect these factors to lead to an economic rebound in the last half of 2001, but the attacks have led them to forecast a delay in the recovery.

Financial markets and the economy have been disrupted by the terrorist attacks. These attacks have increased uncertainty and caused a widespread reevaluation of risk and security. Delays in higher shipping costs in air and ground transport, additional insurance costs, higher expenses for security personnel and equipment, fortification of buildings and facilities, and other measures, will have the effect of imposing something like a "security tax" on an already vulnerable economy. This burden will undermine the economy and in the short run and could tend to adversely affect both productivity growth and the economy's potential growth rate.

Although the precise amount of the extra burden imposed by these security costs is not known, it appears to be large and is growing by the day. Over the last several weeks, private sector economists have begun to consider this cost issue and the potential impact on an already weak economy.

A logical policy response would be to offset those costs by relieving some of the tax burden on the private sector. Monetary policy helped the economic situation with an easing that began in January. The Fed's policy moves so far this year have certainly provided an economic stimulus, but the lags in monetary policy, as we all know, are long and variable. Given the lack of inflationary pressures, prudent action by the Federal Reserve could continue to contribute to improving the economic outlook.

Again, Mr. Chairman, I want to welcome you, and at this point, turn to the Vice Chairman, Senator Reed, for any comments he may have.

[The prepared statement of Representative Saxton appears in the Submissions for the Record on page 27.]

OPENING STATEMENT OF SENATOR JACK REED, VICE CHAIRMAN

Senator Reed. Thank you very much, Mr. Chairman. Thank you, Chairman Greenspan for joining us this morning. Your presence here is a reassuring one. And we appreciate that you are here and thank you, Chairman Saxton, for scheduling this hearing on a very critical topic – our economic outlook and appropriate policy responses. In light of the new fiscal realities we face, economic policy needs to be recalibrated. The key to achieving a rapid recovery is to bolster incomes, because when cash-strapped households cut their spending, business' sales suffer, stifling investment. We need to complement existing monetary policy with an economic stimulus package, but one which has its maximum impact in the short run and does not undermine long-term fiscal discipline.

Specifically, the stimulus package should be large enough to have an impact on a $10 trillion economy, such as about $100 billion, one percent of GDP, a figure which I believe you have supported, Chairman Greenspan. The bulk of the stimulus should be felt in the next two or three quarters when the economy is weak. Often or not, economic stimulus in the past has not been implemented until the economy was already recovering.

The stimulus package should be designed to phase out rapidly so that the stimulus measures do not overheat the economy later in recovery.

Thus, permanent tax cuts or new spending that spin out slowly are not attractive candidates, while safety-net programs, such as unemployment insurance, which are designed to be countercyclical, are attractive options. The stimulus package should maximize the amount of short-term economic activity created per dollar of outlays or revenue lost. For example, a tax cut for low- or moderate-income households who would likely spend all of their extra income would be more effective as stimulus than a similarly-sized tax cut for higher income households who are more likely to save a substantial portion of it.

These principles are outlined in greater detail in a new report prepared by the Democratic staff of the Joint Economic Committee, *Economic Stimulus, Principles and Options*, which evaluates the leading proposals in light of their impacts on the economy and the degree to which they have a stimulative effect. This report is available here in the room and also online on our website.

Earlier this year, Chairman Greenspan, you spoke of the need to resist those policies that could readily resurrect the deficits of the past and the fiscal imbalances that followed in their wake. You also testified about the limits of tax cuts as effective tools to stimulate the economy. I would be interested in your thoughts on how the economic stimulus proposals before the House right now deal with these tenets.

We have an important responsibility before us, to undertake fiscal policies that will protect the most vulnerable in our economy, while ensuring that we do not compromise our economic future. It is a challenge we can meet if we stick to policies which put people back to work and generate productive business investment. Again, thank you, Mr. Chairman, for your attendance today.

[The prepared statement of Senator Reed appears in the Submissions for the Record on page 28.]

Representative Saxton. Thank you very much, Senator Reed. Mr. Chairman, we are here to hear what you have to say, and we always, as I said before, value these opportunities. So we would like to hear from you at this time. You may proceed.

OPENING STATEMENT OF THE HONORABLE ALAN GREENSPAN, CHAIRMAN, BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

Mr. Greenspan. Well, thank you very much, Mr. Chairman. I very much appreciate this opportunity to appear before this Committee to discuss recent developments in the United States economy. Despite the tragic events of September 11, the foundations of our free society remain sound, and I am confident that we will recover and prosper as we have in the past. But before the recovery process gets underway, stability will need to be restored to the American economy and to others around the world. Arguably, that stability was only barely becoming evident in the United States in the period immediately preceding the act of terrorism.

Aggregate measures of production, employment and business spending continued to be weak in August. Consumer spending, however, moved higher that month, and appeared to be reasonably well maintained in the first part of September. Industry analysts suggest that motor vehicle sales were running close to August levels, and chain store sales were only modestly lower. New orders for nondefense capital goods stabilized in August. Moreover, the dramatic rate of decline in profits was slowing. To be sure, these signs were tentative, but on the whole, encouraging.

In the days following the attack, the level of activity declined significantly. The shock was most evident in consumer markets, as many potential purchasers stayed riveted to their televisions and away from shopping malls. Both motor vehicle sales and sales at major chain stores fell off noticeably. The airline and travel industries also suffered severe cutbacks. The unprecedented shutdown of American air travel and tightened border restrictions induced dramatic curtailments of production at some establishments with tight, just-in-time supply chain practices, most notably in the motor vehicle industry.

As the initial shock began to wear off, economic activity recovered somewhat from the depressed levels that immediately followed the attacks, though the recovery has been uneven. Markedly increased incentives induced a sharp rebound in motor vehicle sales by the end of the month that has carried apparently undiminished into the first half of October. However, many retailers of other consumer goods report that sales have only partially retraced the steep drops that occurred in mid-September.

Fortunately, air freight is largely back to normal. Overall airline passenger traffic, while above its mid-September lows, was still off considerably in early October from pre-attack levels. Similarly, the hospitality and entertainment industries have overcome some of their earlier difficulties but continue to struggle.

The effect on financial markets of the devastating attack on the World Trade Center was pronounced, as telecommunications and trading capacities were severely impaired. But the markets are mostly functioning normally now, and as in the past, the infrastructure will be rapidly restored.

For a brief time, the terrorist attacks markedly disrupted payment transfers, leaving those counting on receiving payments caught short. Those needs ultimately were met by the Federal Reserve, both through record lending at the discount window and through an extraordinary infusion of funds through open market operations. To facilitate the channeling of dollar liquidity to foreign financial institutions operating in the United States, 30-day currency swap lines were arranged with major central banks, again, in record volumes.

It was essential in such an environment to meet all appropriate demands for dollar liquidity. As repair of the financial markets and payment infrastructure preceded apace, loans were repaid, open market operations could be scaled back, the unusual swap lines were allowed to expire, and the temporarily bloated balance sheet of the Federal Reserve largely returned to normal.

But even as market functioning and liquidity flows were restored, the potential for heightened uncertainty to damp household and business spending for a time persisted. To cushion these effects, we have eased the stance of monetary policy appreciably since September 11.

We, in the United States, have assumed ourselves to be fairly well-insulated from terrorism or, at most, subject to limited and sporadic episodes similar to those previously observed on a number of occasions in Europe.

We have been aware of the possibility for losses on a much greater scale, but I suspect that those possibilities were deemed so remote that they were never seriously incorporated into most conventional assessments of economic risk.

The shock of the tragedies at the World Trade Center and the Pentagon has reshaped those assessments of risk and required an abrupt realignment of prices in many markets to reflect the expected costs of operating in what we now recognize as a more hostile world. These circumstances pose a difficult challenge for business decisionmaking, not so much because the costs are inordinately large, but because the events, which have potentially substantial consequences, are so uncertain. Insurance deals with this problem by spreading the risk and converting potential large unknown costs into a steady stream of known insurance premiums that facilitates the forward planning so essential to an effective business operation.

Obviously sharp increases in insurance premiums for all forms of businesses are to be expected. Some higher insurance costs, in effect, will be borne implicitly rather than explicitly as firms choose to self-insure, at least in part, rather than lay off all of this risk in the marketplace.

These higher insurance costs, both explicit and implicit, endeavor to anticipate future losses, but in addition, they cover the physical capital and labor resources businesses will be required to devote to enhance security and to increase redundancies as protection against interruption of supplies or production. For example, the degree of comfort businesses have in allowing inventories to shrink to minimal levels in a just-in-time supply chain is lessened. In this regard, increased security threats, not pooled through insurance, have exactly the opposite effect on productivity than that which is gained by an improvement in information technology. In addition to the loss of human life and capital assets, these are important collateral costs associated with the new threats that we now face.

The pronounced rise in uncertainty also has damped consumer spending and capital investment. Households and businesses confronted with heightened uncertainty have pulled back from the marketplace, though that withdrawal has been partial and presumably temporary. The very great economic uncertainties that have arisen in the current environment have also, at least temporarily, resulted in a widening of bond spreads on high-yield instruments.

Markets across our economy will adjust to the altered perceptions of risk that we now confront. Critical to that adjustment process is the behavior of consumers and business people. Behavior is difficult to predict in circumstances such as those we have experienced in the past five weeks. But judging from history, human beings have demonstrated a remarkable capacity to adapt to extraordinarily adverse circumstances, and I expect the same adaptability to become evident in the present situation.

Although it is difficult to determine with any precision, it seems quite likely that a significant repricing of risk has already found its way into our markets as many economic decisions are responding to shifting market signals. But these adjustments in prices and in the associated allocation of resources, when complete, represent one-time level adjustments without necessary implications for our longer-term growth prospects.

Indeed, the exploitation of available networking and other information technologies was only partially completed when the cyclical retrenchment of the past year began. High-tech equipment investment at elevated rates of return will, most likely, resume once very high uncertainty premiums recede to more normal levels. The level of productivity will presumably undergo a one-time downward adjustment as our economy responds to higher levels of perceived risk. But once the adjustment is completed, productivity growth should resume at rates in excess of those that prevailed in the quarter century preceding 1995.

It is worth noting that increased production to enhance security will be counted in measured output without contributing to our standards of living, as was the case during our military buildup of the Cold War. Our productivity measures have always endeavored to capture increased productive efficiency, not increased well-being. We are, in effect, currently using part of our increase in efficiency to supply increased security. Of course, given the heightened risks we face, these investments in security are doubtless quite sound. In any event, such costs are likely to fall short of the costs we incurred for security during the height of the Cold War.

Nobody has the capacity to fathom fully how the effects of the tragedy of September 11 will play out in our economy. But in the weeks ahead, as the initial shock continues to wear off, we should be able to better gauge the ongoing dynamics of how these events are shaping the immediate economic outlook.

For the longer term, prospects for ongoing rapid technological advance and associated faster productivity growth are scarcely diminished. Those prospects borne of the ingenuity of our people and the strength of our system, fortify a promising future for our free nation.

Thank you very much, Mr. Chairman. I look forward to your questions and those of the Committee.

[The prepared statement of Chairman Greenspan appears in the Submissions for the Record on page 30.]

Representative Saxton. Mr. Chairman, thank you very much for sharing those thoughts with us. Let me just take care of a couple of housekeeping measures. Senator Reed has indicated that the Senate is having an important security briefing sometime in the next ten minutes or so, so if some of the Senators disappear, we will understand why. I would also like to ask unanimous consent that Congressman Don Sherwood be permitted to sit on the panel, as he is not a Member of the Joint Economic Committee. Without objection. Thank you.

Mr. Chairman, immediately following the events of September 11, you cautioned policymakers to proceed cautiously, and to take a closer look at economic data that would flow in, in the weeks following September 11. We have begun to see some of that data, and I am wondering if you could comment on what the data covering the period immediately prior to September 11 showed us, and while certainly we don't have a complete picture of the economic situation following the 11th, there is some data that is now available, and would you help us interpret that?

Mr. Greenspan. Well, Mr. Chairman, we interpreted the data that came in at the time before September the 11th, and that information which we have subsequently received for the period before September 11, to indicate that the economy was still weak but showing some signs of stabilization. As I said in my prepared remarks, and I think I said earlier on in my testimony, it was by no means conclusive, but it was certainly encouraging.

Since then, the data are fairly clear as to what is happening, though the interpretation of what it means has yet to fully unfold. That the economy dropped fairly sharply in the days immediately following the attack is confirmed by virtually every measure that we can see, and that it has started to come back is also evident. We see that in the retail area, especially in an uncertain puzzling way, extraordinarily in motor vehicles, because we had a dramatic decline in the middle part of September in motor vehicles. The new incentives came in, and sales came back very sharply in the last 10 days, and from what we can gather, are holding at remarkably high levels in the first half of this month. I say that remarkably in the sense that the discounts which have been put in place, if one looks at previous elasticity of demand in the motor vehicle industry, don't fully account for this upsurge.

So it is a difficult judgment to make. We suspect, as indeed the auto makers suspect, that because the discounts are perceived to be temporary, that a lot of people are moving up sales, and that we would expect a falloff, and indeed the motor vehicle manufacturers are expecting the average for the fourth quarter to be well under the first half of this month.

But outside of the motor vehicle area, things are really quite mixed. Chain store sales are soggy. They have stopped going down, but the evidence that they have turned up in any material way is still quite missing.

Airline travel has come back modestly. It came back reasonably quickly within days after the attack, and load factors rose, but remember, they are load factors after a significant contraction in the number of scheduled flights, which means that the actual revenue passenger miles are still quite significantly below where they were a year ago, and indeed where they were earlier this year.

The entertainment/hotel industry is back to a certain extent – actually occupancy rates have come back, but generally, as I indicated in my prepared remarks, it is evident that there is still a good deal of struggle going on in those areas.

We don't have any real hard evidence on what is happening to capital goods orders, but anecdotal information does suggest that they turned weak late in September and have been weak so far this month.

Home building has been holding up remarkably well, and the starts figures that came out this morning were a continuation of the most previous period of fairly good housing construction. Although again, data on surveys of home builders have indicated that home sales have slipped in recent weeks. It is often difficult to reconcile differing measures of an industry as large and diverse as home building. So until we have more information and it materially works its way through the system, it is not clear what we are seeing. But obviously the home building industry has been a major part of whatever strength we have seen in this economy. And certainly the very high level of turnover of existing homes and the realized capital gains that that engendered in the process has been an important factor in maintaining the level of consumer expenditures for most of this year.

As best we can judge, the closings on existing home sales are still quite high, but we have to remember that there is a lag between actual commitment in purchase and closing, so that we won't really see the impact of what appears to be some softening in existing home sales, as well as new home sales until October data become available, and that may still not capture it fully.

So all in all, I think we are looking at a situation which is by no means as bad as numbers of us were fearful it might turn out to be, but it also has not exhibited a sharp snap back, which has been typical of what happens when you get a major hurricane or natural disaster which breaks down the infrastructure, and has many similar effects to what we have seen since September 11, but which almost never affects demand in any material way or underlying psychology. This clearly has.

Representative Saxton. Well, Mr. Chairman, I think it is fair to say, and I am sure you would agree, that there is a different psychology associated with the events of September 11 than there are with natural disasters. Let me just ask one more quick question, and then we need to proceed to Senator Reed. Beginning in January, Fed policy changed, in that interest rates, Fed funds, were reduced, and in the succeeding months there have been nine reductions, totaling 400 basis points, moving the rate from 6.5 percent to 2.5 percent.

Now, we know from past experience that there is a lag time in the economic benefit that we get from lowering interest rates or the economic effect, I should say, from lowering interest rates. Can you venture any opinion as to when we might begin to see – or have we already begun to see – the effects of recent Fed policy?

Mr. Greenspan. Mr. Chairman, as best we can judge, we have been seeing a considerable amount of impact from the monetary policy decisions we have taken in the financial markets. You could see them in how it is impacting the term structure of rates, how it is affecting yield spreads, and how it is affecting the degree of liquidity in the system. And all of that is behaving as one would generally expect.

There is a distinction between looking at how effective Federal Reserve policy is and what is happening to the economy. My own judgment is that the impact is probably at least partially responsible for the fact that after a very sharp decline very late last year, the economy, for all practical purposes, has been remarkably flat, and as I put it in earlier testimony, despite the fact of this extraordinarily significant wealth effect contraction late last year, the economy, taking all of the tremendous pressures on it, has nonetheless remained standing.

And I would still characterize that as the case despite the attack on September 11. I don't know to what extent there remains significant amounts of impacts in the pipeline which will work their way through. Those are very difficult judgments to make. As we like to say, the lags are variable, meaning it is an economist's way of saying that the distributions of the impact from policy to impacts on economic activity is not simply definable by a simple distribution which works the same way every time.

All I can say to you is that, as best I can judge, the policies have had a significant impact to date. How much further impact, and when it happens, and in what form, still remains to be seen.

Representative Saxton. Well, thank you, Mr. Chairman. I am hopeful that the Fed will remain open to future rate reductions, particularly if this situation persists, and I know that it is unfair to ask you to comment on that subject, and so I won't. But it is certainly my opinion that what you have done in the past has been particularly effective, and we are hopeful that that policy will continue.

Senator Reed.

Senator Reed. Thank you very much. Thank you, Mr. Chairman. Chairman Greenspan, yesterday the Federal Reserve published data that indicated that manufacturers continue to operate below 75 percent of their capacity, and that producers of high-technology equipment now carry more excess capacity than they ever have before. This raises several questions: First, to what extent will lower interest rates help stimulate investment in this climate? Second, to what extent are business tax incentives likely to stimulate investment when businesses are carrying this excess capacity? Will business respond favorably to investment incentives if consumer demand is low and gets lower, because if not, it raises the possibility that an approach that we most prefer would be to stimulate consumption rather than provide investments – Chairman Greenspan?

Mr. Greenspan. The rate of operation in manufacturing is only one of a number of key variables which determines the level of capital investment. To a very substantial extent, investment is determined at the plant level by plant managers who perceive that a certain piece of equipment will enhance the profitability of that operation independently of what is happening elsewhere in the world.

In other words, there are significant amounts of capital investment which are made for cost-reduction purposes and which are essentially unrelated to the level of output or the rate of operations, and as a consequence of that, we often see fairly significant investment emerging in periods when the rate of operation is quite low. It is, however, very substantially of a cost-saving type, and I think that is the type of outlay which is likely to come back as this economy eventually stabilizes.

You are quite correct in saying that until demand changes, the propensity to expand facilities – new plants, greater expanse of output – is likely to be mooted. But that is a typical pattern that we run into but should not, in any way, dissuade us from endeavoring to produce incentives for capital investment, because even though investment has fallen and may indeed still be falling for all we know because of the attack, it is just as important to slow the rate of decline of that investment as to enhance consumer expenditure growth, because arithmetically, obviously it doesn't matter whether you are slowing the rate of decline or you are raising something else. My own impression is that it is in the investment area where the greatest sensitivity for fiscal stimulus lies.

Senator Reed. Mr. Chairman, implementation of the income tax cut that was recently passed has raised two polar recommendations in the context of the present situation. Some would argue that we should pay for the short-run stimulus gradually over the decades ahead by freezing parts of the tax cut, while others suggest that we accelerate parts of the tax cut that would otherwise not kick in until 2004 or 2006. Could you comment upon these polar views of the world?

Mr. Greenspan. Let me just say in general, Senator, that our economy is extraordinarily complex and our understanding of exactly how it works is changing all the time because the economy itself is changing all the time. And as a consequence of that, the models we develop in order to endeavor to capture the economic impact of fiscal policy differences are not all that robust. We know certain things in general, but I am disinclined to get involved in too much of the details, because I don't think we know as much as we need to know, or at least I don't feel comfortable with the exception of a few types of issues where

I think the evidence tells you that certain things have worked in the past, like temporary expensing has clearly worked in the past, and a temporary investment tax credit has worked in the past.

I might add that neither one of those have any long-term value so far as productivity is concerned, since they merely move capital investment up from what it otherwise would have been, and indeed in the process, do create some degree of uncertainty. And what we find in looking at the various impacts of these fiscal policies is that we get very great differences of opinion amongst analysts, all of whom are looking at least at the same data structure. And the reason is that the economy is constantly changing, and the impact of how various taxes and expenditure programs affect the economy is also changing. That is the reason why there have been significant differences on even interpreting how the previous rebates impacted on the economy to date.

Senator Reed. Thank you very much, Mr. Chairman. Thank you, Chairman Saxton.

Representative Saxton. Thank you very much, Senator Reed. We will now go to the gentleman from Texas, Mr. Smith.

Representative Smith. Thank you, Mr. Chairman. Chairman Greenspan, the high-tech sector is generally considered to be one of the driving forces of the economy. Now, I am wondering what we could do to help the high-tech industry get back on its feet, and specifically would it help, for example, to accelerate depreciation schedules, since, as we know, the shelf life of a computer is probably less than two years now, should we shorten the depreciation from five years to two years or one year?

Secondly, would it help if we increased expenditures for Federal research and development? I am looking for particular things we might do for that particular industry.

Mr. Greenspan. No. I understand the question, and I am saying that what we know about a lot of this is less than we sometimes portray. There is a degree of exactitude in some of these analyses. I notice, for example, that the Congressional Budget Office, OMB, and ourselves, we all come up with estimates of the impact which have got four digits to the right of the decimal point. We know that can't be right.

Certainly the issue of moving towards expensing, I think, is helpful in this regard. My own impression of expenditures, especially on research and development, is that that takes a long lead time.

And I think what is crucially important in this discussion is to make a judgment first.

Are you embarking on a tax policy whose purpose is to basically move production from the future to the present, or are you trying to increase the overall rate of growth of the economy over the long run? What you do in both of those different scenarios is really remarkably different, and I think that once the decision is made that what you are looking at is stimulus, it takes a lot of the other issues of productivity, long-term growth, and all of the associated elements there, and changes the mix completely.

Representative Smith. Thank you.

Chairman Greenspan, one other question goes to your testimony where you said that the level of productivity – something you just mentioned a second ago – will presumably undergo a one-time downward adjustment, but once the adjustment is completed productivity growth should resume at rates in excess of those that prevailed in the quarter century preceding 1995. I am wondering if you have any estimate as to how long that one-time downward adjustment will last; and secondly, it is my understanding that economic growth in the quarter century prior to 1995 has not been as great as economic growth or productivity growth since 1995. Is that correct as well?

Mr. Greenspan. Oh, the latter is definitely the case. The numbers are undergoing all sorts of revisions, but there is no question that the rate of growth in productivity, say between 1995 and the year 2000, was markedly greater than that which occurred for the quarter-century before.

Representative Smith. So the economic growth you predict is going to be less than what it has is been for the last five or six years. When—

Mr. Greenspan. I would suspect so, certainly. The problem we have is that, as I point out in my prepared remarks, the impact of technology, information technology in the business decision-making process, enabled a very considerable amount of programmed redundancies that had been put into the business structure in years past to endeavor to offset the possibilities of unforeseen events hitting on production to be reduced.

Indeed, the major operations within the plant are always designed to sustain production levels. The type of data we had, say, 15, 20 years ago, required that we have large inventories, backup people, all sorts of redundancies for unforeseen or even unanalyzable events. What information technology did was to so dramatically increase our insights into real-time behavior that we were able to reduce inventory levels, because we knew exactly when a roll of cold-rolled sheet was going to arrive at the loading platform of the plant, and you could schedule your inventory requirements accordingly.

What the events of September 11 did was to introduce a whole new set of uncertainties, which information technology is not going to improve our insight into. And so it is a reversal of some of the forces which engendered the productivity acceleration over the last five years. My impression is that that will work its way through within – it is not years, it is quarters, and even, conceivably, months. But it does reverse part of what we succeeded in doing. My own impression is it is a partial, but by no means, full reversal, and after that adjustment takes place, the fact that we have only partially exploited all of the networking and other forms of technology advancement suggests that once the very high level of uncertainty that now grips everybody is reduced, the perception of above normal rates of return out there for a lot of this type of equipment is going to create a continuation of the degree of networking and advancing that has had such a material effect on productivity in this country.

Representative Smith. Thank you, Chairman Greenspan. Thank you.

Representative Saxton. Thank you, Mr. Smith, very much.

Mr. Watt, we will turn to you now for your questions.

Representative Watt. Thank you, Mr. Chairman. This obviously is a very, very important subject, but there is also a very important briefing going on in the Senate that Senator Reed and Senator Bingaman had to go to. So what I would like to do, Mr. Chairman, with your permission, is defer to the Senator from New Jersey and let him go so that I can expedite his getting to the briefing also.

Representative Saxton. I would be pleased to recognize at this point Senator Corzine.

Senator Corzine. Mr. Chairman, thank you. Thank you, Congressman Watt, for that courtesy.

Mr. Chairman, first of all, I would like to congratulate the Fed and its, I think, remarkably adept handling of the post-crisis response, the liquidity provision and the return to effective operation of markets and movement of commerce that is underpinned by the financial system. I think you have all done, once again, a remarkable job, and I am complimentary of that.

Also, I think the effort to move rates lower to stimulate the economy, no matter how uncertain that connection is to economic activity, has been a very important ingredient, not only in the recovery that we were looking for prior to September 11, but absolutely necessary afterwards. I have several questions, though, that really go to the – my concern that we live in a world of uncertainty, and the risk of economic recession and its deepening seem to me to be asymmetrically large relative to an overheating and rapid recovery, particularly in a world where additional shocks are at least of some probability. You talked about a snapback that is different than we see in natural disaster circumstances.

I wonder how vulnerable you think our economy is to additional shocks, maybe not of the same dimension, and shouldn't we build in insurance policies in our thinking with regard to stimulus programs that do allow for concern about that? We certainly have threats of that that we live with each other. I would love to hear your comments in that area. And then maybe even more importantly, or at least as importantly, you made a statement which I completely concur with.

Investment is where we get our greatest stimulus, but there is a reality to private sector investment, public sector investment, and whether you believe that investment in public security, public health, public transportation, public infrastructure has some of the same ingredients of improving productivity in our economy with long tails, long after the period in time when the investment is made, to improving economic growth?

Certainly, at least casual economic thinkers might say that the public highway programs that we put in the 1950s ended up having tremendous impact in the long run in the productivity capacity of our economy, and shouldn't we – or I guess I am opining, but shouldn't we be thinking about, as we put together a short-run stimulus program, tying that to long-run productivity in the economy by staying away from pork but involving ourselves in some of those things that might have long tails to them in productivity?

Mr. Greenspan. Senator, with respect to your first question, as you know as well as anybody, and I am sure more than most, when you are in the marketplace, the adjustment process suggests that the changes that occur in risk premiums as a consequence of a major alteration, as we have indeed had on the outlook, partially insulates you against lesser types of events which prior to, say, September 11, could have had some really considerably adverse impact so that there is a discounting in expectation that we will have other events occurring.

Clearly, we don't know the extent to which the markets have discounted or to what level that discounting has occurred, and we probably will not know until we actually see, if at all, a new type of event emerges.

But people, as I said, adjust. Systems are remarkably flexible, and as you know, our economy and our financial system have become quite flexible over the last five, 10 years, and that flexibility in turn has enabled us to absorb shocks which I don't think we could have very readily absorbed in decades past.

So I think we start off at a reasonably good base, but I certainly concur in your concerns that the overall bias to the outlook is clearly biased toward economic weakness, as we have stated innumerable times in our particular post meeting statements of the Federal Open Market Committee.

With respect to the—

Senator Corzine. Mr. Chairman, with – just one quick follow-on. It will take a second. Doesn't that, though, lead us to conclude that whatever we do with regard to stimulus – it is not unlimited. I understand that, but whatever we do, we ought to buy an insurance policy that allows for that degree of uncertainty and stimulus package, and it should be larger rather than smaller; different eyes will look at that in different ways, but that it would lead to a bias that way?

Mr. Greenspan. Well, Senator, I would emphasize that we have to distinguish, as I have noted before, between gross stimulus and net stimulus. We have been, as I indicated earlier, aware of the extent to which the continued extractions of home equity, both as a consequence of the turnover of homes and largely through home equity loans and cash-outs have been a major contributor to the level of consumer spending, and that those extractions in turn have been a function of the level of interest rates, mainly 30-year fixed rate mortgage rates which, as you know, have come down quite appreciably.

One concern that we have to keep in mind is that any stimulus package which augments long-term interest rates will, of necessity, create a lesser degree of expenditure in the households, and the consequence of that is that in any evaluation we make, we have to subtract whatever expectation we perceive would occur as a result of heightened long-term rates from whatever gross stimulus there is.

So I have argued we have to be cautious in looking at what it is we do to make certain that indeed the stimulus we do create is net, on balance, a stimulus. And so I have argued that that requires a degree of caution, and I think that is the appropriate view.

Quickly, with respect to your infrastructure issue, I think there is a problem here where one looks at textbooks on how ideally such infrastructure would be created, and I have no doubt that improved infrastructure does improve the level of private productivity. I am also aware that there is a thing called politics, and over the years I have observed, as I am sure you have, that the propensity to create projects has not always been directly related to enhancing private productivity. And the result of that is that the efficiencies that we see that come off the state and local, and other capital stock, do not very clearly suggest anywhere near the same sort of impact on long-term economic growth that one gets from dollar for dollar in the private sector.

So while I certainly can't argue that infrastructure is irrelevant, I would argue that there are very significant differences, and indeed there are also significant differences in how quickly they can be initiated. I know we go through, or have gone through over the years, endeavors to shorten the lead time of a highway project or public building or something of that nature, and I think history suggests we didn't very readily succeed, that those lead times are still very long, and that we find out that the argument that most economists make that public projects tend to be procyclical rather than countercyclical, in my judgment seems to be confirmed by the evidence.

Representative Saxton. Thank you, Senator.

The gentlelady, Ms. Dunn.

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

Welcome, Mr. Chairman. I wanted to follow along the lines that Senator Corzine began and ask you a couple of questions on the stimulus package. I know that you have reviewed it.

There are a lot of controversial elements in the stimulus package, and in your comments you said that we have to determine what our goal is, whether it is an immediate stimulus or long-term growth. I am very interested in pro-growth tax relief. I think the corporate AMT is an example of that, and also the reduction in the capital gains tax, but I guess I would ask you a question.

If you did take politics out of it, and you gave your own opinion and drew up a plan, is there anything missing from the stimulus package, where you change it in any way, so that we could do an overlay of what would be good for long-term growth, as well as what would enter the economy very swiftly?

Mr. Greenspan. Congresswoman, I think that these turn out at the end of the day to actually be quite different sorts of goals. If you are asking me how I would construct a growth package, as I have testified before in the Ways and Means Committee, this Committee, and a series of other Committees of the House and Senate over the years, I have always thought that eliminating the capital gains tax would be a very helpful addition to getting a more efficient capital stock in the economy.

I have also been inclined to seek to eliminate the double taxation of dividends, and I have even played with the notion of significantly expanding Subchapter S corporation limits to effectively do that at least for small business or larger small businesses.

Those, however, do not in my judgment have any real short-term impact. They project over a longer period, and I think are important factors. And were I constructing long-term growth packages, as I have testified in the past, that is the direction that I would go, but I would scarcely consider them as short-term stimulus, because the evidence, as best as I can read it with all of the caveats I have said previously about how difficult it is to get really good figures on those impacts, is there is very little evidence to suggest that you get a bang-for-the-buck type of impact in these particular types of projects.

I don't deny that you can combine these. I am just basically saying they really do quite different things; and in my judgment, I think we ought to be clear on what it is that we are endeavoring to do.

Representative Dunn. Do you fear that by lowering the capital gains rate we are going to impact the stock market?

Mr. Greenspan. I would not at this stage worry about how you impact the stock market, pro or con. That is going to happen no matter what you do. The focus should be on the economy, and if it is good for the economy, either in the long run or the short run, depending on what your policy is, in my judgment, that is what I think ought to be the determining factor.

Representative Dunn. Let me ask you another question on consumer confidence, since we know it is very important.

I have found it a substantial measurement of the economy, but it is interesting how it has stayed with us so long since a year ago; and I am wondering if there is anything that we can be doing now to increase consumer confidence. If you had your druthers, what would you see coming out of our piece of how we affect the economy, or what should we be concerned about and careful about?

Mr. Greenspan. My answer would be somewhat similar to my view about whether you focus on the stock market or you focus on the economy. I think that it is important for policy to focus on real events. And I find that every time we try to influence people's view of the way they view those real events, we usually find we end up with a lot of unanticipated consequences. Consumer confidence is a rational reaction to people's view of how they see their own daily job, the markets in which they deal, what they see on television and the like.

People make judgments based on what is going on in the real world. I think policy ought to focus on what is going on in the real world. And if we do the right things, consumer confidence will take care of itself.

Representative Dunn. Thank you.

Representative Saxton. Thank you very much, Ms. Dunn.

We will now return to Mr. Watt, who was kind enough to yield to Senator Corzine.

Representative Watt. Thank you, Mr. Chairman. And I will try to be brief, because I know we are going over a lot of the same things over and over again.

I have been listening intently to your suggestions about some things that probably won't work in the stimulus, and also picking up some things that you think will; and I am wondering if you had some druthers about this, what things do you think would work as an effective stimulus, that would have some short-term bang and not the longer-term detriment that you have expressed concern about?

Mr. Greenspan. Well, the data that we come up with basically suggest that some form of temporary expensing comes out probably as having the most immediate impact of the amount of dollars – of budgetary dollars – that are expended. But let me just emphasize what I said previously, this is not a net increment to long-term growth, it is merely moving it up.

Representative Saxton. May I just interrupt to make a quick announcement?

There is a vote on. Mr. Smith has gone to vote. He is going to come back. When he gets back, I am going to go vote. So judge for yourselves whether you want to go earlier or later. But we are not going to stop.

Mr. Greenspan. I don't know enough about some of the various different versions, nor does our analysis give us hard conclusions. The Congress has to act on specific legislation. You don't have the choice not to make those decisions.

Representative Watt. That is why I am not asking you to comment on any particular package. I am asking you what you think will work. Temporary expensing will work. I am not trying to guide you anywhere.

Mr. Greenspan. I understand that.

I wish I could be more responsive to your question and give you a laundry list of things that work. I feel uncomfortable doing that because I think that the – there are only a very few items which show up in the data in a robust manner. Everything else is sort of—

Representative Watt. Well, I was trying to keep from giving you my own bias on this and give you a clean slate to start from. But, if you read your testimony, on page one, you started off talking about motor vehicle sales, chain store sales. Those are consumer-oriented things.

Would you think that something that put some emphasis in this stimulus package on consumer demand would be important?

Mr. Greenspan. The data do show that people tend to spend a share of whatever tax cuts they get. It depends, however, very critically on whether they perceive them to be permanent changes in their after-tax income or a one-shot effect.

And what is most interesting about the most recent rebates is that there were differences of opinion amongst economists as to how that would be viewed. And in retrospect, it turns out that from what surveys we have been able to see, people spent a relatively small part of those tax cuts, but they did spend some. And there is no question that if you reduce individual income taxes, you will get some impact on consumer markets. What is unclear, however, is how much.

Representative Watt. I think I will yield back, Mr. Chairman. I am not getting very far here.

Mr. Greenspan. I tried to be as vague as I could, Congressman.

Representative Watt. I appreciate the vagueness. We are all struggling with this and not doing very well at coming up with specific proposals.

Although I guess I should conclude by saying that it is hard to stimulate production unless you have some demand for production that is being stimulated. I have always been kind of a supporter of the trickle-up theory rather than the trickle-down theory, but my colleagues here have heard me say that before.

Representative Saxton. Thank you very much, Mr. Watt. And we too appreciate your questions.

Mr. Putnam.

Representative Putnam. Thank you, Mr. Chairman. Welcome, Chairman Greenspan.

As the low man on the totem pole who is going to be around to feel the impacts of some of these things for the long term, let me shift gears, if I may, to the macro.

We are currently running approximately a $52 billion unified budget surplus. What will be the – what are your thoughts on the short-term and long-term implications of the Federal Government going back into a deficit situation before the end of this quarter?

Mr. Greenspan. I think you have to distinguish the immediate short-term problems which confront us and which are quite difficult and require different things than we would want to have accomplished over the longer run.

But we still have out there very significant demographic shifts that are in the process of occurring as the baby-boomers retire, and as the ratio of retirees to workers goes up quite appreciably as we get into the next decade and beyond.

And what that requires is that we engender a higher level of investment in the economy in order to produce a level of goods out there which will take care of both the retirees, who are much larger in number, and yet enable the working part of our society to gain increased real wages from gains in productivity.

So we need that higher level of investment to engender the productivity, which implies we need a higher level of national savings to finance it. And that suggests that the very large drains on private savings that the federal government was involved with for so many decades, prior to the surpluses as they arose, is not helpful at all.

We are going to need as much private savings as we can get; and even some public savings is not bad if we cannot get it in the private sector. But going to government deficits is clearly something which, over the longer run, we should endeavor to avoid as best we can, because of the changing commitments and demographics that are out eight, 10, 12 years from now.

Representative Putnam. Will the – will there be a short-term impact to the markets should that deficit spending occur this quarter, or has that already been factored into the climate?

Mr. Greenspan. Treasury publishes a daily Treasury statement which gives you a reasonably good shot at what is happening to the surplus or deficit on a unified budget account almost on a daily basis. And I can assure you that everybody who is involved in the markets reads those data very closely so that they know what is going on. It is not something which is going to fool them or come up as a big surprise.

There are in many respects just as good analysts of the U.S. budget in the private sector as there are in the government, in the administration, or in the Congressional Budget Office (CBO).

Representative Putnam. I have no doubt about that.

Much of your optimism in your prepared remarks about the future returns to productivity. were based upon the productivity of the information technology sector. Are there other sectors of the economy that you are equally optimistic about productivity gains in, that would contribute to a rapid recovery?

Mr. Greenspan. Well, Congressman, I think we are dealing with a very different type of economy than we had 30 or 40 years ago. We have moved toward a globalization which essentially means that the degree of specialization we have all embarked upon is not only enhanced in our domestic economy, but the ever-increasing interaction we have in a global context has created a higher degree of productivity amongst all of our trading partners, including ourselves especially.

So I think that we have got to be aware of the huge demands that demographics are going to impose upon us and look for innovative ways of getting higher degrees of productivity to finance that. And one way is to continue the degree of globalization – opening up markets, opening up trade, opening up the movement of people across national boundaries; and indeed, as I have argued on many occasions in the past, to have a reasonable immigration policy in this country which would go along with that.

I think the events of September 11 have made it very difficult in many of these respects in the short run, and I would hope that we are capable of reaching beyond them, adjusting to them, and continuing on what I consider to be really quite a positive element in the long-term changes that have been occurring in the American economy.

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

Representative Smith. [Presiding.] The gentleman from Pennsylvania, Mr. English, is recognized for his questions.

Representative English. Thank you, Mr. Chairman.

I wanted to thank you, Mr. Chairman, for coming before us to testify at such a critical time. In your testimony, you focus on the need to restore stability to the American economy, and I am delighted to see you particularly focus some of your remarks on the problems in the insurance sector.

May I ask, in your view, given the actuarial difficulties that writers of insurance policies are currently experiencing, is there a necessary and appropriate role for the Federal Government in the area of reinsurance in policies that would cover terrorism in public?

Mr. Greenspan. Congressman, I think so. And I think so for a very important reason which relates to the nature of markets.

A free, open market is one in which you have voluntary exchange to mutual advantage. And the notion of hostile activities is wholly detrimental to the functioning of that type of environment because part of an expansionary economy is one in which people are making commitments or reaching out, taking risks. And what hostile environments do is induce people to withdraw, to disengage, to pull back.

So it is quite conceivable that you could get a level of general hostility that would make viable market functioning very difficult. And in that regard, one can look toward the police power of the state as a means by which you try to extract or subdue that violence to allow markets to function.

So I can conceive of situations in which the insurance requirements of, say, terrorist attacks are so large that the premiums that would be required to effectively enable private insurance companies to insure against all of those risks and still get a rate of return on their capital – I can conceive of situations where those premiums would be so large as to inhibit people from actually taking out that insurance. And, therefore, you are led to what is a very unusual conclusion, that the viability of free markets may, on occasion, when you are dealing with a degree of violence, require that the costs of insurance are basically reinsured by the taxpayers – as indeed they are, for example, in Great Britain and in Israel and in other countries which have run into problems quite similar to ours.

So even though I recognize that there are very significant difficulties in reconciling free markets and government reinsurance, in this very unusual circumstance, they are indeed compatible.

Representative English. I appreciate that guidance, and I think that is a sound and wonderful analysis.

Further on that point, will security costs, in your view, hinder productivity increases significantly over the long term?

On the other hand, is it possible that a public-private drive to enhance network security could actually promote growth in America's technology sector?

Mr. Greenspan. I don't know enough to answer that question. It is a very interesting issue. I don't think we know enough to make a judgment.

Representative English. Well, that is – Mr. Chairman, if I have stumped you, then I feel I have really made my day.

On another issue, given recent international events, and what many are calling a global economic slowdown, should we expect a round of currency devaluations abroad, and what impact is that likely to have on the United States' manufacturing sector?

Mr. Greenspan. I don't think so, Congressman, because remember that exchange rates are bilateral. They really represent a valuation of the currency of one country versus another. And if we are all being impacted equally, as we are effectively by the events of September 11, that in and of itself should not have a material impact. And, indeed, currencies have been one of the very few stable financial prices that we have seen in periods since September 11.

Representative English. Thank you, Mr. Chairman. And this has been truly wonderful testimony.

And I thank you, Mr. Chairman, for your indulgence.

Representative Smith. Thank you, Mr. English. I think I should point out to Chairman Greenspan that you are going to miss a vote in order to ask him questions.

Chairman Greenspan, I am going to take advantage of the absence of other Members and a slight prerogative of the temporary chair to ask you one more question, if I may.

This goes to a column that you may have read in today's paper by Robert Novak. I think he made the point, that I recall, that monetary policy alone may not be enough to restart the economy. And I was going to ask you if you thought Congress's expectations, perhaps the public's expectations were too high for what the Fed could do. Or do you think – that gives you an open question, I guess.

Mr. Greenspan. I think it is important to put in general perspective what policy in general can do.

There is a view out there, Congressman, that fiscal and monetary policy can prevent any recession from occurring. And I find that very puzzling, because the implication obviously is that the only recessions that we get are as a consequence of the failure of policy. Because if policy never failed, then presumably, we would never have a recession. But that runs into a very difficult statistical problem.

Prior to 1913, there was no central bank. And prior to 1913, let's just say World War I to generalize it, I don't think the words "fiscal policy" had any meaning to anybody. And so for all practical purposes, for the period from, let's say, 1835 when the Second Bank of the United States went out of business and the First World War, there was effectively no economic policy to speak of in this country.

But we had an awful lot of recessions, and something else must have been causing them.

And what was obviously causing them is, in fact, what is the major problem today, people. Human psychology is a remarkably unchangeable phenomenon as you go from one generation to the next. We tend to overextend and contract. And what fiscal and monetary policy can do is to ameliorate that process. But the presumption that we have the capability of eliminating that, I think presumes that we have greater control over how humans think and how they behave than indeed is clearly the case.

So I would always argue that monetary policy is effective. Fiscal policy, under certain conditions is effective. But under no conditions would I ever argue that perfect monetary and fiscal policy will eliminate the business cycle. It will not.

Representative Smith. Thank you, Chairman Greenspan.

I wanted to follow up on a question I asked you a few minutes ago during the first round that was in reference to your testimony this morning about a one-time downward adjustment.

Did I understand you to say earlier that you expected that downward adjustment to last only a few months, or do you feel that it will last longer than that?

Mr. Greenspan. I think the question is that markets are now adjusting to the fact that we need more redundancies in the system; that is, you need more back-up facilities. There is greater risk of events which we can no longer effectively assume away. And the consequence of that is you have an elevated level of input without changing output, and so you get a one-shot adjustment.

Whether that occurs in months or over several quarters, I think it is very difficult to say. Clearly it occurs over a time frame. But it is – as I pointed out in my prepared remarks, exactly the reverse of what we gained from the advent of information technology capabilities, which to a major extent improved our ability to make decisions on a real-time basis with real-time information, which means that you had a lesser requirement for redundancies than in the past.

So I didn't mean to imply that it will be over in two months or something like that, but it is not a period of three years.

Representative Smith. I understand. Thank you, Chairman.

One last question: This goes to the economic stimulus package that you have been asked about several times today. I noticed in your answer a few minutes ago to Congresswoman Jennifer Dunn's questions that not one of the suggestions you made for long-term economic growth was actually in the economic stimulus package, for instance, cutting the capital gains tax.

Do you think we are on the right track with that economic stimulus plan, by limiting it just to the short term, or should we also consider some long-term growth components that are not presently in that economic stimulus package?

Mr. Greenspan. Congressman, that is a judgment that Congress has to make. As an economist I can tell you, to the extent that we know much about this, what the various impacts and what the relationships are in all sorts of combinations. Obviously, you always want to be in the position to do as much as you can to promote long-term economic growth, and especially in the context of the demographics which I mentioned previously. That is an important issue that we do have to keep in mind.

But I think that unless we are clear in our own views as to what it is that is being done between short-term stimulus, which by definition has very little long-term carryover, or long-term policies, which by definition have very small short-term stimulus, I am not sure that one benefits any way that I am aware of by mixing the two.

That is what I am saying. But that is a policy judgment which the Congress has got to make. I mean, there are arguments against what I just said. And one can make these arguments. One can say that it is better to have a mixture of both, and that may be right. But I say, if you do that, be very clear that is indeed exactly what you are doing.

Representative Smith. Thank you, Chairman Greenspan. I don't have any further questions.

I don't see the other Members present. I know that Chairman Saxton is on his way back from the House floor, and I hope you will be able to wait a couple of minutes for him to be able to thank you in person for appearing today. And I hate to stall, but I do expect him to walk in the door any minute.

Let me just ask finally, Chairman Greenspan, if you have anything else you would like to add to what you have already said, that you think will be useful for Members of Congress to know.

Mr. Greenspan. I think I have made the major points that I thought would be useful.

Representative Smith. Let my see if we have any other questions. Hold on for a second.

The gentlewoman from New York.

Representative Maloney. I am from the great city and state of New York. I am glad to welcome another New Yorker and to thank him very much for his leadership during this crisis. I would like to start with a New York question.

The insurance support program that Congress and the President have talked about, if you could comment on it. We are seeing a credit contraction that is going on that may worsen if that challenge is not addressed.

Secondly, in your comments today and yesterday, the Federal Reserve published data that indicate that production is way down, that manufacturers are operating at below 75 percent of their capacity and that producers of high-tech equipment are now carrying more excess capacity than ever before.

And so I would like to ask really a three-part question in response to that and in response to some of the things you said today.

With so much excess capacity, how effective are lower interest rates in stimulating interest in this environment, and would it be stimulative to reduce taxes on business capital investment at a time of such excess capacity or to do what you were talking about before, the temporary expensing when we have such excess capacity?

And thirdly, you mentioned that you had looked at the results of some of the tax cuts, and that people spend a share of the taxes that they get. But there is one proposed tax cut that I can assure you that everyone will spend, every single cent, that is the rebate for the lowest income people. They will spend it. They need to spend it. Would that in any way stimulate and help the economy?

And I would like to end with the New York question. Every time the mayor speaks nationally, Mayor Giuliani, he responds to really the outpouring of support from across this country; and he says, "If you want to help New York, come to New York, spend money, go to our restaurants and invest in our city, help us get back on our feet."

And when you talk to the industry leaders, whether it is Broadway, they have closed 11 total shows. But those that are open, they say people aren't buying long-term tickets, they are coming from New Yorkers that are reacting patriotically or someone gives a grant that lets a whole group of people that are helping the recovery go.

Many restaurants are closing or they have gone to half-price. And would the stimulus of a rebate or a tax deduction for going to New York and spending money help not only New York, but around the country. If you look at the two industries that are hurt the most – our airlines and our tourism; the President has said, "Go to Disneyland" – would not a rebate or a deduction, offered to families to do such, would that not help stimulate?

And I might add also, I feel in New York, families, individuals are feeling tremendous pressure, tension, sadness and possibly a stimulus or a support for them to spend time with their families on something that is enjoyable might not only help the financial, but the mental health of the country at this point.

Thank you again for all that you have done. I think you really reacted with great leadership and appropriately and have helped instill a confidence in Americans, and we appreciate it.

Mr. Greenspan. Well, thank you very much.

Representative Saxton. [Presiding.] Thank you, Ms. Maloney. I appreciate it.

Representative Maloney. He didn't answer my question. I gave him five, and he hasn't answered even one of them. And three of them were New York-specific.

Representative Saxton. Thank you. I thought that you were having an exchange.

Representative Maloney. No.

Mr. Greenspan. As you know, I was born in New York and lived there for a very long period of my life. And the one thing that characterizes that city is a sense, rightly or wrongly, that everything is sort of advanced and wonderful with respect to new technologies and new entertainment, the highest level of civilization, the best chefs, everything. We always thought that that was the quintessential New York, that anyone else who could put a baseball team on the field that could beat the New York Yankees deserved a little press, but not much.

What has happened, and I think you pointed it out, Congresswoman, there has been a subdued sense in the city. And until that subdued sense unwinds and we get back to some of the spirit that I experienced all of my life, until that comes back, we will have a subdued city. But it is not going to stay that way for long. New Yorkers don't know how to be subdued. And it is one of the problems which I think sort of puts us in conflict with a lot of other of our colleagues around the country.

But what I thought was utterly remarkable is the support that the city got from the rest of this nation, and that is – in that sense, I was both proud to be a native New Yorker and proud to be an American.

Representative Maloney. But, you didn't answer my questions. On the insurance support program, that has –

Mr. Greenspan. I did, in part, answer that earlier.

Representative Maloney. You did?

Mr. Greenspan. Let me just say very briefly, I think that the type of program that the administration is coming up with seems, to me, in the right ball park. It is coming at an issue which is inherently a very difficult one.

Representative Maloney. I will read the transcript. I was running back and forth.

But also the rebate for the lowest income residents, would that happen—

Mr. Greenspan. I didn't want to comment very specifically on a lot of the different elements that are involved in various different packages. All I would say to you is, what evidence we have suggests that while it is certainly the case that – as you pointed out earlier, that we are operating at a low operating rate, that capital investment would seemingly not be stimulated by that.

It is true that expansion of new facilities is doubtless retarded by the fact that the operating rates are low, but a goodly part of capital investment is cost savings. And cost savings, especially in this type of environment, is actually created by incentives. And if we can have a significant amount of capital investment, which would be important, even though it is not of the capacity-expanding type, as far as the level of economic activity is concerned, there is really no difference between whether you are building a new plant or you are putting in a piece of equipment which reduces your cost. I think the latter would be where most of the improvements in investment are likely to take place.

Representative Maloney. You spoke strongly for the temporary expensing. But when production is so low and people are not buying, how does the temporary expensing—

Mr. Greenspan. Because they are endeavoring to reduce their costs. And the reduction of costs is a particularly important issue when, indeed, demand is low; that is really all you can do to improve your profitability. That is what people tend to do.

Representative Maloney. Thank you very much.

Representative Saxton. Mr. Chairman, we have been through all of the Members on the Committee today and you have responded very well – thank you very much – to our questions. We appreciate that very much.

We are going to have another vote here in a few moments and so rather than to move forward with another round of questions, I think we will say thank you and we will go get our voting done.

And your optimism in terms of us returning to normal and the fading impact, we hope, of the incidents of September 11, that is good news to us and to the American people. So we thank you for bringing your message here to share with us today. And we look forward to seeing you again in the future.

Mr. Greenspan. Thank you very much, Mr. Chairman.

Representative Saxton. The hearing is adjourned.

[Whereupon, at 11:40 a.m., the hearing was adjourned.]

PREPARED STATEMENT OF REPRESENTATIVE JIM SAXTON, CHAIRMAN

I would like to welcome Chairman Greenspan before the Committee to testify on monetary policy and the economic outlook. We appreciate your appearance here today, and look forward to your testimony.

I would also like to take this opportunity to thank Chairman Greenspan for his leadership and the Federal Reserve for the actions undertaken to cushion the effects of the September 11 terrorist attacks. The Federal Reserve's ability to deal with such an unspeakable crime has served the country well, and we are in your debt. It is also encouraging that the American people and economy have demonstrated amazing resilience in the face of these attacks.

Even before the events of September 11, the available economic data indicated that the economic slowdown that began in the middle of 2000 continued. The rate of real GDP growth has slowed quite sharply since the second quarter of 2000, barely remaining positive in the second quarter of this year. The manufacturing sector has been hard hit, losing over 1 million jobs since July of 2000. Investment growth has fallen over the last several quarters, and corporate profits are weak.

On the other hand, housing and consumer spending have held up fairly well. In addition, since last January the Fed has reduced interest rates nine times, Congress has lowered the tax drag on the economy, and energy prices are declining. Many economists had expected these factors to lead to an economic rebound in the last half of 2001, but the attacks have led them to forecast a delay in the recovery.

Financial markets and the economy have been disrupted by the terrorist attacks. The attacks have increased uncertainty, and caused a widespread reevaluation of risk and security. Delays and higher shipping costs in air and ground transport, additional insurance costs, higher expenses for security personnel and equipment, fortification of buildings and facilities, and other measures will have the effect of imposing something like a "security tax" on an already vulnerable economy. This burden will undermine the economy in the short run, and could tend to adversely affect both productivity growth and the economy's potential growth rate.

Although the precise amount of the extra burden imposed by these security costs is not known, it appears to be large and growing by the day. Over the last several weeks private sector economists have begun to consider this cost issue and its potential impact on an already weak economy. A logical policy response would be to offset these costs by relieving some of the tax burden on the private sector.

Monetary policy has addressed the economic situation with an easing that began last January. The Fed's policy moves so far this year have certainly provided economic stimulus, but the lags in monetary policy are long and variable. Given the lack of inflationary pressures, prudent action by the Federal Reserve could also contribute to improving the economic outlook.

PREPARED STATEMENT OF SENATOR JACK REED, VICE CHAIRMAN

Thank you, Chairman Greenspan, for coming to testify before us. Thank you, too, Mr Chairman Saxton, this opportunity to discuss and debate our economic outlook and appropriate policies.

In light of the new fiscal realities we face, economic policy needs to be recalibrated. The key to achieving a rapid recovery is to bolster incomes, because when cash-strapped household cut their spending, business sales suffer, stifling investment. We need to complement existing monetary policy with an economic stimulus package – but one that has its maximum impact in the short run and does not undermine long-term fiscal discipline. Specifically:

- <u>The stimulus package should be large enough to have an impact on a $10 trillion economy</u>, up to about $100 billion (1 percent of GDP), a figure which I believe you have supported, Chairman Greenspan.
- <u>The bulk of the stimulus should be felt in the next two or three quarters when the economy is weak</u>. More often than not, economic stimulus in the past has not been implemented until the economy was already recovering.
- <u>The Stimulus package should be designed to phase out rapidly, so that the stimulus measures do not overheat the economy later in recovery</u>. Thus permanent tax cuts or new spending that spin out slowly are not attractive candidates, while safety net programs (such as Unemployment Insurance), which are designed to be counter-cyclical, are.
- <u>The stimulus package should maximize the amount of short-term economic activity created per dollar of outlays or revenue lost</u>. For example, a tax cut for low- or moderate-income households who are likely to spend nearly all of the extra income is more effective as stimulus than a similarly sized tax cut for higher-income households who are more likely to save a substantial portion of it.

These principles are outlined in greater detail in a new report prepared by the Democratic Staff of the Joint Economic Committee. The report, *Economic Stimulus: Principles and Options*, evaluates the leading proposals in light of their impacts on the economy and the degree to which they have a stimulative effect. The report is available online at <www.senate.gov/~jec>.

Earlier this year, Chairman Greenspan, you spoke of the need to "resist those polices that could readily resurrect the deficits of the past and the fiscal imbalances that followed in their wake." You also testified about the limits of tax cuts as effective tools to stimulate the economy. I would be interested in your thoughts on how the economic stimulus proposal before the House right now deals with these tenets.

We have an important responsibility before us – to undertake fiscal policies that will protect the most vulnerable in our economy while ensuring that we do not compromise our economic future. It is a challenge we can meet, if we stick to policies which put people back to work and generate productive business investment.

PREPARED STATEMENT OF THE HONORABLE ALAN GREENSPAN, CHAIRMAN, BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

I appreciate this opportunity to appear before the Committee to discuss recent developments in the United States economy. Despite the tragic events of September 11, the foundations of our free society remain sound, and I am confident that we will recover and prosper as we have in the past.

But before the recovery process gets under way, stability will need to be restored to the American economy and to others around the world. Arguably, that stability was only barely becoming evident in the United States in the period immediately preceding the act of terrorism.

Aggregate measures of production, employment, and business spending continued to be weak in August. Consumer spending, however, moved higher that month and appeared to be reasonably well maintained in the first part of September. Industry analysts suggest that motor vehicle sales were running close to August levels, and chain store sales were only modestly lower. New orders for nondefense capital goods stabilized in August. Moreover, the dramatic rate of decline in profits was slowing. To be sure, these signs were tentative but, on the whole, encouraging.

In the days following the attack, the level of activity declined significantly. The shock was most evident in consumer markets, as many potential purchasers stayed riveted to their televisions and away from shopping malls. Both motor vehicle sales and sales at major chain stores fell off noticeably. The airline and travel industries also suffered severe cutbacks.

The unprecedented shutdown of American air travel and tightened border restrictions induced dramatic curtailments of production at some establishments with tight just-in-time supply chain practices, most notably in the motor vehicle industry.

As the initial shock began to wear off, economic activity recovered somewhat from the depressed levels that immediately followed the attacks, though the recovery has been uneven. Markedly increased incentives induced a sharp rebound in motor vehicle sales by the end of the month that has carried apparently undiminished into the first half of October. However, many retailers of other consumer goods report that sales have only partially retraced the steep drops that occurred in mid-September. Fortunately, air freight is largely back to normal. Overall airline passenger traffic, while above its mid-September lows, was still off considerably in early October from pre-attack levels. Similarly, the hospitality and entertainment industries have overcome some of their earlier difficulties but continue to struggle.

The effect on financial markets of the devastating attack on the World Trade Center was pronounced, as telecommunications and trading capacities were severely impaired. But the markets are mostly functioning normally now, and as in the past, the infrastructure will be rapidly restored.

For a brief time, the terrorist attacks markedly disrupted payment transfers, leaving those counting on receiving payments caught short. Those needs ultimately were met by the Federal Reserve, both through record lending at the discount window and through an extraordinary infusion of funds through open-market operations. To facilitate the channeling of dollar liquidity to foreign financial institutions operating in the United States, thirty-day currency swap lines were arranged with major central banks, again in record volumes. It was essential in such an environment to meet all appropriate demands for dollar liquidity. As repair of the financial markets and payment infrastructure proceeded apace, loans were repaid, open-market operations could be scaled back, the unusual swap lines were allowed to expire, and the temporarily bloated balance sheet of the Federal Reserve largely returned to normal.

But even as market functioning and liquidity flows were restored, the potential for heightened uncertainty to damp household and business spending for a time persisted. To cushion these effects, we have eased the stance of monetary policy appreciably since September 11.

We in the United States have assumed ourselves to be fairly well-insulated from terrorism or, at most, subject to limited and sporadic episodes similar to those previously observed on a number of occasions in Europe.

We have been aware of the possibility for losses on a much greater scale. But I suspect that those possibilities were deemed so remote that they were never seriously incorporated into most conventional assessments of economic risk.

The shock of the tragedies at the World Trade Center and the Pentagon has reshaped those assessments of risk and required an abrupt realignment of prices in many markets to reflect the expected costs of operating in what we now recognize as a more hostile world. These circumstances pose a difficult challenge for business decisionmaking, not so much because the costs are inordinately large, but because the events, which have potentially substantial consequences, are so uncertain. Insurance deals with this problem by spreading the risk and converting potential large unknown costs into a steady stream of known insurance premiums that facilitates the forward planning so essential to an effective business operation.

Obviously, sharp increases in insurance premiums for all forms of businesses are to be expected. Some higher insurance costs, in effect, will be borne implicitly rather than explicitly, as firms choose to self-insure, at least in part, rather than lay off all of this risk in the marketplace.

These higher insurance costs, both explicit and implicit, endeavor to anticipate future losses. But in addition, they cover the physical capital and labor resources businesses will be required to devote to enhanced security, and to increased redundancies as protection against interruption of supplies or production. For example, the degree of comfort businesses have in allowing inventories to shrink to minimal levels in a just-in-time supply chain is lessened. In this regard, increased security threats, not pooled through insurance, have exactly the opposite effect on productivity than that which is gained by an improvement in information technology. In addition to the loss of human life and capital assets, these are important collateral costs associated with the new threats that we now face.

The pronounced rise in uncertainty also has damped consumer spending and capital investment; households and businesses, confronted with heightened uncertainty, have pulled back from the marketplace, though that withdrawal has been partial and presumably temporary. The very great economic uncertainties that have arisen in the current environment have also, at least temporarily, resulted in a widening of bond spreads on high-yield instruments.

Markets across our economy will adjust to the altered perceptions of risk that we now confront. Critical to that adjustment process is the behavior of consumers and business people. Behavior is difficult to predict in circumstances such as those we have experienced in the past five weeks. But judging from history, human beings have demonstrated a remarkable capacity to adapt to extraordinarily adverse circumstances. And, I expect the same adaptability to become evident in the present situation.

Although it is difficult to determine with any precision, it seems quite likely that a significant repricing of risk has already found its way into our markets, as many economic decisions are responding to shifting market signals. But these adjustments in prices and in the associated allocation of resources, when complete, represent one-time level adjustments, without necessary implications for our longer-term growth prospects.

Indeed, the exploitation of available networking and other information technologies was only partially completed when the cyclical retrenchment of the past year began. High-tech equipment investment at elevated rates of return will, most likely, resume once very high uncertainty premiums recede to more normal levels.

The level of productivity will presumably undergo a one-time downward adjustment as our economy responds to higher levels of perceived risk. But once the adjustment is completed, productivity growth should resume at rates in excess of those that prevailed in the quarter-century preceding 1995.

It is worth noting that increased production to enhance security will be counted in measured output without contributing to our standards of living, as was the case during our military buildup of the Cold War. Our productivity measures have always endeavored to capture increased productive efficiency, not increased well-being. We are, in effect, currently using part of our increase in efficiency to supply increased security. Of course, given the heightened risks we face, these investments in security are, doubtless, quite sound. In any event, such costs are likely to fall short of the costs we incurred for security during the height of the Cold War.

Nobody has the capacity to fathom fully how the effects of the tragedy of September 11 will play out in our economy. But in the weeks ahead, as the initial shock continues to wear off, we should be able to better gauge how the ongoing dynamics of these events are shaping the immediate economic outlook.

For the longer term, prospects for ongoing rapid technological advance and associated faster productivity growth are scarcely diminished. Those prospects, born of the ingenuity of our people and the strength of our system, fortify a promising future for our free nation.

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THE EMPLOYMENT SITUATION: OCTOBER 2001

HEARING

before the

JOINT ECONOMIC COMMITTEE CONGRESS OF THE UNITED STATES

ONE HUNDRED SEVENTH CONGRESS

FIRST SESSION

November 2, 2001

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THE EMPLOYMENT SITUATION: OCTOBER 2001

Friday, November 2, 2001

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

The Committee met, pursuant to notice, at 9:35 a.m., in Room 2360, Rayburn House Office Building, Honorable Jim Saxton, Chairman of the Committee, presiding.

Present: Representative Saxton. Senators Reed, Bennett and Corzine.

Staff Present: Chris Frenze, Bob Keleher, Darryl Evans, Colleen J. Healy, Brian Higginbotham, Pat Ruggles, Daphne Clones-Federing, Matthew Salomon, and Russell Comeau.

OPENING STATEMENT OF REPRESENTATIVE JIM SAXTON, CHAIRMAN

Representative Saxton. Good morning. I would like to welcome Acting Commissioner Orr before the Joint Economic Committee (JEC) to testify on the unemployment situation.

The employment data released today are the first to reflect the effects of the September 11 terrorist attacks. Payroll employment declined by 415,000, with job losses posted throughout the private sector. The factory employment declined for the 15th month in a row. According to the separate household survey, the unemployed rate increased by half a percentage point, to 5.4 percent.

The economic effects of the events of September 11 will aggravate an already weak economic situation. Although the resilience of the American people and the economy has been very encouraging, the attacks have taken their toll, deepening the slowdown. A variety of economic statistics confirm that the economic slowdown that began in the middle of 2000 continues.

Earlier this week, the Commerce Department reported that gross domestic product (GDP) declined slightly in the third quarter of 2001. This shrinkage of the economy is a matter of concern even if the decline was less than many economists had expected. A review of GDP accounts show that in recent orders the fall of investment has been a major negative force on the economy, a fact that policymakers should consider in addressing the need for economic stimulus. The GDP report confirms the weakness apparent in most other economic data.

As I pointed out in September, one result of the terrorist attacks will be the new spending on security. That will not increase the quality or quantity of production. Firms have to increase spending on security personnel, sophisticated security equipment, fortification of buildings and facilities and other related expenditures.

These new expenses will have economic effects similar to the imposition of something that I call a "security tax" on an already vulnerable economy. The logical policy response is for changes in tax policy that address this problem with offsetting tax reductions. For example, faster write-offs for security and other investments would offset at least some of the new security expenses and also address the bias in the income tax system against investment.

Let me just pause from my prepared remarks to say that over the last decade or more some have been puzzled by the resilience and the length of the period of economic growth that we experienced; and as we searched for the underlying reasons that produced that positive long period of time of economic growth, one of the factors that we identified was the increased productivity of the American workforce because of increases in the use of new technologies.

To continue to invest in those new technologies presumably would have a similar effect going forward. However, to divert resources from the use of new technologies and the acquisition of new technologies to expenditures for security reasons does not have the same effect as those kinds of investments that we have made during the last two decades or more.

So this is a matter of some concern, and it prompted me to ask our staff to prepare a report that addresses these issues, which we will have on our JEC website by the close of business today. And for those of you who have not accessed our website, the address is www.house.gov/jec.

[The report, *Tax Policy for Economic Growth*, is available online at <http://www.house.gov/jec/growth.pdf>.]

As Chairman Greenspan recently suggested before this Committee, tax incentives for capital investment are among the most effective forms of fiscal stimulus. Short-term temporary tax relief will not be effective because taxpayers know that it is not permanent. It is not a permanent improvement to their incomes. Effective tax stimulus would improve incentives to work, incentives to save and invest by reducing tax penalties on these activities. Some measure of tax relief is needed for individuals and firms burdened by the uncertainty and expenses of the new security situation.

It is simply my view that the weakness in business and consumer spending can be best addressed through monetary policy. An aggressive cut in the Federal funds rate by the Federal Reserve this coming Tuesday is the best policy action that could be taken to bolster the demand side of the economy over the short term.

Commissioner, thank you for being here; and we will turn it now to the Vice Chairman, Senator Jack Reed.

[The prepared statement of Representative Saxton appears in the Submissions for the Record on page 19.]

OPENING STATEMENT OF SENATOR JACK REED, VICE CHAIRMAN

Senator Reed. Thank you very much, Mr. Chairman, and thank you, Acting Commissioner Orr, for coming to testify before us today.

The Bureau of Labor Statistics' (BLS) measures of employment and job losses for October will help us to understand how the economy is currently performing. Economic conditions appear to be deteriorating. Earlier this week, we learned that gross domestic product fell 0.4 percent during the third quarter. Yesterday, we learned that private wages and salary fell again in September, the second monthly decline in a row.

Factory operating rates are at their lowest levels in two decades, and today you report that unemployment has risen to 5.4 percent. Help is needed.

We must craft a fiscal stimulus package that can spur the economy into recovery quickly while not undermining fiscal discipline over the long run.

History has shown that the key to achieving a rapid recovery is to bolster family incomes, something that the stimulus package passed by the House is unlikely to achieve. Indeed, I can't see many of the package's aspects even increasing investment.

Marginal incentives for businesses that boost their capital spending will mean little to the economy when cash-strapped households cut their spending, causing further curtailments in investment. Instead, we should direct the stimulus towards those Americans who are most vulnerable to the economic slowdown.

We should help lower-income working Americans who pay payroll taxes yet received no rebate earlier this year. We should broaden unemployment insurance coverage so that almost all of those who lost jobs can get help and increase benefits so that people receive enough to cover their basic needs. And we should help the newly unemployed keep their health insurance by subsidizing premiums.

The foundations of our economy are strong, and our people and businesses resilient. Decline in GDP was less than expected. In order to shore up the economy's weaknesses we need policies that are temporary, immediate and targeted to those people and businesses which will best spark our economy's engine.

I look forward to hearing your detailed report, Acting Commissioner Orr, on the employment statistics.

[The prepared statement of Senator Reed appears in the Submissions for the Record on page 21.]

Representative Saxton. Senator Reed, thank you very much.

We usually just limit this to two opening statements. Senator Corzine is here, and we have the luxury of offering you the opportunity to say whatever, Senator.

Senator Corzine. Well, if I might.

Welcome. I welcome the Acting Commissioner and am pleased to see you, and I appreciate the Chairman holding this hearing.

The numbers that you will talk to us about this morning really are quite stark and I think confirm what many in the economy recognize as a period of rather severe deterioration and economic performance.

Like both the Chairman and my colleague, Senator Reed, I certainly argue for a very forceful and quick stimulus program that addresses the needs of our economy. I think there are issues that I would like to hear you talk about on how we get people back to work. I look forward to this discussion, and I think it is imperative, given that our economic needs have been dramatically exposed by the events of today's announcement.

Thank you.

Representative Saxton. Thank you, Senator.

Commissioner, the floor is yours. Thank you for being with us.

OPENING STATEMENT OF LOIS ORR, ACTING COMMISSIONER, BUREAU OF LABOR STATISTICS: ACCOMPANIED BY KENNETH V. DALTON, ASSOCIATE COMMISSIONER, OFFICE OF PRICES AND LIVING CONDITIONS; AND PHILIP L. RONES, ASSISTANT COMMISSIONER OF CURRENT EMPLOYMENT ANALYSIS

Ms. Orr. Thank you, Mr. Chairman and Members of the Committee. I appreciate the opportunity to comment today on the October labor market data that we released earlier this morning.

As you know, payroll employment dropped sharply over the month in a wide range of industries. The unemployment rate climbed to 5.4 percent in October, the highest rate in nearly five years. Unlike the September data we released in early October, these changes include at least some of the immediate impacts of the events of September 11. I would like to note, however, that the attacks' impact cannot be separated from some of the other influences on the job market today.

The decline in total nonfarm payroll employment was 415,000 in October, an unusually large single-month drop. As you may recall, this followed a very sizable decline of 213,000 in September, which was preceded by a decline of roughly 50,000 the prior month. Since its recent peak in March, nonfarm employment has fallen by nearly 900,000. Private sector job losses have been even greater. That is, 1.2 million over the very same period.

In October, nearly every industry division had a substantial decline in employment. Job losses in manufacturing continued to be heavy and widespread, totalling 142,000 in October. Although factory employment has been in decline for some time, since March alone it has fallen by more than 800,000.

Since manufacturing employment's peak in April of 1998, its employment is down 1.6 million. In services, which is perhaps what is most striking in the report today, employment fell by 111,000 in October, the fourth and I might add largest decline this year in an industry that had only one other monthly decline since May of 1991. Particularly large job losses occurred in the health supply industry and hotels, 107,000 and 46,000, respectively.

Health supply employment, which was at its peak about a year ago, is now roughly half a million persons lower in total employment.

About a year ago, we had three and a half million people working in the temporary help industry, and today it is three million. Employment in the temporary help industry has declined monthly for the past 13 months.

Employment in the hotel industry has declined since the beginning of this year by approximately a hundred thousand. Half of that loss occurred between September and October.

In the transportation industry, air transportation and transportation services, and I would say transportation services, mainly travel agencies, employment dropped by 42,000 in air transportation scheduled airlines and 11,000 in the travel agencies or transportation service. As with hotels, these large declines were undoubtedly related to cutbacks in travel since September 11.

I will go on with the story. It doesn't get any better.

Retail trade posted its second large job loss in a row as weakness continued in eating and drinking places. For the past three months, we have had major declines in eating and drinking establishments, so that just in the period from August to the present employment in that industry is 115,000 less than it was three months ago.

In addition, in retail trade we would expect at this time for some holiday hiring to begin boosting employment, but that has failed to happen at the rate that we would expect it to occur and in particular I would note in apparel stores and in some of the miscellaneous retailers like toy shops and the gift shops. That holiday hiring we haven't seen as yet.

Elsewhere, employment in construction and in wholesale trade also fell over the month. There have been several very modest declines in construction so far in this calendar year, and construction employment continues to be higher than it was a year ago, in fact 74,000 workers higher.

Wholesale trade, especially reflecting the decline in output and durable goods industry, also is declining, and that is approximately a hundred thousand over the past year.

I could note that there are a few industries that have added jobs in October. That includes health services, which added roughly 15,000 employees, private education, a modest increase in mortgage banking, guard services, noting what you were commenting about earlier, and some of the social services.

Then I would like to note some of our data from our household survey. As I mentioned earlier, the unemployment rate is up half a percentage point to 5.4 percent. That is the highest jobless rate since late 1996.

The number of unemployed in October grew by more than 700,000, and most of that increase in unemployment reflects persons who had lost jobs as opposed to those who had left jobs voluntarily or who have been out of the labor force and were reentering. Weak labor market conditions were pervasive, but increases in jobless rates were particularly severe for blue collar workers.

I note that unemployment rates for virtually all categories of workers, be it by occupation, race, gender, education, increased between September and October.

Civilian employment as we measure it by our household survey fell by about 600,000, and the proportion of the population with a job in October declined to 63.3 percent. The number of part-time workers who would have preferred to work full time increased sharply for the second consecutive month, rising from 3.3 million persons in August to 4.5 million in October. This two month increase was concentrated among workers whose hours were reduced because of slack work or unforeseeable business conditions.

In summary, employment in almost all major nonfarm industry groups fell in October. Total job loss was 415,000. The unemployment rate rose by half a percent.

My colleagues and I would now be glad to answer your questions. Thank you.

[The prepared statement of Acting Commissioner Orr, together with the accompanying Press Release No. 01-397, appear in the Submissions for the Record on page 22.]

Representative Saxton. Commissioner, thank you very much for a very concise statement.

In preparing to come here today, and we got a look at these numbers earlier this morning, we looked back to see when was the last time we had the decrease in employment to this extent, and we believe it was in 1980. Does that sound right?

Ms. Orr. That sounds exactly right.

Representative Saxton. So it has been the better part of 21 years since we have seen this kind of a decline in employment, which is obviously cause for concern.

Commissioner, I want to emphasize the effects of the terrorist strike. That would be a good thing to do. But it is also a good thing to do to understand that, as you pointed out in your statement, there are other factors that are at play here, and we need to understand those as well. For example, this trend that has ended up in exhibiting this large employment loss started more than a year ago, didn't it? Would you explain to us when this trend and decline actually started?

Ms. Orr. Well, we reached our peak in nonfarm payroll employment in March of this year. But, prior to that time, there were a number of points along the way where there were declines.

As I noted earlier, employment reached its peak in manufacturing in 1998; and between 1998 and 2000, roughly a year ago, there were some declines that were not nearly of the order that we have seen more recently.

Representative Saxton. Commissioner, let me refer – you just spoke about loss of manufacturing jobs. We have a chart here which shows that a very significant decline in the growth of manufacturing jobs began in the middle of 2000, perhaps around the July time frame. Is that correct?

[Chart 1 entitled "All Employees: Manufacturing" appears in the Submissions for the Record on page 47.]

Ms. Orr. Right, with some decline between 1998 and 2000.

Also, as it shows on the chart—

Representative Saxton. That trend had nothing to do with the September strike. The numbers – that trend that we show on this chart has nothing to do with September 11, right?

Ms. Orr. We have also seen a similar decline starting roughly the same point in 2000 in temporary help. We have now experienced a decline in temporary help every month for the past 13 months.

Representative Saxton. We can say the same thing about GDP growth. The rate of growth declined over that period of time.

We have another chart I believe that demonstrates what happened in terms of the rate of GDP growth, again, beginning in the second quarter of 2000, which was fairly robust, and then by the third and fourth quarters of 2000 the rate of GDP growth had declined significantly and has continued the same trend. So it is important to put the events of 9-11 in this perspective so that we don't come to the conclusion that what we see here in terms of the 415,000 job loss totally is a result of the events of September 11.

[Chart 2 entitled "Gross Domestic Product" appears in the Submissions for the Record on page 48.]

What are the most important aspects of today's employment data that do provide the information about the effects of the terrorist strike?

Ms. Orr. Certainly a large number of the industries that all of us have come to feel were impacted and had reports from various industry spokespersons have pretty much been in the travel-related arena, so that air transportation, the travel agents, hotels, some question about eating and drinking places – because there has certainly been a large decline there. The decline, of what that is related to, it will be very difficult to say.

Auto services and in particular rental cars, parking fees, those kinds of expenditures, those kinds of activities are ones which we say are a surprise that we would like to take a look at, can take a look at and say to what extent do they account for some of the change since September 11.

I put together a table for myself in which I looked at the employment change between September and October in these industries and then compared that change to the average monthly change in those industries of the prior three months.

So, for example, in air transportation, a 42,000 employment decline between September and October. During the July through September period, the monthly decline has been 5,000.

Similarly, transportation services – again these are mainly the travel agencies – declined 11,000 for September to October, and in the prior three months the average monthly change was a 2,000 decline.

Hotels had an employment decline of 46,000 between September and October; and during the prior three months, the monthly average was a 5,000 decline.

Auto services declined 13,000 between September and October; in the previous three months the change had been an increase of 1,000 each month.

Then of course, the guard services, I have here, is a contrasting industry. In the period July through September, it experienced no net change in employment whatsoever. It was actually up from August to September and then up 22,000 between September and October, just as you had indicated that we would expect to see in selected industries some changes.

Representative Saxton. Commissioner, how much of October's unemployment decline related to results from the terrorist attacks? Can you give us any idea about that?

Ms. Orr. That is as close as I get in terms of describing the numbers in September to October and then taking a look at what has been happening in the several months, and even then we can't completely disentangle the influence of market issues in general and the terrorist attack. But it is clear that in these industries there were substantial changes in employment. Substantial declines remain with magnitudes that weren't consistent with recent patterns.

Representative Saxton. Are there any sectors of the economy that you might expect to see expand as a result of the events of September 11?

Ms. Orr. Security, as you and I have both said. I suppose that there are those who would say we might want to look at some of the defense-related industries, you know, over the longer haul.

I have several of my staff here with me. Do any of you have any help for me here?

Representative Saxton. You have certainly put your fingers on the two areas that we would expect to see growth, certainly in security. As we walk across our campus here we saw the results of this very clearly, and as well – as I watched *Fox News*, I guess it was this morning, report on warnings relative to various facilities across the country – bridges this week – obviously, there are additional costs and expenditures in growth in areas of security along those lines.

Again, I think this is something that we are going to have to deal with in terms of understanding the effects of large expenditures or significant expenditures on security issues and how transferring our resources from productive uses in terms of the economy to security uses – not that we shouldn't do the security. Obviously, that is an important set of expenditures where we are going to have to divert some resources. But, at the same time, we also need to understand that there is an economic effect related to the division of those resources.

For those who may be interested and who were not here when I announced it earlier, by the end of the day today we will have posted on our Joint Economic Committee website a report entitled *Tax Policy for Economic Growth* that takes into account the diversion of resources from more economically productive expenditures to these security expenditures. The report can be downloaded from our website at <www.house.gov/jec/growth.pdf>.

So, with that, let me turn to Senator Reed for whatever comments he may have.

Senator Reed. Thank you, Mr. Chairman.

Thank you, Commissioner, for your testimony and for your responses to our questions.

You indicated in your testimony that increases in jobless rates were particularly severe for blue collar workers. Can you expand on that? And you also might indicate what these workers typically earn.

Ms. Orr. I am sorry?

Senator Reed. What they typically earn. What are the typical wages that you mentioned for these blue collar workers?

Ms. Orr. Well, I think part of the reason for the sharp decline in employment or the increased unemployment for blue collar workers is that many of those workers are in our factories, are in manufacturing where we have seen a substantial amount of job loss, as I mentioned 1.6 million over the past two and a half years.

Phil, did you have – rather than train me in front of you all, you can just go ahead and do it.

Representative Saxton. We are always pleased to hear from Mr. Rones.

Mr. Rones. Thank you. I am pleased to be here.

But this is a month where none of us are bringing you particularly good news.

We have a quarterly news release that we put out on weekly earnings for different groups, including occupational groups. Just as an example, if you look at the two main categories of blue collar workers, one would be – and I use these terms loosely here, because it is not the classification system – one would be more skilled workers. One would be somewhat less skilled. The more skilled is precision production, craft and repair.

The most recent median weekly earnings for the third quarter is $627 a week. For the less skilled, what we call operators, fabricators, laborers, $475.

Just as comparison, if you look at professional and managerial, which is the top category, that is $867. There are a wide range of different types of jobs in what we call blue collar. Some of them are fairly skilled and fairly well paid. Some of them are the most basic labor jobs at the low end of the wage spectrum.

Senator Reed. So it appears from the numbers that you are reporting today, that the brunt of this job loss is being borne by relatively low-paid workers; is that fair to say?

Mr. Rones. What we have seen recently is that while there have been losses in employment across the whole wage spectrum in recent years, and it is probably the case even in recent months, probably the hardest hit is the group in the middle, and many of the factory types of workers that we have talked about already in the hearing today, many of those are in the middle-income group.

Senator Reed. The other group that also appears to be affected adversely is minority employment. I think the numbers that you are releasing today suggest that black unemployment rose a full percentage point, 8.7 to 9.7 percent. That is higher than the overall unemployment rate has risen.

Ms. Orr. Yes.

Senator Reed. And so in the minority communities this is becoming particularly difficult to bear. Is that a fair statement, Commissioner?

Ms. Orr. Yes.

Senator Reed. One other issue that you raised, among many, was regarding the retail sector. You also seemed to suggest that, at this point, Christmas doesn't look to be a joyful experience from the economic perspective. Are you anticipating, because we have not seen the traditional hiring of seasonal workers, that we are going to have a very difficult Christmas period for retail?

Ms. Orr. Well, let me say I hope not. On the other hand, we simply have not seen a lot of the holiday employment buildup that we had seen in many other years.

Mr. Rones. Right. Obviously, we don't anticipate – we are very good with the things we know. But as Commissioner Orr said earlier, there are parts of retail trade where we normally expect to see seasonal hiring begin in September, more so in October, and they would continue to build through the season. And some of them – department stores, for instance – this month were pretty much on track with seasonal hiring, but some of the smaller stores, the apparel stores, things like sporting goods, toy stores, gift shops, those type of things, we really haven't seen the seasonal hiring that we typically get. What that means for next month, I think part of that depends on the psychology of the consumer between now and next month.

Senator Reed. Well, I think that is exactly right.

And the question is, what we can do within the next few weeks to improve the psychology of the consumer? Again, I think a panoply of incentives for business is not as good as putting more money into the hands of the people who are losing their jobs, their health care, and looking forward to the next several weeks of a very, very bleak economic situation. That is what the consumer confidence of most anyone. That is a challenge that we have to face in the next several weeks.

There is another issue that you raised with respect to part-time workers. Within your report the last month the Bureau reported that the number of workers who can only find part-time work because of economic conditions increased by more than three-quarters of a million people, up by 25 percent. Can you tell me what happened in October to that category of individuals?

Ms. Orr. That category of individuals increased so that we now, between the two months, have moved from 3.3 million to 4.5 million. So those numbers have definitely increased.

Senator Reed. And for my edification are those numbers included within the formal unemployment numbers?

Ms. Orr. They are not in our formal unemployment data that we announced today. Persons who are working part time involuntarily or for economic reasons are not part of the measurement of unemployment. We do have a wide range of unemployment estimates that we produce regularly, but the one we regularly cite is this one.

Senator Reed. So let me understand. The number you cited, the 5.4 percent, is a huge increase in and of itself, but it—

Ms. Orr. Yes.

Senator Reed. But parallel with that is another huge increase in those people who are looking for part-time work.

Ms. Orr. Those persons that are looking for full-time work. That number includes people that are looking for full-time work, and those persons who perhaps were working full time and had their hours cut because of slack business conditions or for some other economic reasons.

Do you want to add anything to that?

Mr. Rones. One of our alternative measures, labor underutilization, does include the workers that you are talking about, those who are working less than full time, but who want to work full time.

Senator Reed. Do you have a measure of how that number has changed in the last few weeks?

Mr. Rones. Some of the components that are not part of the official measurement we don't seasonally adjust or we don't have available on a monthly basis, but if you look at the September figure, which is the most recent figure that we have, that includes everything. If you add total unemployed, plus the group that you talked about, the part time for economic reasons, plus the marginally attached, those are people who say that they wanted a job and have looked in the past year, but are not looking now, the rate was 8.3 percent.

This is not seasonally adjusted, again, because all of the components are not seasonally adjusted. You compare that to the official unemployment rate last month, not seasonally adjusted, which was 4.7 percent. So it added 3.6 percent points to the official rate.

Senator Reed. You would assume that if the numbers were comparable today, that we would have a higher number in that larger category obviously?

Mr. Rones. Yes. In fact, with the increase in part-time economic as well as unemployment, there may be a little bit of a spread.

Senator Reed. So a higher spread between the two numbers. Thank you very much.

Representative Saxton. Thank you, Senator Reed.

Senator Bennett.

Senator Bennett. Thank you very much, Mr. Chairman. And I appreciate your panel being here.

I wanted to focus on a few other aspects of the economy, primarily looking forward. I always say that the only time you will know that the recession is over is when every single forecaster and expert unanimously concludes that we are in the trough from which we will never recover.

The same is also true – the example that we should have known that this was coming was when during the 2000 campaign we were told America was in the very best possible times, and this was going to go on forever.

There is a *Business Week* test that somebody applies that says as soon as your picture appears on the cover of *Business Week* as the businessman or woman of the year, your company is doomed because the recognition you get at that point.

On that basis I am a little concerned to read the forecasters coming out of Wall Street as these numbers came up as news last week, came up on the GDP, where it says the GDP going down by only four tenths of one percent, they expected much more, indicates that perhaps we are going to get through this recession with much less damage than they had previously thought.

That consensus tells me that we are nowhere near the bottom, and it is only when they are all in full agreement that things are never going to get better that they will start to turn around.

With that very unscientific but, unfortunately, historically accurate analysis, I wanted to talk about how long this is going to last. In historic terms this is a relatively mild recession, 5.4 percent unemployment, horrific as it is, coming in a half point increase in a single month is still below historic norms for major recessions. I am old enough to remember the recessions in 1958, 1959, that had unemployment figures in double digits. The last recession which economists look back on and say was relatively mild by historic terms had unemployment figures at 7.5 percent. So we are still well below that.

You look at the last recession, which again was considered to be relatively mild, to start off the first quarter of that recession with only four tenths of one percent of negative growth is relatively mild.

My own instinct tells me, however, that this one, however relatively mild it might be in terms of its downturn, is going to be historically long; that it is going to take us longer to get out of this than we have gotten out of some others. I just throw that out, would like your – your sense of smell about this.

Get away from the numbers for just a minute. I know you live with the numbers, and the numbers are the safe things to cling to, but all of us as politicians have had consultants who gave us poll numbers that were very safe to cling to, and our own sense of smell out on the campaign trial told us that is not what is really happening. You live in this world all of the time. I am not going to hold you to any forecasts. I'm not going to quote your words back to you. I just wanted to take advantage of your being here and say, let's kind of look up from the page for a minute, look around, and ask ourselves how long is this going to last.

Any reaction? Anybody willing to take that one on?

Ms. Orr. Well, I am willing to speak up and say that the traditional thing that the BLS Commissioners say is we are in the business of measuring what is going on. We are not in the business of doing policy analysis or making predictions.

That said, I would just say that in terms of my experience in the Bureau and looking at the data that we have, that one of the things that strikes me is that there is a lot of convergence of the data. We don't seem to have much in the way of anomalies. Our household survey and our establishment survey together suggest that our measurements are quite good, and they are telling us real serious things.

Senator Bennett. Anybody else want to take a shot at that?

Well, let me go on a little further. Again, I have a sense that part of this recession, part of the cause of this recession is overcapacity. And, yes, it is nice if we can get money in the hands of customers to buy things, and presumably they take goods. But if you look around the world, and we live in the world economy, we have substantial overcapacity in steel production. I don't think there is a steel mill anywhere in the world that is making satisfactory profits. And every one of them is shaky because worldwide we have got maybe 25 or 30 percent overcapacity, and they are all new steel mills. The traditional economic circumstances where the old and inefficient get forced out, everybody invested in steel mills around the world, and we have significant overcapacity, and until somebody really goes broke, or until the demand for steel absolutely astounds us, goes through the roof so we can soak up that capacity, I think that we are in for a very long period of time.

I remember, because I was a lessor at the time, real estate in New York City – Manhattan – suddenly had enough buildings come on the market simultaneously that they had an overwhelming glut of available office space, and all of a sudden you could buy office space in New York City for less than you could buy it, say, in Salt Lake City. And it took years for the demand to finally catch up and fill those offices. Now finally it did. But there were a number of very significant real estate developers in New York who went bankrupt and stayed bankrupt for a long period of time.

We can apply that to this economy. That is the concern that I have, where in historic terms doing fairly well, even as we get the gloomy news you have given us this morning, because other recessions have been significantly deeper than this one appears to be. But if this one drags on for 18 months, or 24 months, or 36 months, then we are where the Japanese are, and of course theirs has gone on for 10 years now. I don't want to get into that.

Well, thank you for your statistics. I understand your position, and I will still continue to wonder how long this thing is going to go.

Thank you, Mr. Chairman.

Representative Saxton. Thank you, Senator.

Senator Corzine.

Senator Corzine. Thank you, Mr. Chairman.

I want to pursue a line a little bit about where is the need, since I think we as policymakers will be addressing a desire to find a stimulus package that has the most power, the most efficiency.

I would love to hear your comments a little more on the minority breaks that we saw, very substantial increase in both black and Hispanic unemployment, this blue collar effort, and then the – the nature of income of some of these declines in hotel – for the participants in the hotel and health service that you were talking about.

I understand the manufacturing blue collar jobs that you are talking about may be more moderate income, but certainly not hotel workers and health services don't tend to be the highest-income jobs. Certainly 16- to 25-year-olds don't tend to have the highest-income jobs.

Would you comment a little bit about those various categories and whether they are – I am reading them right, that the 16 to 25, minorities, and a number of the services have seen substantial increases in unemployment as reflected in these statistics? Aren't these the people that if they are hurting most benefited least from the expansion?

Mr. Rones. The first thing I would say is to really repeat what we had said before is that when we look at the data in recent months, particularly October, the increases in unemployment are really across the board, even among the best educated. We see increases in the unemployment rates for the top socioeconomic types of occupations.

Senator Corzine. Just on that point I see the college rate went from 2.4 to 2.7. That is slightly different going from 8.7 to 9.7.

Mr. Rones. Exactly. If you look at it from the occupational side, we see almost the exact same thing. The managers and professionals, which are clearly college-educated, go from 2.4 to 2.7. At the same time, the technical, sales, and administrative support, more of the middle-income types of white collar occupations, rose from 4.3 to 4.7. At the other end, the less skilled blue collar workers that we talked about before have higher rates and, at least this month, a larger increase: from 7.5 to 8.7 percent.

Senator Corzine. It does look like a substantial difference. I don't know whether it is statistically significant in the samples that you are taking. I asked that question because when we structure a so-called stimulus package for potential a – a severe recession, since I think we are in the trend as opposed to a – saying that we are – we can reflect the nature of the recession, particularly by the statistics released today, it is hard to understand how we cannot focus on those that seem to be suffering the most in this process.

Do you have data on the discouraged workers, people that have dropped out, stayed out, but – I have trouble finding it in the statistics for this month.

Ms. Orr. We had in our press release, page three, persons not in the labor force. About 1.4 million persons were marginally attached to the labor force in October, up from one million a year earlier. These persons wanted and were available for work and had looked for a job sometime in the prior 12 months, but were not counted as unemployed because they had not actively searched in the four weeks preceding the survey.

The number of discouraged workers was 330,000 in October, up by 100,000 from a year earlier.

Senator Corzine. All right.

Ms. Orr. Of course, with discouraged workers, they are not looking because they think that no job is available.

Senator Corzine. In light of those statistics, do you have any comments on unemployment duration? One of the debates is about whether we should extend the term of unemployment insurance. It is lengthy is indicative of those kinds of needs.

Mr. Rones. The duration rates don't necessarily behave the way the other data do. We believe that is because early in a downturn in the labor market, you get a lot of the newly jobless people coming into unemployment. All of those people being laid off have short duration, so the average will tend to go down early on.

So you have two things going on. You have an increase in the flow of people coming into unemployment now, and it is compounded by the fact that it is harder to leave unemployment because the job market is so weak. So we have actually seen increases in the short-term unemployment and the long-term unemployment at the same time.

And if you look at just the average measures, which I tend to not like to do for this reason, they look like they are not moving very much.

Senator Corzine. Could you talk just a bit, little bit, about this health care issue? Since I have been here for six or seven months, each month we have always tended to see increases in health care workers.

Ms. Orr. You would presume that there was no reason that that would particularly stop in the current circumstances. In fact, after we began some of the anxieties with regard to bioterrorism, maybe it would be increasing. I was surprised actually to see either those numbers are flat or they actually decreased a bit in the service sector.

In health services we had a modest employment increase of about 14- or 15,000 between September and October. That was about half the rate of growth that we have seen in health care earlier in the year. We know that health care has been experiencing a lot of occupational shortages.

Senator Corzine. I appreciate it.

Representative Saxton. Well, thank you very much, Senator. Do you have anything further?

Senator Reed. If I may ask just one or two additional questions.

Do your statistics reflect the concentration of unemployment through the country? It seems, for example, that we have been talking about very big increases in minority unemployment, in youthful unemployment, in blue collar unemployment, which would suggest to me, and I wonder if you could help me clarify this, that impact is going to be found in urban settings, and perhaps it is focused in some regions and other regions are escaping this. Do you have any sort of regional feel for the data?

Ms. Orr. We produce, as you probably know, data on employment and unemployment for all of the major metropolitan areas in the country, for counties as well as data for states. That data that we have for the states and areas right now is for the month of September, so we are not capturing the most current kind of information as yet in our state and local data.

Senator Reed. Does that data reveal trends already prior to September 11, or is it simply evenly distributed across the country?

Ms. Orr. It really doesn't capture effects of September 11, although unemployment is not the same or employment growth is not the same across all states. For example, there are a number of the Midwestern states where there are lots of manufacturing jobs, and unemployment there has risen. New York City's unemployment rate went from 5.8 to 6.2 from August to September.

So we do have a lot of data that gives us insight about what is going on on a state and local basis.

Senator Reed. Let me just amplify a point to wrap this up. In terms of this issue, at some point you have data that will suggest differences in unemployment growth around the country. Is that—

Ms. Orr. We have it right now. We simply don't have it so that it includes the month of October.

Do you want to share some information from our releases, Mr. Rones?

Mr. Rones. If you look at the data through September and look at the regions around the country where we have had the biggest increases in unemployment, let's say over the year preceding September, New

England had the largest over-the-year unemployment increase, which was more than a percentage point.

Other areas that have increased nearly that much are the East North-central. North Carolina, I would note, has had substantial increases in unemployment. The South Atlantic and Mountain divisions have seen their unemployment rate rise by nearly a percentage point.

Senator Reed. Mr. Chairman, thank you.

One final point is that if you look at these statistics, the impact seems to be low-wage or middle-income wage workers, high minority workers. Not only is it incumbent upon us to come up with a strategy to help them, but also the immediate impact would be a significant increase in demand for social services at the state and local level since these are typically the types of workers who qualify based on income levels and who need these services. So we are looking at that impact not only at the national level, but each state and locality. Thank you.

Representative Saxton. Thank you.

I would just like to thank the Members for participating this morning and thank the Commissioner for giving us the opportunity to glean from the statistics that you bring us. Perhaps it is worthwhile to say at this point that the reason that this process takes place is so that we can understand where the economy is moving.

And as my three colleagues and I have tried to point out, there is a trend in the process here that we need to be very concerned about and begin to tailor our policy, programs of one kind or another to try to do what the federal government can to offset this very disturbing and negative trend. As Senator Bennett pointed out, we would like it to be shorter rather than longer. As Senator Reed pointed out, there are folks on the lower end of the economic scale who we need to be concerned about, and there are a number of ways that we can address these questions.

Recently the House passed an economic stimulus package, which was patterned after an economic stimulus package that passed in 1963, during the term of John Kennedy, which he spearheaded to try to stimulate economic growth by reducing taxes, and, in effect, today offset some of the so-called security taxes that I keep talking about.

We can also rely on our friends over at the Fed, who I hope on Tuesday will continue the easing policy that they have demonstrated over the past seven or eight months. We are hoping that on Tuesday we will see an additional easing which will result in a 25 or 50 basis point reduction in short-term rates. And as was articulated by Senator Reed, I suspect that by the time this economic package works its way through the House and gets to the President's desk, there will be some additional short-term help, if you will, for some folks that need it most.

And we thank you for helping us to understand the situation in which the economy finds itself, and having different opinions perhaps to one extent, or what we will try to put together – that is individuals with different opinions, we will try to put together an economic stimulus package that will be good for the American economy and the American people.

Thank you for helping us with this. We appreciate and we look forward to seeing you in the months ahead.

[Whereupon, at 10:35 a.m., the Committee was adjourned.]

SUBMISSIONS FOR THE RECORD

PREPARED STATEMENT OF REPRESENTATIVE JIM SAXTON, CHAIRMAN

I would like to welcome Acting Commissioner Orr before the Joint Economic Committee to testify on the October employment situation.

The employment data released today are the first to reflect the effects of the September 11 terrorist attacks. Payroll employment declined by 415,000, with job losses posted throughout the private sector. Factory employment declined for the 15th month in a row. According to the separate household survey, the unemployment rate increased half a percentage point to 5.4 percent.

The economic effects of the events of September 11 will aggravate an already weak economic situation. Although the resilience of the American people and economy has been very encouraging, the attacks have taken their toll, deepening the slowdown. A variety of economic statistics confirm that the economic slowdown that began in the middle of 2000 continues.

Earlier this week, the Commerce Department reported that GDP declined slightly in the third quarter of 2001. This shrinkage of the economy is a matter for concern, even if the decline was less than many economists had expected. A review of the GDP accounts shows that in recent quarters the fall of investment has been a major negative force on the economy, a fact that policymakers should consider in addressing the need for economic stimulus. The GDP report confirms the weakness apparent in most other economic data.

As I pointed out in September, one result of the terrorist attacks will be new spending on security that will not increase the quantity or quality of production. Firms will have to increase spending on security personnel, sophisticated security equipment, fortification of buildings and facilities, and other related expenditures.

These new expenses will have economic effects similar to the imposition of a "security tax" on an already vulnerable economy. The logical policy response is for changes in tax policy to address this problem with an offsetting tax reduction. For example, faster write-offs for security and other investments would offset at least some of the new security expenses and also address the bias in the income tax system against investment.

As Chairman Greenspan recently suggested before this Committee, tax incentives for capital investment are among the most effective form of fiscal stimulus. Short-term, temporary tax relief will not be effective because taxpayers know that it is not a permanent improvement in their incomes. Effective tax stimulus would improve incentives to work, save and invest by reducing the tax penalties for these activities. Some measure of relief is needed for individuals and firms burdened by the uncertainty and expenses of the new security situation.

It is my view that the weakness in business and consumer spending can be best addressed through monetary policy. An aggressive cut in the federal funds rate by the Federal Reserve this Tuesday is the best policy action that could be taken to bolster the demand side of the economy.

PREPARED STATEMENT OF SENATOR JACK REED, VICE CHAIRMAN

Thank you, Acting Commissioner Orr, for coming to testify before us today. The Bureau of Labor Statistics' measures of unemployment and job loss for October will help us to understand how the economy is currently performing.

Economic conditions appear to be deteriorating. Earlier this week, we learned that GDP fell 0.4 percent during the third quarter. Yesterday we learned that private wages and salaries fell in September, the second monthly decline in a row. Factory operating rates are at their lowest levels in two decades and, today, you report that unemployment has risen to 5.4 percent.

Help is needed. We must craft a fiscal stimulus package that can spur the economy into recovery quickly while not undermining fiscal discipline over the long run.

History has shown that the key to achieving a rapid recovery is to bolster family incomes, something that the stimulus package passed by the house is unlikely to achieve. Marginal incentives for businesses to boost their capital spending will mean little to the economy when cash-strapped households cut their spending, causing further curtailments in investment.

Instead, we should direct the stimulus towards those Americans who are most vulnerable to the economic slowdown. We should help lower-income working Americans who pay payroll taxes, yet received no rebate earlier this year. We should broaden unemployment insurance coverage so that people receive enough to cover their basic needs. And we should help the newly unemployed keep their health insurance by subsidizing premiums.

The foundations of our economy are strong, and our people and businesses resilient. The decline in GDP was less than expected. In order to shore up the economy's weaknesses, we need policies that are temporary, immediate, and targeted to those people and businesses which will best spark our economy's engine.

FOR DELIVERY: 9:30 A.M., E.S.T.
FRIDAY, NOVEMBER 2, 2001

Advance copies of this statement are made available to the press under lock-up conditions with the explicit understanding that the data are embargoed until 8:30 a.m. Eastern Standard Time.

Statement of

Lois Orr
Acting Commissioner
Bureau of Labor Statistics

before the

Joint Economic Committee

UNITED STATES CONGRESS

Friday, November 2, 2001

Mr. Chairman and Members of the Committee:

Thank you for the opportunity to comment on the October labor market data we released this morning.

Payroll employment dropped sharply over the month in most industries. The unemployment rate climbed to 5.4 percent in October, the highest rate in nearly 5 years. These changes include the impact of the events of September 11. The attacks' impact, however, cannot be separated from other influences on the job market.

The decline in total nonfarm payroll employment was 415,000 in October, an unusually large single-month drop.

This followed a sizable decline of 213,000 in September. Since its recent peak in March, nonfarm employment has fallen by nearly 900,000. Private sector job losses have been even greater—1.2 million over the same period.

In October, nearly every industry division had a substantial decline in employment. Job losses in manufacturing continued to be heavy and widespread, totalling 142,000 in October. Although factory employment has been in decline for some time, since March alone it has fallen by more than 800,000.

In services, employment fell by 111,000 in October, the fourth (and largest) decline this year in an industry that had had only one other monthly decline since May 1991. Particularly large job losses occurred in the help supply industry and in hotels.

In the transportation industry, air transportation and transportation services (largely travel agencies) employment dropped by 42,000 and 11,000, respectively. As with hotels, these large declines were undoubtedly related to cutbacks in travel since September 11.

Retail trade posted its second large job loss in a row, as weakness continued in eating and drinking places. In addition, some other areas of retail that normally would begin holiday hiring in October failed to add jobs at usual levels. These include apparel stores and miscellaneous retailers, such as toy stores and gift shops.

Elsewhere, employment in construction and in wholesale trade also fell over the month. In contrast, a few industries added jobs in October, including health services, private education, mortgage banking, and guard services.

Turning now to data from our household survey, the unemployment rate rose by half a percentage point in October to 5.4 percent, the highest jobless rate since late 1996. The number of unemployed grew by more than 700,000 in October. Most of the over-the-month increase in unemployment reflected persons who had lost jobs, as opposed to those who had left jobs voluntarily or had been out of the labor force. Weak labor market conditions were pervasive, but increases in jobless rates were particularly severe for blue-collar workers. The unemployment rates for adult men, adult women, whites, blacks, and Hispanics all increased in October.

Civilian employment fell by about 600,000 and the proportion of the population with a job in October declined to 63.3 percent. The number of part-time workers who would have preferred to work full time increased sharply for the second consecutive month, rising from 3.3 million in August to 4.5 million in October. The 2-month increase was concentrated among workers whose hours were reduced because of slack work or unfavorable business conditions.

In summary, employment in almost all major nonfarm industry groups fell in October; the total job loss was 415,000. The unemployment rate rose by one-half percentage point to 5.4 percent, the highest rate in nearly 5 years.

My colleagues and I now would be glad to answer your questions.

News
United States Department of Labor
Bureau of Labor Statistics
Washington, D.C. 20212

Technical information:
Household data: (202) 691-6378 http://www.bls.gov/cps/
Establishment data: 691-6555 http://www.bls.gov/ces/
Media contact: 691-5902

USDL 01-397

Transmission of material in this release is embargoed until 8:30 A.M. (EST), Friday, November 2, 2001.

THE EMPLOYMENT SITUATION: OCTOBER 2001

Employment fell sharply in October, and the unemployment rate jumped to 5.4 percent, the Bureau of Labor Statistics of the U.S. Department of Labor reported today. Nonfarm payroll employment dropped by 415,000 over the month, by far the largest of three consecutive monthly declines. The job losses in October were spread across most industry groups, with especially large declines in manufacturing and services.

The labor market data from the household and payroll surveys for the month of October are the first data from these surveys to reflect broadly the impact of the terrorist attacks of September 11. The labor market had been weakening before the attacks, and those events clearly exacerbated this weakness. It is not possible, however, to quantify the job-market effects of the terrorist attacks.

Chart 1. Unemployment rate, seasonally adjusted, November 1998 - October 2001

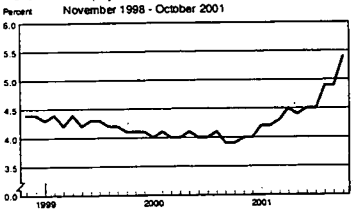
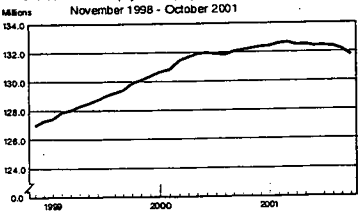


Chart 2. Nonfarm payroll employment, seasonally adjusted, November 1998 - October 2001



Unemployment (Household Survey Data)

The number of unemployed persons increased by 732,000 to 7.7 million in October. The unemployment rate rose by 0.5 percentage point to 5.4 percent, seasonally adjusted, the highest level since December 1996. Since October 2000, when both measures had reached their most recent lows, the unemployment level has risen by 2.2 million and the rate by 1.5 percentage points. (See table A-1.)

The unemployment rates for most of the major worker groups—adult men (4.8 percent), adult women (4.8 percent), whites (4.8 percent), blacks (9.7 percent), and Hispanics (7.2 percent)—rose in October. (See tables A-1 and A-2.)

Table A. Major indicators of labor market activity, seasonally adjusted
(Numbers in thousands)

Category	Quarterly averages 2001		Monthly data 2001			Sept.-Oct. change
	II	III	Aug.	Sept.	Oct.	
HOUSEHOLD DATA	Labor force status					
Civilian labor force	141,461	141,771	141,350	142,190	142,303	113
Employment	135,130	134,984	134,393	135,181	134,562	-619
Unemployment	6,331	6,787	6,957	7,009	7,741	732
Not in labor force	70,072	70,367	70,785	70,167	70,279	112
	Unemployment rates					
All workers	4.5	4.8	4.9	4.9	5.4	0.5
Adult men	4.0	4.2	4.4	4.3	4.8	.5
Adult women	3.8	4.2	4.2	4.4	4.8	.4
Teenagers	14.0	15.2	16.1	14.7	15.5	.8
White	3.9	4.2	4.3	4.3	4.8	.5
Black	8.2	8.6	9.1	8.7	9.7	1.0
Hispanic origin	6.5	6.2	6.3	6.4	7.2	.8
ESTABLISHMENT DATA	Employment					
Nonfarm employment	132,483	p132,342	132,395	p132,182	p131,767	p-415
Goods-producing[1]	25,310	p24,986	24,963	p24,873	p24,699	p-174
Construction	6,866	p6,863	6,861	p6,862	p6,832	p-30
Manufacturing	17,882	p17,555	17,533	p17,443	p17,301	p-142
Service-producing[1]	107,173	p107,356	107,432	p107,309	p107,068	p-241
Retail trade	23,546	p23,570	23,583	p23,522	p23,441	p-81
Services	41,052	p41,094	41,129	p41,106	p40,995	p-111
Government	20,782	p20,980	21,005	p21,003	p21,027	p24
	Hours of work[2]					
Total private	34.2	p34.1	34.0	p34.1	p34.0	p-0.1
Manufacturing	40.8	p40.7	40.7	p40.6	p40.4	p-.2
Overtime	3.9	p4.0	4.1	p3.9	p3.8	p-.1
	Indexes of aggregate weekly hours (1982=100)[2]					
Total private	151.4	p150.3	150.1	p149.9	p148.8	p-1.1
	Earnings[2]					
Average hourly earnings, total private	$14.25	p$14.40	$14.40	p$14.45	p$14.47	p$0.02
Average weekly earnings, total private	487.46	p490.93	489.60	p492.75	p491.98	p-.77

[1] Includes other industries, not shown separately.
[2] Data relate to private production or nonsupervisory workers.
p=preliminary.

The number of newly unemployed persons, those unemployed for less than 5 weeks, rose by 401,000 to 3.2 million in October. (See table A-6.) The number of unemployed job losers not on temporary layoff grew by 518,000 over the month and has increased by 1.4 million since last December. (See table A-7.)

Total Employment and the Labor Force (Household Survey Data)

Total employment dropped by 619,000 in October to 134.6 million, seasonally adjusted, and the employment-population ratio fell by 0.4 percentage point to 63.3 percent. Since January, employment has fallen by about 1.4 million, and the employment ratio has declined by 1.2 percentage points. (See table A-1.)

The number of persons who worked part time for economic reasons rose by 274,000 in October to 4.5 million, seasonally adjusted. These are persons who would have preferred to work full time but worked part time because their hours had been cut back or because they were unable to find a full-time job. Since August, the number of persons who worked part time for economic reasons has increased by about 1.1 million. Most of this rise has been among persons whose hours were cut due to slack work or business conditions. (See table A-4.)

Both the total number of persons in the civilian labor force (142.3 million) and the labor force participation rate (66.9 percent) were little changed in October. (See table A-1.)

Persons Not in the Labor Force (Household Survey Data)

About 1.4 million persons (not seasonally adjusted) were marginally attached to the labor force in October, up from 1.0 million a year earlier. These persons wanted and were available for work and had looked for a job sometime in the prior 12 months but were not counted as unemployed because they had not actively searched for work in the 4 weeks preceding the survey. The number of discouraged workers was 330,000 in October, up from 230,000 a year earlier. Discouraged workers, a subset of the marginally attached, were not currently looking for work specifically because they believed no jobs were available for them. (See table A-10.)

Industry Payroll Employment (Establishment Survey Data)

Nonfarm payroll employment fell by 415,000 in October to 131.8 million, seasonally adjusted. This was the largest employment decrease since May 1980 and followed a decline of 213,000 in September. Since the recent employment peak in March, overall job losses have totaled 887,000; losses in the private sector have totaled 1.2 million. In October, employment was down in nearly every major industry. (See table B-1.)

Widespread job losses continued in manufacturing, as factory employment fell by 142,000. October was the 15th consecutive month of factory job losses, bringing the decline in employment since July 2000 to 1.3 million. In October, large employment cutbacks continued in both electrical equipment (22,000) and industrial machinery (21,000). These two industries have accounted for a third of the factory jobs lost since July 2000. Auto manufacturing declined by 21,000 over the month.

Elsewhere in the goods-producing sector, employment in construction fell by 30,000, following 3 months of little change. In October, declines in general building contracting and heavy construction were coupled with continued decreases in special trades. Since May, employment in special trades has fallen by 56,000. In mining, oil and gas extraction lost 4,000 jobs in October. Employment in the industry had grown during the first half of this year but has weakened in recent months due to sharp declines in the price of oil.

The services industry lost 111,000 jobs in October, the largest decline in the history of this series. A sizable decrease in help supply employment (107,000), which provides workers to other businesses, reflected economic uncertainty in other industries. Subsequent to the September 11 terrorist attacks, employment declines accelerated markedly in travel-related industries, including hotels (46,000) and auto services (13,000), notably in auto rental agencies and in parking services. In October, job growth slowed in health services, but the industry has added nearly a quarter of a million jobs thus far this year. Educational and social services both added jobs over the month.

Retail trade employment declined for the third straight month in October, with an over-the-month decrease of 81,000. About half the October losses were in eating and drinking places, where employment was down by 115,000 since July. Over the month, employment decreased in apparel stores and miscellaneous retail establishments, after seasonal adjustment; these industries added fewer workers than usual at the beginning of the holiday employment buildup.

Employment declines continued in transportation and public utilities with a loss of 55,000 jobs in October. Over-the-month job losses occurred in air transportation (42,000) and transportation services (11,000), which includes travel agencies. Declines in these industries accelerated sharply following the September 11 attacks.

Wholesale trade employment fell by 23,000 jobs in October, following a similar loss in September. Since its last peak in November 2000, the industry has lost 105,000 jobs. Over-the-month declines were concentrated in durable goods distribution.

Slow growth continued for the third consecutive month in finance, insurance, and real estate, following losses in June and July. Over the month, employment in mortgage banking remained on an upward trend, as that industry continued to benefit from low interest rates. In contrast, security brokerages lost jobs again in October; since March, employment in the industry has fallen by 31,000.

Employment in local government, excluding education, increased by 26,000 in October, after seasonal adjustment. The industry had shown no growth in the prior 2 months. Other parts of government were little changed in October.

Weekly Hours (Establishment Survey Data)

The average workweek for production or nonsupervisory workers on private nonfarm payrolls edged down by 0.1 hour in October to 34.0 hours, seasonally adjusted. The manufacturing workweek decreased by 0.2 hour to 40.4 hours. Manufacturing overtime was down by 0.1 hour to 3.8 hours. Since July 2000, the factory workweek has fallen by 1.4 hours and factory overtime by 0.9 hour. (See table B-2.)

The index of aggregate weekly hours of production or nonsupervisory workers on private nonfarm payrolls fell by 0.7 percent in October to 148.8 (1982=100), seasonally adjusted. The index is down by 2.2 percent from its recent peak in January. The manufacturing index fell by 1.3 percent to 94.7 in October and has fallen by 11.5 percent since July 2000. (See table B-5.)

Hourly and Weekly Earnings (Establishment Survey Data)

Average hourly earnings of production or nonsupervisory workers on private nonfarm payrolls increased by 2 cents in October to $14.47, seasonally adjusted. This followed a gain of 5 cents (as revised) in September. Average weekly earnings fell by 0.2 percent in October to $491.98. Over the year, average hourly earnings increased by 4.1 percent and average weekly earnings grew by 2.9 percent. (See table B-3.)

The Employment Situation for November 2001 is scheduled to be released on Friday, December 7, at 8:30 A.M. (EST).

New Seasonal Factors for Establishment Survey Data

Following usual practice, the 6-month updates to seasonal adjustment factors for the establishment survey data will be introduced with next month's release of November data. These factors will be used for the September 2001 through April 2002 estimates and will be published in the December 2001 issue of *Employment and Earnings*. These factors will be available on Friday, November 30, on the Internet (http://www.bls.gov/ces/) or by calling (202) 691-6555.

Explanatory Note

This news release presents statistics from two major surveys, the Current Population Survey (household survey) and the Current Employment Statistics survey (establishment survey). The household survey provides the information on the labor force, employment, and unemployment that appears in the A tables, marked HOUSEHOLD DATA. It is a sample survey of about 60,000 households conducted by the U.S. Census Bureau for the Bureau of Labor Statistics (BLS).

The establishment survey provides the information on the employment, hours, and earnings of workers on nonfarm payrolls that appears in the B tables, marked ESTABLISHMENT DATA. This information is collected from payroll records by BLS in cooperation with State agencies. In June 2001, the sample included about 350,000 establishments employing about 39 million people.

For both surveys, the data for a given month relate to a particular week or pay period. In the household survey, the reference week is generally the calendar week that contains the 12th day of the month. In the establishment survey, the reference period is the pay period including the 12th, which may or may not correspond directly to the calendar week.

Coverage, definitions, and differences between surveys

Household survey. The sample is selected to reflect the entire civilian noninstitutional population. Based on responses to a series of questions on work and job search activities, each person 16 years and over in a sample household is classified as employed, unemployed, or not in the labor force.

People are classified as *employed* if they did any work at all as paid employees during the reference week; worked in their own business, profession, or on their own farm; or worked without pay at least 15 hours in a family business or farm. People are also counted as employed if they were temporarily absent from their jobs because of illness, bad weather, vacation, labor-management disputes, or personal reasons.

People are classified as *unemployed* if they meet all of the following criteria: They had no employment during the reference week; they were available for work at that time; and they made specific efforts to find employment sometime during the 4-week period ending with the reference week. Persons laid off from a job and expecting recall need not be looking for work to be counted as unemployed. The unemployment data derived from the household survey in no way depend upon the eligibility for or receipt of unemployment insurance benefits.

The *civilian labor force* is the sum of employed and unemployed persons. Those not classified as employed or unemployed are *not in the labor force*. The *unemployment rate* is the number unemployed as a percent of the labor force. The *labor force participation rate* is the labor force as a percent of the population, and the *employment-population ratio* is the employed as a percent of the population.

Establishment survey. The sample establishments are drawn from private nonfarm businesses such as factories, offices, and stores, as well as Federal, State, and local government entities. *Employees on nonfarm payrolls* are those who received pay for any part of the reference pay period, including persons on paid leave. Persons are counted in each job they hold. *Hours and earnings* data are for private businesses and relate only to production workers in the goods-producing sector and nonsupervisory workers in the service-producing sector.

Differences in employment estimates. The numerous conceptual and methodological differences between the household and establishment surveys result in important distinctions in the employment estimates derived from the surveys. Among these are:

- The household survey includes agricultural workers, the self-employed, unpaid family workers, and private household workers among the employed. These groups are excluded from the establishment survey.
- The household survey includes people on unpaid leave among the employed. The establishment survey does not.
- The household survey is limited to workers 16 years of age and older. The establishment survey is not limited by age.
- The household survey has no duplication of individuals, because individuals are counted only once, even if they hold more than one job. In the establishment survey, employees working at more than one job and thus appearing on more than one payroll would be counted separately for each appearance.

Other differences between the two surveys are described in "Comparing Employment Estimates from Household and Payroll Surveys," which may be obtained from BLS upon request.

Seasonal adjustment

Over the course of a year, the size of the nation's labor force and the levels of employment and unemployment undergo sharp fluctuations due to such seasonal events as changes in weather, reduced or expanded production, harvests, major holidays, and the opening and closing of schools. The effect of such seasonal variation can be very large; seasonal fluctuations may account for as much as 95 percent of the month-to-month changes in unemployment.

Because these seasonal events follow a more or less regular pattern each year, their influence on statistical trends can be eliminated by adjusting the statistics from month to month. These adjustments make nonseasonal developments, such as declines in economic activity or increases in the participation of women in the labor force, easier to spot. For example, the large number of youth entering the labor force each June is likely to obscure any other changes that have taken place relative to May, making it difficult to determine if the level of economic activity has risen or declined. However, because the effect of students finishing school in previous years is known, the statistics for the current year can be adjusted to allow for a comparable change. Insofar as the seasonal adjustment is made correctly, the adjusted figure provides a more useful tool with which to analyze changes in economic activity.

In both the household and establishment surveys, most seasonally adjusted series are independently adjusted. However, the adjusted series for many major estimates, such as total payroll employment, employment in most major industry divisions, total employment, and

unemployment are computed by aggregating independently adjusted component series. For example, total unemployment is derived by summing the adjusted series for four major age-sex components; this differs from the unemployment estimate that would be obtained by directly adjusting the total or by combining the duration, reasons, or more detailed age categories.

The numerical factors used to make the seasonal adjustments are recalculated twice a year. For the household survey, the factors are calculated for the January-June period and again for the July-December period. For the establishment survey, updated factors for seasonal adjustment are calculated for the May-October period and introduced along with new benchmarks, and again for the November-April period. In both surveys, revisions to historical data are made once a year.

Reliability of the estimates

Statistics based on the household and establishment surveys are subject to both sampling and nonsampling error. When a sample rather than the entire population is surveyed, there is a chance that the sample estimates may differ from the "true" population values they represent. The exact difference, or *sampling error*, varies depending on the particular sample selected, and this variability is measured by the standard error of the estimate. There is about a 90-percent chance, or level of confidence, that an estimate based on a sample will differ by no more than 1.6 standard errors from the "true" population value because of sampling error. BLS analyses are generally conducted at the 90-percent level of confidence.

For example, the confidence interval for the monthly change in total employment from the household survey is on the order of plus or minus 292,000. Suppose the estimate of total employment increases by 100,000 from one month to the next. The 90-percent confidence interval on the monthly change would range from -192,000 to 392,000 (100,000 +/- 292,000). These figures do not mean that the sample results are off by these magnitudes, but rather that there is about a 90-percent chance that the "true" over-the-month change lies within this interval. Since this range includes values of less than zero, we could not say with confidence that employment had, in fact, increased. If, however, the reported employment rise was half a million, then all of the values within the 90-percent confidence interval would be greater than zero. In this case, it is likely (at least a 90-percent chance) that an employment rise had, in fact, occurred. The 90-percent confidence interval for the monthly change in unemployment is +/- 273,000, and for the monthly change in the unemployment rate it is +/- .19 percentage point.

In general, estimates involving many individuals or establishments have lower standard errors (relative to the size of the estimate) than estimates which are based on a small number of observations. The precision of estimates is also improved when the data are cumulated over time such as for quarterly and annual averages. The seasonal adjustment process can also improve the stability of the monthly estimates.

The household and establishment surveys are also affected by *nonsampling error*. Nonsampling errors can occur for many reasons, including the failure to sample a segment of the population, inability to obtain information for all respondents in the sample, inability or unwillingness of respondents to provide correct information on a timely basis, mistakes made by respondents, and errors made in the collection or processing of the data.

For example, in the establishment survey, estimates for the most recent 2 months are based on substantially incomplete returns; for this reason, these estimates are labeled preliminary in the tables. It is only after two successive revisions to a monthly estimate, when nearly all sample reports have been received, that the estimate is considered final.

Another major source of nonsampling error in the establishment survey is the inability to capture, on a timely basis, employment generated by new firms. To correct for this systematic underestimation of employment growth (and other sources of error), a process known as bias adjustment is included in the survey's estimating procedures, whereby a specified number of jobs is added to the monthly sample-based change. The size of the monthly bias adjustment is based largely on past relationships between the sample-based estimates of employment and the total counts of employment described below.

The sample-based estimates from the establishment survey are adjusted once a year (on a lagged basis) to universe counts of payroll employment obtained from administrative records of the unemployment insurance program. The difference between the March sample-based employment estimates and the March universe counts is known as a benchmark revision, and serves as a rough proxy for total survey error. The new benchmarks also incorporate changes in the classification of industries. Over the past decade, the benchmark revision for total nonfarm employment has averaged 0.3 percent, ranging from zero to 0.7 percent.

Additional statistics and other information

More comprehensive statistics are contained in *Employment and Earnings*, published each month by BLS. It is available for $26.00 per issue or $50.00 per year from the U.S. Government Printing Office, Washington, DC 20402. All orders must be prepaid by sending a check or money order payable to the Superintendent of Documents, or by charging to Mastercard or Visa.

Employment and Earnings also provides measures of sampling error for the household survey data published in this release. For unemployment and other labor force categories, these measures appear in tables 1-B through 1-D of its "Explanatory Notes." Measures of the reliability of the data drawn from the establishment survey and the actual amounts of revision due to benchmark adjustments are provided in tables 2-B through 2-H of that publication.

Information in this release will be made available to sensory impaired individuals upon request. Voice phone: 202-691-5200; TDD message referral phone: 1-800-877-8339.

 HOUSEHOLD DATA

Table A-1. Employment status of the civilian population by sex and age

(Numbers in thousands)

Employment status, sex, and age	Not seasonally adjusted			Seasonally adjusted[1]					
	Oct. 2000	Sept. 2001	Oct. 2001	Oct. 2000	June 2001	July 2001	Aug. 2001	Sept. 2001	Oct. 2001
TOTAL									
Civilian noninstitutional population	210,378	212,357	212,581	210,378	211,725	211,921	212,135	212,357	212,581
Civilian labor force	140,893	141,578	142,004	141,000	141,354	141,774	141,350	142,190	142,303
Participation rate	67.0	66.7	66.8	67.0	66.8	66.9	66.6	67.0	66.9
Employed	135,771	134,868	134,896	135,464	134,932	135,379	134,393	135,181	134,562
Employment-population ratio	64.5	63.5	63.5	64.4	63.7	63.9	63.4	63.7	63.3
Agriculture	3,277	3,371	3,265	3,241	2,995	3,045	3,117	3,220	3,200
Nonagricultural industries	132,494	131,497	131,633	132,223	131,937	132,334	131,276	131,961	131,362
Unemployed	5,122	6,708	7,108	5,536	6,422	6,395	6,957	7,009	7,741
Unemployment rate	3.6	4.7	5.0	3.9	4.5	4.5	4.9	4.9	5.4
Not in labor force	69,485	70,781	70,577	69,378	70,370	70,147	70,785	70,167	70,279
Persons who currently want a job	4,051	4,348	4,338	4,377	4,600	4,529	4,858	4,539	4,700
Men, 16 years and over									
Civilian noninstitutional population	101,075	102,110	102,229	101,075	101,786	101,885	101,995	102,110	102,229
Civilian labor force	75,231	75,689	75,811	75,371	75,462	75,719	75,518	76,058	76,051
Participation rate	74.4	74.1	74.2	74.6	74.1	74.3	74.0	74.5	74.4
Employed	72,552	72,284	72,017	72,427	71,926	72,279	71,690	72,333	71,871
Employment-population ratio	71.8	70.8	70.4	71.7	70.7	70.9	70.3	70.8	70.3
Unemployed	2,679	3,405	3,794	2,944	3,535	3,439	3,828	3,724	4,179
Unemployment rate	3.6	4.5	5.0	3.9	4.7	4.5	5.1	4.9	5.5
Men, 20 years and over									
Civilian noninstitutional population	92,969	93,917	94,015	92,969	93,616	93,706	93,810	93,917	94,015
Civilian labor force	71,185	71,750	71,901	71,155	71,346	71,555	71,514	71,894	71,953
Participation rate	76.6	76.4	76.5	76.5	76.2	76.4	76.2	76.6	76.5
Employed	69,011	68,952	68,748	68,774	68,466	68,745	68,402	68,826	68,481
Employment-population ratio	74.2	73.4	73.1	74.0	73.1	73.4	72.9	73.3	72.8
Agriculture	2,264	2,301	2,184	2,219	2,035	2,028	2,140	2,175	2,117
Nonagricultural industries	66,747	66,651	66,564	66,555	66,430	66,717	66,262	66,651	66,365
Unemployed	2,175	2,799	3,152	2,381	2,880	2,810	3,112	3,069	3,472
Unemployment rate	3.1	3.9	4.4	3.3	4.0	3.9	4.4	4.3	4.8
Women, 16 years and over									
Civilian noninstitutional population	109,303	110,247	110,353	109,303	109,939	110,035	110,140	110,247	110,353
Civilian labor force	65,662	65,887	66,194	65,629	65,893	66,055	65,833	66,132	66,252
Participation rate	60.1	59.8	60.0	60.0	59.9	60.0	59.8	60.0	60.0
Employed	63,219	62,584	62,881	63,037	63,006	63,100	62,703	62,848	62,691
Employment-population ratio	57.8	56.8	57.0	57.7	57.3	57.3	56.9	57.0	56.8
Unemployed	2,443	3,303	3,312	2,592	2,887	2,956	3,130	3,284	3,562
Unemployment rate	3.7	5.0	5.0	3.9	4.4	4.5	4.8	5.0	5.4
Women, 20 years and over									
Civilian noninstitutional population	101,448	102,277	102,371	101,448	102,023	102,067	102,165	102,277	102,371
Civilian labor force	61,747	62,230	62,358	61,528	61,890	62,145	62,172	62,242	62,252
Participation rate	60.9	60.8	60.9	60.6	60.7	60.9	60.9	60.9	60.8
Employed	59,788	59,446	59,587	59,425	59,510	59,752	59,562	59,489	59,237
Employment-population ratio	58.9	58.1	58.2	58.8	58.3	58.5	58.3	58.2	57.9
Agriculture	753	842	853	748	752	773	766	826	853
Nonagricultural industries	59,035	58,604	58,734	58,677	58,759	58,978	58,796	58,663	58,384
Unemployed	1,959	2,784	2,771	2,103	2,380	2,394	2,610	2,754	3,016
Unemployment rate	3.2	4.5	4.4	3.4	3.8	3.9	4.2	4.4	4.8
Both sexes, 16 to 19 years									
Civilian noninstitutional population	15,960	16,163	16,195	15,960	16,086	16,145	16,161	16,163	16,195
Civilian labor force	7,960	7,595	7,745	8,317	8,118	8,074	7,684	8,054	8,097
Participation rate	49.9	47.0	47.8	52.1	50.5	50.0	47.4	49.8	50.0
Employed	6,972	6,469	6,583	7,265	6,956	6,883	6,429	6,867	6,844
Employment-population ratio	43.7	40.0	40.5	45.5	43.2	42.6	39.8	42.5	42.3
Agriculture	260	228	227	274	209	244	211	219	231
Nonagricultural industries	6,712	6,242	6,335	6,991	6,748	6,638	6,218	6,648	6,613
Unemployed	988	1,126	1,162	1,052	1,162	1,191	1,236	1,187	1,253
Unemployment rate	12.4	14.8	15.3	12.6	14.3	14.8	16.1	14.7	15.5

[1] The population figures are not adjusted for seasonal variation; therefore, identical numbers appear in the unadjusted and seasonally adjusted columns.

HOUSEHOLD DATA

Table A-2. Employment status of the civilian population by race, sex, age, and Hispanic origin

(Numbers in thousands)

Employment status, race, sex, age, and Hispanic origin	Not seasonally adjusted			Seasonally adjusted[1]					
	Oct. 2000	Sept. 2001	Oct. 2001	Oct. 2000	June 2001	July 2001	Aug. 2001	Sept. 2001	Oct. 2001
WHITE									
Civilian noninstitutional population	174,899	176,220	176,372	174,899	175,789	175,924	176,069	176,220	176,372
Civilian labor force	117,477	117,853	118,251	117,603	117,733	117,982	117,726	118,290	118,597
Participation rate	67.2	66.9	67.0	67.2	67.0	67.1	66.9	67.1	67.2
Employed	113,807	113,013	113,104	113,584	113,037	113,237	112,703	113,201	112,900
Employment-population ratio	65.1	64.1	64.1	64.9	64.3	64.4	64.0	64.2	64.0
Unemployed	3,669	4,840	5,147	4,019	4,696	4,745	5,024	5,089	5,696
Unemployment rate	3.1	4.1	4.4	3.4	4.0	4.0	4.3	4.3	4.8
Men, 20 years and over									
Civilian labor force	60,258	60,672	60,875	60,286	60,389	60,432	60,575	60,784	61,031
Participation rate	76.9	76.8	76.9	76.9	76.6	76.6	76.7	76.9	77.1
Employed	58,724	58,610	58,495	58,557	58,244	58,362	58,297	58,493	58,320
Employment-population ratio	74.9	74.2	73.9	74.7	73.9	74.0	73.8	74.0	73.7
Unemployed	1,535	2,063	2,380	1,729	2,145	2,069	2,278	2,292	2,711
Unemployment rate	2.5	3.4	3.9	2.9	3.6	3.4	3.8	3.8	4.4
Women, 20 years and over									
Civilian labor force	50,461	50,713	50,839	50,281	50,431	50,684	50,656	50,651	50,759
Participation rate	60.2	60.1	60.2	60.0	59.9	60.2	60.1	60.0	60.1
Employed	49,057	48,773	48,911	48,777	48,749	48,925	48,839	48,724	48,668
Employment-population ratio	58.5	57.8	57.9	58.2	57.9	58.1	57.9	57.8	57.6
Unemployed	1,405	1,941	1,928	1,504	1,682	1,759	1,817	1,927	2,091
Unemployment rate	2.8	3.8	3.8	3.0	3.3	3.5	3.6	3.8	4.1
Both sexes, 16 to 19 years									
Civilian labor force	6,757	6,468	6,537	7,036	6,913	6,868	6,495	6,855	6,807
Participation rate	53.2	50.4	50.9	55.4	54.0	53.6	50.7	53.5	53.0
Employed	6,027	5,630	5,698	6,250	6,044	5,950	5,567	5,984	5,912
Employment-population ratio	47.5	43.9	44.4	49.2	47.2	46.5	43.4	46.7	46.1
Unemployed	730	837	839	786	869	916	928	870	895
Unemployment rate	10.8	12.9	12.8	11.2	12.6	13.3	14.3	12.7	13.1
Men	10.9	13.3	13.9	11.8	14.5	13.7	15.8	13.5	14.8
Women	10.7	12.5	11.8	10.5	10.6	13.0	12.7	11.9	11.5
BLACK									
Civilian noninstitutional population	25,339	25,644	25,686	25,339	25,533	25,565	25,604	25,644	25,686
Civilian labor force	16,634	16,719	16,733	16,627	16,756	16,693	16,712	16,792	16,735
Participation rate	65.6	65.2	65.1	65.6	65.6	65.3	65.3	65.5	65.2
Employed	15,469	15,269	15,202	15,401	15,343	15,374	15,195	15,327	15,104
Employment-population ratio	61.0	59.5	59.2	60.8	60.1	60.1	59.3	59.8	58.8
Unemployed	1,165	1,450	1,531	1,226	1,413	1,320	1,517	1,466	1,631
Unemployment rate	7.0	8.7	9.1	7.4	8.4	7.9	9.1	8.7	9.7
Men, 20 years and over									
Civilian labor force	7,443	7,436	7,393	7,383	7,317	7,395	7,424	7,468	7,319
Participation rate	73.2	72.3	71.7	72.8	71.5	72.1	72.3	72.6	71.0
Employed	6,945	6,897	6,817	6,868	6,744	6,808	6,752	6,904	6,730
Employment-population ratio	68.3	67.1	68.2	67.5	65.9	66.4	65.8	67.1	65.3
Unemployed	498	538	576	515	573	586	672	564	589
Unemployment rate	6.7	7.2	7.8	7.0	7.8	7.9	9.0	7.6	8.0
Women, 20 years and over									
Civilian labor force	8,272	8,433	8,441	8,262	8,491	8,409	8,424	8,424	8,461
Participation rate	65.1	65.5	65.5	65.0	66.3	65.5	65.6	65.4	65.6
Employed	7,822	7,764	7,752	7,786	7,917	7,903	7,842	7,772	7,706
Employment-population ratio	61.5	60.3	60.1	61.3	61.8	61.6	61.0	60.4	59.8
Unemployed	450	669	689	476	573	506	582	652	755
Unemployment rate	5.4	7.9	8.2	5.8	6.8	6.0	6.9	7.7	8.9
Both sexes, 16 to 19 years									
Civilian labor force	919	851	896	982	948	890	864	901	955
Participation rate	37.4	34.2	36.1	39.9	38.2	35.8	34.8	36.2	38.4
Employed	702	608	632	747	681	663	601	651	668
Employment-population ratio	28.5	24.4	25.4	30.4	27.5	26.7	24.2	26.2	26.8
Unemployed	217	243	266	235	267	227	263	250	287
Unemployment rate	23.6	28.5	29.7	23.9	28.2	25.5	30.4	27.7	30.1
Men	25.3	29.8	30.0	27.0	30.7	28.9	32.5	30.5	31.2
Women	22.3	27.1	29.4	21.2	26.0	24.3	28.1	24.8	29.0

See footnotes at end of table.

Table A-2. Employment status of the civilian population by race, sex, age, and Hispanic origin — Continued

(Numbers in thousands)

Employment status, race, sex, age, and Hispanic origin	Not seasonally adjusted			Seasonally adjusted[1]					
	Oct. 2000	Sept. 2001	Oct. 2001	Oct. 2000	June 2001	July 2001	Aug. 2001	Sept. 2001	Oct. 2001
HISPANIC ORIGIN									
Civilian noninstitutional population	22,618	23,288	23,351	22,618	23,090	23,157	23,222	23,288	23,351
Civilian labor force	15,503	15,815	16,007	15,491	15,570	15,788	15,772	15,813	16,004
Participation rate	68.5	67.9	68.5	68.5	67.4	68.2	67.9	67.9	68.5
Employed	14,743	14,817	14,903	14,711	14,538	14,843	14,778	14,802	14,858
Employment-population ratio	65.2	63.6	63.8	65.0	63.0	64.1	63.6	63.6	63.6
Unemployed	760	998	1,104	780	1,032	945	994	1,010	1,146
Unemployment rate	4.9	6.3	6.9	5.0	6.6	6.0	6.3	6.4	7.2

[1] The population figures are not adjusted for seasonal variation; therefore, identical numbers appear in the unadjusted and seasonally adjusted columns.

NOTE: Detail for the above race and Hispanic-origin groups will not sum to totals because data for the "other races" group are not presented and Hispanics are included in both the white and black population groups.

Table A-3. Employment status of the civilian population 25 years and over by educational attainment

(Numbers in thousands)

Educational attainment	Not seasonally adjusted			Seasonally adjusted[1]					
	Oct. 2000	Sept. 2001	Oct. 2001	Oct. 2000	June 2001	July 2001	Aug. 2001	Sept. 2001	Oct. 2001
Less than a high school diploma									
Civilian noninstitutional population	27,931	27,478	27,325	27,931	28,504	27,679	27,468	27,478	27,325
Civilian labor force	12,162	12,126	12,037	12,192	12,170	12,188	11,799	11,859	12,073
Percent of population	43.5	44.1	44.1	43.7	42.7	44.0	43.0	43.2	44.2
Employed	11,437	11,271	11,183	11,408	11,338	11,380	10,943	10,932	11,139
Employment-population ratio	40.9	41.0	40.9	40.8	39.8	41.1	39.8	39.8	40.8
Unemployed	724	855	854	784	831	808	856	927	934
Unemployment rate	6.0	7.1	7.1	6.4	6.8	6.6	7.3	7.8	7.7
High school graduates, no college[2]									
Civilian noninstitutional population	57,365	57,400	57,221	57,365	57,099	56,947	57,513	57,400	57,221
Civilian labor force	36,979	36,712	36,782	36,985	36,821	36,970	37,096	36,873	36,855
Percent of population	64.5	64.0	64.3	64.5	64.5	64.9	64.5	64.2	64.4
Employed	35,783	35,232	35,206	35,707	35,391	35,468	35,460	35,303	35,137
Employment-population ratio	62.4	61.4	61.5	62.2	62.0	62.3	61.7	61.5	61.4
Unemployed	1,196	1,479	1,575	1,278	1,431	1,502	1,636	1,571	1,717
Unemployment rate	3.2	4.0	4.3	3.5	3.9	4.1	4.4	4.3	4.7
Less than a bachelor's degree[3]									
Civilian noninstitutional population	44,767	45,424	45,471	44,767	44,812	45,444	45,339	45,424	45,471
Civilian labor force	33,179	33,585	33,583	32,896	33,314	33,296	33,481	33,880	33,331
Percent of population	74.1	73.9	73.9	73.5	74.3	73.3	73.8	74.6	73.3
Employed	32,423	32,467	32,295	32,103	32,263	32,301	32,407	32,696	31,975
Employment-population ratio	72.4	71.5	71.0	71.7	72.0	71.1	71.5	72.0	70.3
Unemployed	755	1,117	1,288	793	1,051	994	1,075	1,184	1,356
Unemployment rate	2.3	3.3	3.8	2.4	3.2	3.0	3.2	3.5	4.1
College graduates									
Civilian noninstitutional population	45,785	46,870	47,371	45,785	46,348	46,784	46,734	46,870	47,371
Civilian labor force	36,161	36,998	37,354	36,022	36,592	36,634	36,649	36,896	37,281
Percent of population	79.0	78.9	78.9	78.7	78.9	78.3	78.4	78.7	78.7
Employed	35,612	36,072	36,404	35,431	35,796	35,859	35,870	36,000	36,259
Employment-population ratio	77.8	77.0	76.8	77.4	77.2	76.6	76.8	76.8	76.5
Unemployed	550	926	950	591	796	775	779	896	1,023
Unemployment rate	1.5	2.5	2.5	1.6	2.2	2.1	2.1	2.4	2.7

[1] The population figures are not adjusted for seasonal variation, therefore, identical numbers appear in the unadjusted and seasonally adjusted columns.

[2] Includes high school diploma or equivalent.

[3] Includes the categories, some college, no degree; and associate degree.

HOUSEHOLD DATA

Table A-4. Selected employment indicators

(In thousands)

Category	Not seasonally adjusted			Seasonally adjusted					
	Oct. 2000	Sept. 2001	Oct. 2001	Oct. 2000	June 2001	July 2001	Aug. 2001	Sept. 2001	Oct. 2001
CHARACTERISTIC									
Total employed, 16 years and over	135,771	134,868	134,898	135,464	134,932	135,379	134,393	135,181	134,562
Married men, spouse present	43,710	43,436	43,319	43,345	43,428	43,294	43,172	43,091	42,932
Married women, spouse present	34,008	33,597	33,492	33,622	33,380	33,603	33,805	33,664	33,160
Women who maintain families	8,475	8,381	8,264	8,449	8,529	8,567	8,323	8,240	8,215
OCCUPATION									
Managerial and professional specialty	40,977	41,899	42,148	40,745	41,987	41,917	41,750	41,775	41,974
Technical, sales, and administrative support	39,440	38,645	38,489	39,521	38,998	39,067	38,664	39,114	38,566
Service occupations	18,229	18,210	18,071	18,555	18,576	18,642	18,052	18,357	18,421
Precision production, craft, and repair	15,083	14,866	14,914	15,050	14,794	14,997	15,050	14,941	14,840
Operators, fabricators, and laborers	18,663	17,730	17,951	18,305	17,564	17,571	17,655	17,679	17,583
Farming, forestry, and fishing	3,378	3,517	3,326	3,318	3,136	3,166	3,154	3,306	3,251
CLASS OF WORKER									
Agriculture:									
Wage and salary workers	2,063	2,003	1,945	2,041	1,775	1,786	1,850	1,884	1,909
Self-employed workers	1,179	1,342	1,292	1,182	1,166	1,256	1,239	1,290	1,299
Unpaid family workers	35	26	27	32	36	22	29	23	25
Nonagricultural industries:									
Wage and salary workers	123,690	122,744	122,943	123,461	123,009	123,432	122,686	123,278	122,658
Government	19,009	19,222	19,235	19,073	18,812	18,919	19,219	19,397	19,274
Private industries	104,682	103,522	103,706	104,388	104,197	104,513	103,467	103,881	103,384
Private households	787	768	848	812	744	790	827	809	875
Other industries	103,895	102,754	102,860	103,576	103,453	103,723	102,640	103,072	102,509
Self-employed workers	8,678	8,657	8,598	8,561	8,741	8,574	8,481	8,563	8,487
Unpaid family workers	126	95	93	136	94	88	113	102	105
PERSONS AT WORK PART TIME									
All industries:									
Part time for economic reasons	2,851	3,765	3,954	3,222	3,637	3,466	3,326	4,188	4,482
Slack work or business conditions	1,708	2,561	2,706	1,909	2,299	2,120	2,086	2,861	3,023
Could only find part-time work	873	1,005	1,032	947	1,025	999	935	1,081	1,134
Part time for noneconomic reasons	19,583	18,994	19,451	18,758	18,472	18,845	19,153	18,825	18,595
Nonagricultural industries:									
Part time for economic reasons	2,704	3,648	3,825	3,044	3,532	3,336	3,196	4,045	4,342
Slack work or business conditions	1,609	2,480	2,623	1,808	2,234	2,059	2,004	2,759	2,953
Could only find part-time work	856	988	1,017	923	1,024	985	911	1,070	1,108
Part time for noneconomic reasons	19,030	18,406	18,878	18,206	18,039	18,309	18,580	18,278	18,031

NOTE: Persons at work excludes employed persons who were absent from their jobs during the entire reference week for reasons such as vacation, illness, or industrial dispute. Part time for noneconomic reasons excludes persons who usually work full time but worked only 1 to 34 hours during the reference week for reasons such as holidays, illness, and bad weather.

Table A-5. Selected unemployment indicators, seasonally adjusted

Category	Number of unemployed persons (in thousands)			Unemployment rates[1]					
	Oct. 2000	Sept. 2001	Oct. 2001	Oct. 2000	June 2001	July 2001	Aug. 2001	Sept. 2001	Oct. 2001
CHARACTERISTIC									
Total, 16 years and over	5,536	7,009	7,741	3.9	4.5	4.5	4.9	4.9	5.4
Men, 20 years and over	2,381	3,069	3,472	3.3	4.0	3.9	4.4	4.3	4.8
Women, 20 years and over	2,103	2,754	3,016	3.4	3.8	3.9	4.2	4.4	4.8
Both sexes, 16 to 19 years	1,052	1,187	1,253	12.6	14.3	14.8	16.1	14.7	15.5
Married men, spouse present	913	1,197	1,384	2.1	2.6	2.6	2.7	2.7	3.1
Married women, spouse present	862	1,165	1,275	2.5	3.0	2.8	3.0	3.3	3.7
Women who maintain families	482	623	607	5.4	6.3	6.2	6.7	7.0	6.9
Full-time workers	4,456	5,908	6,353	3.8	4.4	4.4	4.8	5.0	5.4
Part-time workers	1,087	1,107	1,393	4.5	5.3	5.1	5.6	4.5	5.6
OCCUPATION[2]									
Managerial and professional specialty	725	1,032	1,183	1.7	2.0	2.2	2.5	2.4	2.7
Technical, sales, and administrative support	1,471	1,762	1,909	3.6	4.0	4.0	4.3	4.3	4.7
Precision production, craft, and repair	532	758	928	3.4	4.5	4.2	4.8	4.8	5.9
Operators, fabricators, and laborers	1,250	1,430	1,685	6.4	7.9	7.2	7.7	7.5	8.7
Farming, forestry, and fishing	238	252	210	6.7	6.2	7.5	8.7	7.1	6.1
INDUSTRY									
Nonagricultural private wage and salary workers	4,401	5,707	6,494	4.0	4.8	4.7	5.1	5.2	5.9
Goods-producing industries	1,353	1,725	1,928	4.7	5.5	5.6	6.2	6.2	6.9
Mining	37	27	39	7.1	6.8	3.7	4.3	4.8	7.0
Construction	517	642	702	6.5	6.7	6.8	7.5	7.6	8.4
Manufacturing	799	1,056	1,186	4.0	5.0	5.1	5.7	5.6	6.2
Durable goods	461	659	813	3.8	5.0	4.7	5.8	5.6	6.9
Nondurable goods	338	397	373	4.3	4.9	5.7	5.5	5.4	5.2
Service-producing industries	3,048	3,982	4,566	3.8	4.5	4.4	4.8	4.9	5.6
Transportation and public utilities	220	311	491	2.8	4.4	3.3	3.5	3.9	6.0
Wholesale and retail trade	1,326	1,643	1,673	4.8	5.3	5.2	5.6	5.9	6.1
Finance, insurance, and real estate	185	228	221	2.3	2.6	3.2	2.7	2.8	2.7
Services	1,317	1,800	2,181	3.6	4.4	4.3	4.9	4.8	5.7
Government workers	399	423	468	2.0	2.0	2.1	2.1	2.1	2.4
Agricultural wage and salary workers	197	143	186	8.8	9.6	10.9	10.2	7.1	8.9

[1] Unemployment as a percent of the civilian labor force.
[2] Seasonally adjusted unemployment data for service occupations are not available because the seasonal component, which is small relative to the trend-cycle and irregular components, cannot be separated with sufficient precision.

Table A-6. Duration of unemployment

(Numbers in thousands)

Duration	Not seasonally adjusted			Seasonally adjusted					
	Oct. 2000	Sept. 2001	Oct. 2001	Oct. 2000	June 2001	July 2001	Aug. 2001	Sept. 2001	Oct. 2001
NUMBER OF UNEMPLOYED									
Less than 5 weeks	2,330	2,792	2,896	2,510	2,809	2,612	3,004	2,764	3,165
5 to 14 weeks	1,548	2,127	2,267	1,755	2,084	2,150	2,100	2,361	2,570
15 weeks and over	1,244	1,790	1,943	1,311	1,540	1,587	1,817	1,884	2,062
15 to 26 weeks	647	1,002	1,081	702	804	935	982	1,089	1,174
27 weeks and over	597	787	862	609	737	652	835	795	888
Average (mean) duration, in weeks	13.0	13.1	13.5	12.4	13.0	12.5	13.3	13.1	13.0
Median duration, in weeks	6.0	7.2	7.3	6.1	6.2	6.7	6.5	7.4	7.4
PERCENT DISTRIBUTION									
Total unemployed	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Less than 5 weeks	45.5	41.6	40.8	45.0	43.7	41.1	43.4	39.4	40.6
5 to 14 weeks	30.2	31.7	31.9	31.5	32.4	33.9	30.3	33.7	33.0
15 weeks and over	24.3	26.7	27.3	23.5	23.9	25.0	26.3	26.9	26.4
15 to 26 weeks	12.6	14.9	15.2	12.6	12.5	14.7	14.2	15.5	15.1
27 weeks and over	11.6	11.7	12.1	10.9	11.4	10.3	12.1	11.3	11.4

Table A-7. Reason for unemployment

(Numbers in thousands)

Reason	Not seasonally adjusted			Seasonally adjusted					
	Oct. 2000	Sept. 2001	Oct. 2001	Oct. 2000	June 2001	July 2001	Aug. 2001	Sept. 2001	Oct. 2001
NUMBER OF UNEMPLOYED									
Job losers and persons who completed temporary jobs	2,076	3,243	3,701	2,446	3,291	3,252	3,409	3,600	4,360
On temporary layoff	531	786	864	825	940	1,003	1,079	1,118	1,360
Not on temporary layoff	1,544	2,457	2,838	1,621	2,351	2,249	2,330	2,482	3,000
Permanent job losers	1,066	1,795	2,062	(1)	(1)	(1)	(1)	(1)	(1)
Persons who completed temporary jobs	479	663	775	(1)	(1)	(1)	(1)	(1)	(1)
Job leavers	846	893	923	815	810	774	894	800	893
Reentrants	1,838	2,137	2,051	1,868	1,906	1,912	2,166	2,108	2,098
New entrants	363	434	430	398	477	436	495	476	462
PERCENT DISTRIBUTION									
Total unemployed	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Job losers and persons who completed temporary jobs	40.5	48.4	52.1	44.3	50.8	51.0	49.0	51.5	55.8
On temporary layoff	10.4	11.7	12.2	14.9	14.5	15.7	15.5	16.0	17.4
Not on temporary layoff	30.1	36.6	39.9	29.3	36.3	35.3	33.5	35.5	38.4
Job leavers	16.5	13.3	13.0	14.7	12.5	12.1	12.8	11.5	11.4
Reentrants	35.9	31.9	28.9	33.8	29.4	30.0	31.1	30.2	26.8
New entrants	7.1	6.5	6.1	7.2	7.4	6.8	7.1	6.8	5.9
UNEMPLOYED AS A PERCENT OF THE CIVILIAN LABOR FORCE									
Job losers and persons who completed temporary jobs	1.5	2.3	2.6	1.7	2.3	2.3	2.4	2.5	3.1
Job leavers	.6	.6	.6	.6	.6	.5	.6	.6	.6
Reentrants	1.3	1.5	1.4	1.3	1.3	1.3	1.5	1.5	1.5
New entrants	.3	.3	.3	.3	.3	.3	.4	.3	.3

[1] Not available.

Table A-8. Range of alternative measures of labor underutilization

(Percent)

Measure	Not seasonally adjusted			Seasonally adjusted					
	Oct. 2000	Sept. 2001	Oct. 2001	Oct. 2000	June 2001	July 2001	Aug. 2001	Sept. 2001	Oct. 2001
U-1 Persons unemployed 15 weeks or longer, as a percent of the civilian labor force	.9	1.3	1.4	.9	1.1	1.1	1.3	1.3	1.4
U-2 Job losers and persons who completed temporary jobs, as a percent of the civilian labor force	1.5	2.3	2.6	1.7	2.3	2.3	2.4	2.5	3.1
U-3 Total unemployed, as a percent of the civilian labor force (official unemployment rate)	3.6	4.7	5.0	3.9	4.5	4.5	4.9	4.9	5.4
U-4 Total unemployed plus discouraged workers, as a percent of the civilian labor force plus discouraged workers	3.8	4.9	5.2	(1)	(1)	(1)	(1)	(1)	(1)
U-5 Total unemployed, plus discouraged workers, plus all other marginally attached workers, as a percent of the civilian labor force plus all marginally attached workers	4.3	5.6	5.9	(1)	(1)	(1)	(1)	(1)	(1)
U-6 Total unemployed, plus all marginally attached workers, plus total employed part time for economic reasons, as a percent of the civilian labor force plus all marginally attached workers	6.3	8.3	8.7	(1)	(1)	(1)	(1)	(1)	(1)

[1] Not available.

NOTE: This range of alternative measures of labor underutilization replaces the U1-U7 range published in table A-7 of this release prior to 1994. Marginally attached workers are persons who currently are neither working nor looking for work but indicate that they want and are available for a job and have looked for work sometime in the recent past. Discouraged workers, a subset of the marginally attached, have given a job-market related reason for not currently looking for a job. Persons employed part time for economic reasons are those who want and are available for full-time work but have had to settle for a part-time schedule. For further information, see "BLS introduces new range of alternative unemployment measures," in the October 1995 issue of the *Monthly Labor Review*.

Table A-9. Unemployed persons by sex and age, seasonally adjusted

Age and sex	Number of unemployed persons (in thousands)			Unemployment rates[1]					
	Oct. 2000	Sept. 2001	Oct. 2001	Oct. 2000	June 2001	July 2001	Aug. 2001	Sept. 2001	Oct. 2001
Total, 16 years and over	5,536	7,009	7,741	3.9	4.5	4.5	4.9	4.9	5.4
16 to 24 years	2,044	2,448	2,639	8.9	10.4	10.1	11.5	10.7	11.6
16 to 19 years	1,052	1,187	1,253	12.6	14.3	14.8	16.1	14.7	15.5
16 to 17 years	488	498	538	15.2	16.0	19.3	19.1	16.2	17.2
18 to 19 years	570	694	715	11.1	13.1	11.8	14.7	13.9	14.4
20 to 24 years	992	1,262	1,385	6.8	8.2	7.5	9.0	8.5	9.5
25 years and over	3,481	4,558	5,086	2.9	3.5	3.4	3.7	3.8	4.3
25 to 54 years	2,979	3,933	4,400	3.0	3.6	3.6	3.9	3.9	4.4
55 years and over	510	628	677	2.8	2.8	2.8	3.0	3.3	3.5
Men, 16 years and over	2,944	3,724	4,179	3.9	4.7	4.5	5.1	4.9	5.5
16 to 24 years	1,122	1,353	1,458	9.4	11.8	10.4	12.4	11.3	12.4
16 to 19 years	563	656	707	13.4	15.9	15.1	17.9	15.8	17.3
16 to 17 years	286	288	322	17.6	18.0	19.0	22.7	18.3	20.4
18 to 19 years	277	370	383	10.7	14.5	13.0	15.4	14.3	15.2
20 to 24 years	559	697	750	7.3	9.5	7.9	9.5	8.9	9.8
25 years and over	1,814	2,373	2,714	2.9	3.4	3.5	3.7	3.7	4.2
25 to 54 years	1,538	2,047	2,335	2.9	3.5	3.6	3.9	3.8	4.3
55 years and over	280	343	391	2.8	3.0	3.0	3.3	3.3	3.7
Women, 16 years and over	2,592	3,284	3,562	3.9	4.4	4.5	4.8	5.0	5.4
16 to 24 years	922	1,096	1,181	8.4	8.9	9.7	10.4	10.1	10.8
16 to 19 years	489	531	546	11.9	12.7	14.4	14.2	13.6	13.6
16 to 17 years	202	209	216	12.8	14.0	19.6	15.5	13.9	14.0
18 to 19 years	293	324	331	11.6	11.6	10.6	13.9	13.5	13.5
20 to 24 years	433	565	635	6.3	6.7	7.1	8.4	8.2	9.1
25 years and over	1,667	2,185	2,372	3.0	3.5	3.4	3.7	3.9	4.3
25 to 54 years	1,441	1,886	2,065	3.1	3.8	3.6	3.8	4.0	4.4
55 years and over	230	285	287	2.8	2.5	2.5	2.7	3.3	3.3

[1] Unemployment as a percent of the civilian labor force.

Table A-10. Persons not in the labor force and multiple jobholders by sex, not seasonally adjusted

(Numbers in thousands)

Category	Total		Men		Women	
	Oct. 2000	Oct. 2001	Oct. 2000	Oct. 2001	Oct. 2000	Oct. 2001
NOT IN THE LABOR FORCE						
Total not in the labor force	69,485	70,577	25,844	26,418	43,640	44,159
Persons who currently want a job	4,051	4,338	1,618	1,867	2,433	2,471
Searched for work and available to work now[1]	1,036	1,395	423	647	613	748
Reason not currently looking:						
Discouragement over job prospects[2]	230	330	112	172	118	157
Reasons other than discouragement[3]	806	1,065	311	475	495	591
MULTIPLE JOBHOLDERS						
Total multiple jobholders[4]	7,550	7,112	3,956	3,697	3,594	3,415
Percent of total employed	5.6	5.3	5.5	5.1	5.7	5.4
Primary job full time, secondary job part time	4,183	3,710	2,387	2,135	1,798	1,575
Primary and secondary jobs both part time	1,596	1,646	536	569	1,060	1,078
Primary and secondary jobs both full time	292	235	209	145	84	90
Hours vary on primary or secondary job	1,420	1,483	790	829	629	655

[1] Data refer to persons who have searched for work during the prior 12 months and were available to take a job during the reference week.

[2] Includes thinks no work available, could not find work, lacks schooling or training, employer thinks too young or old, and other types of discrimination.

[3] Includes those who did not actively look for work in the prior 4 weeks for such reasons as child-care and transportation problems, as well as a small number for which reason for nonparticipation was not determined.

[4] Includes persons who work part time on their primary job and full time on their secondary job(s), not shown separately.

ESTABLISHMENT DATA

Table B-1. Employees on nonfarm payrolls by industry

(In thousands)

Industry	Not seasonally adjusted				Seasonally adjusted					
	Oct. 2000	Aug. 2001	Sept. 2001p	Oct. 2001p	Oct. 2000	June 2001	July 2001	Aug. 2001	Sept. 2001p	Oct. 2001p
Total	132,978	132,207	132,522	132,606	132,145	132,431	132,449	132,395	132,182	131,767
Total private	112,104	112,422	111,734	111,283	111,564	111,603	111,517	111,390	111,179	110,740
Goods-producing	25,989	25,422	25,197	24,973	25,713	25,186	25,122	24,963	24,873	24,699
Mining	559	578	575	574	551	565	567	569	568	566
Metal mining	40.1	35.3	35.2	34.6	40	35	34	35	35	35
Coal mining	76.0	79.3	79.8	81.2	76	78	79	80	80	81
Oil and gas extraction	324.1	346.7	344.4	341.9	320	340	341	342	342	338
Nonmetallic minerals, except fuels	118.8	116.9	115.7	116.1	115	112	113	112	111	112
Construction	6,978	7,199	7,104	7,052	6,758	6,864	6,867	6,861	6,862	6,832
General building contractors	1,576.3	1,623.7	1,598.9	1,587.2	1,549	1,551	1,554	1,557	1,565	1,559
Heavy construction, except building	972.2	1,008.5	1,004.7	996.4	904	925	935	932	933	927
Special trade contractors	4,429.4	4,566.8	4,500.8	4,468.6	4,305	4,388	4,378	4,372	4,364	4,346
Manufacturing	18,452	17,645	17,518	17,347	18,404	17,757	17,688	17,533	17,443	17,301
Production workers	12,589	11,870	11,791	11,657	12,545	11,956	11,900	11,782	11,705	11,616
Durable goods	11,138	10,560	10,474	10,360	11,126	10,692	10,624	10,523	10,457	10,349
Production workers	7,571	7,047	6,993	6,904	7,560	7,157	7,102	7,022	6,972	6,895
Lumber and wood products	828.7	809.0	805.0	797.5	821	798	797	793	794	790
Furniture and fixtures	560.9	520.6	514.2	504.7	559	532	531	519	513	503
Stone, clay, and glass products	583.3	577.7	574.2	571.0	577	572	569	568	566	565
Primary metal industries	695.2	644.5	638.8	632.0	695	654	648	643	639	632
Blast furnaces and basic steel products	221.7	208.4	207.1	206.8	(1)	(1)	(1)	(1)	(1)	(1)
Fabricated metal products	1,540.5	1,472.6	1,464.9	1,452.2	1,536	1,478	1,478	1,468	1,461	1,448
Industrial machinery and equipment	2,114.9	1,978.3	1,955.8	1,932.9	2,123	2,031	2,007	1,980	1,961	1,940
Computer and office equipment	364.8	350.1	342.8	341.4	365	357	353	348	342	342
Electronic and other electrical equipment	1,739.3	1,566.9	1,548.4	1,527.3	1,738	1,624	1,589	1,565	1,548	1,526
Electronic components and accessories	703.9	620.1	609.8	600.3	704	650	634	618	610	600
Transportation equipment	1,816.7	1,747.3	1,737.4	1,711.1	1,822	1,749	1,752	1,750	1,743	1,717
Motor vehicles and equipment	993.3	930.7	922.9	901.1	995	931	936	931	924	903
Aircraft and parts	463.3	464.9	465.8	462.6	463	465	466	465	466	463
Instruments and related products	860.6	861.4	852.2	846.7	861	865	865	858	852	847
Miscellaneous manufacturing	398.2	382.1	383.3	384.9	394	389	388	379	380	381
Nondurable goods	7,314	7,085	7,044	6,987	7,278	7,065	7,064	7,010	6,986	6,952
Production workers	5,018	4,823	4,798	4,753	4,985	4,799	4,798	4,760	4,733	4,721
Food and kindred products	1,702.4	1,731.4	1,727.2	1,709.0	1,678	1,685	1,680	1,674	1,678	1,685
Tobacco products	33.3	33.6	33.7	33.2	32	33	33	35	33	32
Textile mill products	519.9	468.2	463.0	456.7	518	472	471	465	460	455
Apparel and other textile products	620.7	555.8	555.2	545.0	616	567	571	554	551	541
Paper and allied products	654.6	631.5	630.3	626.7	655	635	632	628	628	627
Printing and publishing	1,545.5	1,483.5	1,469.3	1,465.4	1,544	1,495	1,489	1,483	1,472	1,463
Chemicals and allied products	1,037.7	1,038.2	1,029.6	1,025.5	1,038	1,033	1,039	1,035	1,032	1,026
Petroleum and coal products	127.5	130.4	131.1	129.5	126	128	128	127	129	128
Rubber and misc. plastics products	1,002.6	949.7	943.4	935.8	1,002	953	957	947	942	935
Leather and leather products	69.8	63.1	60.9	60.4	69	64	64	62	61	60
Service-producing	106,989	106,785	107,325	107,633	106,432	107,245	107,327	107,432	107,309	107,068
Transportation and public utilities	7,121	7,077	7,112	7,053	7,076	7,118	7,108	7,082	7,062	7,007
Transportation	4,605	4,525	4,573	4,515	4,559	4,571	4,561	4,539	4,524	4,468
Railroad transportation	235.6	227.8	226.4	225.6	234	227	226	226	226	224
Local and interurban passenger transit	493.8	423.3	499.5	501.1	477	483	485	486	486	484
Trucking and warehousing	1,889.2	1,875.6	1,865.8	1,860.7	1,861	1,867	1,863	1,844	1,836	1,834
Water transportation	202.1	214.3	210.8	210.4	200	201	203	203	205	208
Transportation by air	1,295.3	1,303.5	1,293.0	1,250.7	1,298	1,310	1,304	1,303	1,295	1,253
Pipelines, except natural gas	13.6	14.3	14.0	14.1	14	14	14	14	14	14
Transportation services	475.6	466.5	463.7	451.9	475	469	466	463	462	451
Communications and public utilities	2,516	2,552	2,539	2,538	2,517	2,547	2,547	2,543	2,538	2,539
Communications	1,668.8	1,699.4	1,693.0	1,692.0	1,668	1,700	1,700	1,695	1,692	1,691
Electric, gas, and sanitary services	846.9	852.9	846.4	846.0	849	847	847	848	846	848
Wholesale trade	7,076	7,033	6,993	6,983	7,059	7,022	7,017	7,010	6,988	6,965
Durable goods	4,205	4,154	4,121	4,103	4,205	4,166	4,149	4,134	4,123	4,102
Nondurable goods	2,871	2,879	2,872	2,880	2,854	2,856	2,868	2,876	2,865	2,863

See footnotes at end of table.

Table B-1. Employees on nonfarm payrolls by industry—Continued

(In thousands)

Industry	Not seasonally adjusted				Seasonally adjusted					
	Oct. 2000	Aug. 2001	Sept. 2001p	Oct. 2001p	Oct. 2000	June 2001	July 2001	Aug. 2001	Sept. 2001p	Oct. 2001p
Retail trade	23,358	23,732	23,550	23,415	23,380	23,561	23,606	23,583	23,522	23,441
Building materials and garden supplies	1,007.0	1,031.1	1,013.1	1,008.3	1,012	1,014	1,008	1,014	1,014	1,014
General merchandise stores	2,858.3	2,747.3	2,747.6	2,817.8	2,829	2,818	2,810	2,800	2,794	2,790
Department stores	2,507.7	2,407.5	2,406.8	2,472.4	2,481	2,471	2,458	2,449	2,445	2,447
Food stores	3,530.1	3,551.5	3,528.5	3,537.8	3,527	3,544	3,536	3,531	3,532	3,535
Automotive dealers and service stations	2,432.2	2,461.8	2,444.8	2,438.6	2,426	2,431	2,435	2,441	2,434	2,432
New and used car dealers	1,124.7	1,138.6	1,138.0	1,136.8	1,122	1,128	1,131	1,133	1,134	1,134
Apparel and accessory stores	1,200.8	1,228.1	1,203.7	1,204.1	1,202	1,227	1,219	1,224	1,220	1,206
Furniture and home furnishings stores	1,143.3	1,128.8	1,124.7	1,137.7	1,142	1,136	1,137	1,137	1,138	1,137
Eating and drinking places	8,060.5	8,467.9	8,359.0	8,117.6	8,137	8,241	8,310	8,280	8,237	8,195
Miscellaneous retail establishments	3,125.3	3,115.1	3,128.4	3,152.9	3,105	3,150	3,151	3,156	3,153	3,132
Finance, insurance, and real estate	7,546	7,699	7,626	7,612	7,569	7,631	7,618	7,623	7,628	7,633
Finance	3,713	3,780	3,750	3,749	3,725	3,767	3,755	3,758	3,755	3,760
Depository institutions	2,014.7	2,050.2	2,033.6	2,033.5	2,023	2,041	2,039	2,037	2,038	2,042
Commercial banks	1,414.7	1,432.9	1,420.9	1,419.0	1,421	1,428	1,426	1,423	1,424	1,425
Savings institutions	251.8	256.7	254.9	255.5	253	256	255	255	256	256
Nondepository institutions	674.6	711.0	705.4	707.9	678	699	703	709	706	711
Mortgage bankers and brokers	301.9	324.9	321.7	324.5	303	317	321	324	323	326
Security and commodity brokers	767.6	762.3	755.7	750.4	767	766	755	755	754	750
Holding and other investment offices	256.4	256.6	255.3	256.7	257	261	258	257	257	257
Insurance	2,332	2,363	2,355	2,354	2,337	2,356	2,357	2,357	2,361	2,359
Insurance carriers	1,575.3	1,603.0	1,595.4	1,594.8	1,580	1,598	1,599	1,598	1,600	1,600
Insurance agents, brokers, and service	756.3	760.3	759.6	758.9	757	758	758	759	761	759
Real estate	1,501	1,556	1,521	1,509	1,507	1,508	1,506	1,508	1,512	1,514
Services[2]	41,014	41,459	41,256	41,247	40,767	41,085	41,046	41,129	41,106	40,995
Agricultural services	835.5	906.5	878.0	863.9	808	833	834	837	839	836
Hotels and other lodging places	1,928.1	2,077.1	1,962.3	1,858.9	1,927	1,920	1,922	1,912	1,905	1,859
Personal services	1,226.1	1,237.8	1,241.9	1,246.3	1,259	1,279	1,281	1,284	1,278	1,279
Business services	10,124.7	9,699.2	9,692.4	9,657.2	9,939	9,666	9,592	9,588	9,560	9,470
Services to buildings	995.8	1,003.5	997.4	997.4	994	1,008	998	997	994	996
Personnel supply services	4,072.0	3,608.9	3,619.0	3,549.8	3,890	3,556	3,517	3,521	3,508	3,386
Help supply services	3,646.9	3,212.7	3,227.5	3,163.7	3,465	3,161	3,127	3,113	3,111	3,004
Computer and data processing services	2,126.2	2,196.4	2,190.1	2,192.4	2,135	2,205	2,202	2,194	2,199	2,202
Auto repair, services, and parking	1,267.3	1,313.0	1,305.8	1,294.6	1,268	1,303	1,312	1,307	1,306	1,293
Miscellaneous repair services	368.0	364.7	363.8	365.5	366	361	360	362	363	364
Motion pictures	576.6	607.0	583.8	573.1	588	602	595	589	592	585
Amusement and recreation services	1,694.5	2,067.3	1,847.6	1,713.1	1,747	1,768	1,772	1,777	1,764	1,766
Health services	10,144.4	10,404.1	10,401.2	10,425.5	10,146	10,329	10,354	10,384	10,414	10,428
Offices and clinics of medical doctors	1,936.6	1,995.0	1,990.2	1,990.7	1,938	1,981	1,983	1,990	1,993	1,992
Nursing and personal care facilities	1,799.4	1,832.0	1,830.4	1,834.3	1,799	1,821	1,823	1,825	1,831	1,834
Hospitals	4,004.6	4,118.2	4,121.3	4,131.9	4,005	4,086	4,098	4,114	4,127	4,132
Home health care services	646.8	651.4	656.4	657.3	646	648	647	653	656	656
Legal services	1,010.4	1,034.2	1,023.2	1,025.9	1,014	1,027	1,026	1,028	1,031	1,029
Educational services	2,479.8	2,119.8	2,400.9	2,622.5	2,329	2,426	2,432	2,452	2,446	2,465
Social services	2,956.7	3,031.2	3,065.0	3,098.4	2,950	3,056	3,048	3,076	3,081	3,092
Child day care services	738.3	702.8	753.5	766.8	724	756	760	765	754	753
Residential care	815.4	853.9	847.2	852.3	817	845	847	848	850	854
Museums and botanical and zoological gardens	108.2	119.6	112.2	111.9	107	111	111	111	111	111
Membership organizations	2,467.7	2,540.3	2,489.8	2,498.1	2,482	2,501	2,493	2,503	2,513	2,513
Engineering and management services	3,454.5	3,563.2	3,514.5	3,519.7	3,467	3,529	3,540	3,544	3,529	3,532
Engineering and architectural services	1,034.1	1,063.8	1,069.4	1,068.5	1,034	1,059	1,064	1,067	1,067	1,069
Management and public relations	1,109.2	1,128.7	1,118.3	1,115.7	1,108	1,124	1,119	1,123	1,121	1,114
Services, nec	49.8	52.8	51.5	50.9	(1)	(1)	(1)	(1)	(1)	(1)
Government	20,874	19,785	20,788	21,323	20,581	20,828	20,932	21,005	21,003	21,027
Federal	2,610	2,632	2,818	2,609	2,622	2,621	2,626	2,622	2,625	2,622
Federal, except Postal Service	1,752.3	1,785.7	1,774.5	1,765.5	1,762	1,772	1,772	1,774	1,776	1,776
State	4,923	4,658	4,907	5,068	4,798	4,881	4,909	4,913	4,940	4,938
Education	2,167.4	1,827.0	2,094.8	2,275.3	2,035	2,089	2,117	2,122	2,140	2,137
Other State government	2,755.2	2,831.3	2,811.7	2,793.1	2,763	2,792	2,792	2,791	2,800	2,801
Local	13,341	12,495	13,263	13,646	13,161	13,326	13,397	13,470	13,438	13,467
Education	7,690.4	6,447.1	7,446.4	7,866.5	7,445	7,515	7,575	7,650	7,618	7,621
Other local government	5,650.3	6,048.0	5,816.9	5,779.1	5,716	5,811	5,822	5,820	5,820	5,846

[1] These series are not published seasonally adjusted because the seasonal component, which is small relative to the trend-cycle and irregular components, cannot be separated with sufficient precision.

[2] Includes other industries, not shown seperately.

p = preliminary.

Table B-2. Average weekly hours of production or nonsupervisory workers[1] on private nonfarm payrolls by industry

Industry	Not seasonally adjusted				Seasonally adjusted					
	Oct. 2000	Aug. 2001	Sept. 2001p	Oct. 2001p	Oct. 2000	June 2001	July 2001	Aug. 2001	Sept. 2001p	Oct. 2001p
Total private	34.7	34.4	34.3	34.0	34.4	34.2	34.2	34.0	34.1	34.0
Goods-producing	41.3	40.7	40.7	40.4	40.8	40.4	40.5	40.3	40.2	39.9
Mining	43.8	43.6	44.0	43.3	43.1	43.3	43.3	43.4	43.7	42.6
Construction	40.2	40.1	39.8	39.4	39.2	39.4	39.4	39.2	39.1	38.4
Manufacturing	41.6	40.8	41.0	40.7	41.4	40.7	40.8	40.7	40.6	40.4
Overtime hours	4.6	4.2	4.3	4.0	4.5	3.9	4.0	4.1	3.9	3.8
Durable goods	42.1	41.2	41.3	40.9	41.9	40.9	41.2	41.1	40.9	40.7
Overtime hours	4.7	4.2	4.1	3.8	4.6	3.9	4.0	4.1	3.8	3.7
Lumber and wood products	41.3	41.2	41.6	41.0	40.9	40.4	41.1	40.9	41.4	40.7
Furniture and fixtures	40.0	40.0	39.7	38.7	39.7	38.4	39.7	39.7	39.0	38.4
Stone, clay, and glass products	43.9	44.6	45.2	44.3	43.2	44.0	44.0	43.9	44.3	43.6
Primary metal industries	44.4	43.6	44.4	43.5	44.4	43.9	44.1	43.7	43.9	43.5
Blast furnaces and basic steel products	44.9	44.6	45.9	44.6	45.1	45.1	44.7	44.6	45.5	44.8
Fabricated metal products	42.6	41.5	41.5	41.2	42.2	41.2	41.6	41.5	41.1	40.8
Industrial machinery and equipment	41.9	40.1	40.4	40.1	42.0	40.4	40.8	40.2	40.3	40.1
Electronic and other electrical equipment	41.1	39.2	39.3	39.2	40.7	39.3	38.9	39.1	39.0	38.9
Transportation equipment	43.4	42.7	41.9	42.0	43.0	41.9	42.2	42.8	41.3	41.6
Motor vehicles and equipment	44.5	44.3	42.9	43.0	43.9	43.0	43.0	44.6	42.1	42.4
Instruments and related products	41.2	40.4	41.2	40.8	41.2	40.8	40.8	40.4	41.3	40.8
Miscellaneous manufacturing	38.9	38.3	37.9	37.8	38.6	38.4	38.4	38.2	37.6	37.5
Nondurable goods	40.9	40.3	40.7	40.4	40.6	40.4	40.3	40.1	40.2	40.1
Overtime hours	4.5	4.4	4.6	4.3	4.3	3.9	4.0	4.1	4.1	4.1
Food and kindred products	42.0	41.6	42.0	41.8	41.5	41.2	40.9	41.1	40.9	41.3
Tobacco products	40.9	40.1	40.8	40.5	40.3	40.4	40.5	39.9	39.9	40.0
Textile mill products	40.7	40.1	40.3	39.6	40.6	40.4	39.7	39.8	39.9	39.5
Apparel and other textile products	37.6	37.1	36.7	36.5	37.5	37.5	37.7	36.9	36.7	36.4
Paper and allied products	42.6	41.2	42.2	41.6	42.3	41.7	41.9	41.2	41.7	41.3
Printing and publishing	38.5	38.2	38.4	38.2	38.2	38.0	38.2	38.0	38.0	38.0
Chemicals and allied products	42.3	42.0	42.2	42.1	42.3	42.2	42.7	42.1	42.0	42.1
Petroleum and coal products	43.0	43.0	42.9	41.8	(2)	(2)	(2)	(2)	(2)	(2)
Rubber and misc. plastics products	41.4	40.5	41.2	40.7	41.2	40.7	40.6	40.5	40.9	40.5
Leather and leather products	37.7	36.7	36.5	36.1	37.4	36.2	35.7	36.4	36.1	35.9
Service-producing	33.0	32.9	32.8	32.5	32.8	32.8	32.6	32.6	32.6	32.6
Transportation and public utilities	39.0	38.1	38.0	37.7	38.6	38.1	37.8	37.8	37.5	37.7
Wholesale trade	38.7	38.3	38.7	38.1	38.4	38.3	38.2	38.3	38.5	38.1
Retail trade	28.9	29.3	28.8	28.5	28.9	28.7	28.6	28.6	28.7	28.7
Finance, insurance, and real estate	36.6	36.1	36.7	35.8	36.2	36.5	36.2	36.2	36.2	36.0
Services	32.9	32.8	32.7	32.5	32.6	32.8	32.7	32.5	32.6	32.6

[1] Data relate to production workers in mining and manufacturing; construction workers in construction; and nonsupervisory workers in transportation and public utilities; wholesale and retail trade; finance, insurance, and real estate; and services. These groups account for approximately four-fifths of the total employees on private nonfarm payrolls.

[2] This series is not published seasonally adjusted because the seasonal component, which is small relative to the trend-cycle and irregular components, cannot be separated with sufficient precision.

p = preliminary.

Table B-3. Average hourly and weekly earnings of production or nonsupervisory workers[1] on private nonfarm payrolls by industry

Industry	Average hourly earnings				Average weekly earnings			
	Oct. 2000	Aug. 2001	Sept. 2001p	Oct. 2001p	Oct. 2000	Aug. 2001	Sept. 2001p	Oct. 2001p
Total private	$13.97	$14.28	$14.51	$14.50	$484.76	$491.23	$497.69	$493.00
Seasonally adjusted	13.90	14.40	14.45	14.47	478.16	489.60	492.75	491.98
Goods-producing	15.65	16.06	16.15	16.17	646.35	653.64	657.31	653.27
Mining	17.28	17.53	17.71	17.77	756.86	764.31	779.24	769.44
Construction	18.22	18.43	18.52	18.59	732.44	739.04	737.10	732.45
Manufacturing	14.53	14.89	15.01	15.01	604.45	607.51	615.41	610.91
Durable goods	14.99	15.37	15.48	15.48	631.08	633.24	639.32	633.13
Lumber and wood products	12.09	12.37	12.45	12.35	499.32	509.64	517.92	506.35
Furniture and fixtures	11.86	12.29	12.35	12.34	474.40	491.60	490.30	477.56
Stone, clay, and glass products	14.75	15.17	15.23	15.21	647.53	676.58	688.40	673.80
Primary metal industries	16.48	17.06	17.26	17.11	731.71	743.82	766.34	744.29
Blast furnaces and basic steel products	19.84	20.63	20.88	20.47	890.82	920.10	958.39	912.96
Fabricated metal products	14.01	14.34	14.43	14.34	596.83	595.11	598.85	590.81
Industrial machinery and equipment	15.66	15.96	16.05	16.09	656.15	640.00	648.42	645.21
Electronic and other electrical equipment	14.00	14.72	14.84	14.80	575.40	577.02	583.21	580.16
Transportation equipment	18.88	19.08	19.30	19.43	819.39	814.72	808.67	816.06
Motor vehicles and equipment	19.26	19.39	19.68	19.91	857.07	858.98	844.27	856.13
Instruments and related products	14.62	15.00	15.08	15.15	602.34	606.00	621.30	618.12
Miscellaneous manufacturing	11.75	12.23	12.37	12.34	457.08	468.41	468.82	466.45
Nondurable goods	13.81	14.17	14.32	14.32	564.83	571.05	582.82	578.53
Food and kindred products	12.59	12.87	12.97	13.00	528.78	535.39	544.74	543.40
Tobacco products	21.47	21.90	21.70	21.66	878.12	878.19	885.36	877.23
Textile mill products	11.23	11.39	11.39	11.36	457.06	456.74	459.02	449.86
Apparel and other textile products	9.37	9.44	9.56	9.52	352.31	350.22	350.85	347.48
Paper and allied products	16.43	16.87	17.12	17.18	699.92	695.04	722.46	714.69
Printing and publishing	14.50	14.87	15.01	14.95	558.25	568.03	576.38	571.09
Chemicals and allied products	18.27	18.54	18.86	18.75	772.82	778.68	795.89	789.38
Petroleum and coal products	22.14	22.20	22.27	22.39	952.02	954.60	955.38	935.90
Rubber and misc. plastics products	12.98	13.44	13.51	13.52	537.37	544.32	556.61	550.26
Leather and leather products	10.33	10.35	10.30	10.19	389.44	379.85	375.95	367.86
Service-producing	13.44	13.75	14.02	14.00	443.52	452.38	459.86	455.00
Transportation and public utilities	16.38	16.97	17.09	17.12	638.82	646.56	649.42	645.42
Wholesale trade	15.45	15.75	16.03	15.83	597.92	603.23	620.36	603.12
Retail trade	9.59	9.79	9.92	9.93	277.15	286.85	285.70	283.01
Finance, insurance, and real estate	15.24	15.84	16.03	15.90	557.78	571.82	588.30	569.22
Services	14.11	14.46	14.78	14.79	464.22	474.29	483.31	480.68

[1] See footnote 1, table B-2.

p = preliminary.

Table B-4. Average hourly earnings of production or nonsupervisory workers[1] on private nonfarm payrolls by industry, seasonally adjusted

Industry	Oct. 2000	June 2001	July 2001	Aug. 2001	Sept. 2001p	Oct. 2001p	Percent change from: Sept. 2001-Oct. 2001
Total private:							
Current dollars	$13.90	$14.31	$14.34	$14.40	$14.45	$14.47	0.1
Constant (1982) dollars[2]	7.90	7.95	8.00	8.03	8.02	N.A.	(3)
Goods-producing	15.57	15.90	15.93	16.01	16.04	16.08	.2
Mining	17.30	17.73	17.74	17.69	17.65	17.79	.8
Construction	18.02	18.28	18.26	18.35	18.36	18.39	.2
Manufacturing	14.54	14.81	14.86	14.93	14.96	15.02	.4
Excluding overtime[4]	13.80	14.13	14.18	14.24	14.30	14.34	.3
Service-producing	13.39	13.84	13.87	13.93	13.98	14.00	.1
Transportation and public utilities	16.39	16.91	16.88	16.95	17.04	17.14	.6
Wholesale trade	15.37	15.86	15.84	15.81	15.98	15.84	-.9
Retail trade	9.57	9.83	9.84	9.87	9.86	9.91	.5
Finance, insurance, and real estate	15.20	15.86	15.91	15.99	16.01	15.97	-.2
Services	14.07	14.54	14.61	14.71	14.77	14.80	.2

1 See footnote 1, table B-2.
2 The Consumer Price Index for Urban Wage Earners and Clerical Workers (CPI-W) is used to deflate this series.
3 Change was -.1 percent from August 2001 to September 2001, the latest month available.
4 Derived by assuming that overtime hours are paid at the rate of time and one-half.
N.A. = not available.
p = preliminary.

Table B-5. Indexes of aggregate weekly hours of production or nonsupervisory workers[1] on private nonfarm payrolls by industry

(1982=100)

Industry	Not seasonally adjusted				Seasonally adjusted					
	Oct. 2000	Aug. 2001	Sept. 2001p	Oct. 2001p	Oct. 2000	June 2001	July 2001	Aug. 2001	Sept. 2001p	Oct. 2001p
Total private	154.0	153.4	151.8	149.8	151.8	151.2	150.8	150.1	149.9	148.8
Goods-producing	118.8	113.9	112.8	110.7	115.7	111.5	111.5	110.3	109.4	107.7
Mining	54.1	56.7	56.5	55.9	52.3	55.0	55.1	55.3	55.2	54.0
Construction	198.4	204.6	199.5	195.9	185.8	190.1	190.3	188.5	187.7	183.2
Manufacturing	105.7	97.7	97.6	95.7	104.6	98.1	98.0	96.8	95.9	94.7
Durable goods	111.3	101.2	100.7	98.6	110.4	102.2	102.1	100.8	99.5	97.8
Lumber and wood products	147.2	142.2	142.6	138.9	144.2	137.6	139.5	138.0	139.7	136.4
Furniture and fixtures	140.7	128.9	126.1	120.1	139.2	127.1	130.1	127.6	123.8	118.9
Stone, clay, and glass products	122.1	121.4	123.0	120.1	118.8	118.9	118.9	117.0	118.6	116.8
Primary metal industries	91.5	82.0	83.2	80.3	91.6	84.4	83.4	82.3	82.2	80.3
Blast furnaces and basic steel products	69.7	64.3	66.0	63.8	70.4	65.6	64.2	64.1	64.9	64.3
Fabricated metal products	122.8	112.7	112.1	110.3	121.1	112.5	113.7	112.6	110.7	108.8
Industrial machinery and equipment	101.4	88.4	88.0	86.4	102.1	92.0	91.5	88.9	88.1	86.7
Electronic and other electrical equipment	109.5	91.2	90.1	88.4	108.4	95.9	92.4	90.9	89.2	87.7
Transportation equipment	120.2	111.7	109.2	107.5	119.5	110.0	111.2	112.6	108.0	107.0
Motor vehicles and equipment	160.9	147.6	142.3	139.0	159.3	143.2	145.1	149.6	140.2	137.3
Instruments and related products	75.2	72.6	73.1	71.8	75.6	73.6	73.8	72.4	73.5	72.2
Miscellaneous manufacturing	100.5	92.2	92.2	92.1	98.1	95.0	94.3	90.6	90.2	90.0
Nondurable goods	98.0	93.0	93.3	91.7	96.7	92.5	92.4	91.3	90.9	90.5
Food and kindred products	119.9	120.4	121.3	119.1	116.2	115.3	114.0	114.5	113.2	115.6
Tobacco products	49.4	49.3	50.5	50.0	45.9	48.0	48.1	51.4	47.4	47.5
Textile mill products	73.6	65.7	64.9	63.1	73.0	66.3	65.3	64.7	63.8	62.7
Apparel and other textile products	53.4	46.5	45.9	44.7	52.8	48.0	48.6	45.9	45.7	44.2
Paper and allied products	103.3	96.5	98.5	96.8	102.5	97.8	97.8	95.8	96.8	96.0
Printing and publishing	121.3	114.2	114.2	112.9	120.3	114.6	114.7	113.7	112.9	112.2
Chemicals and allied products	99.1	96.9	96.9	96.3	99.2	97.4	99.1	97.0	96.6	96.3
Petroleum and coal products	71.1	74.3	75.4	72.7	70.3	71.6	71.8	73.3	73.7	71.5
Rubber and misc. plastics products	146.7	134.9	136.2	133.3	145.9	136.4	136.4	134.3	134.9	132.4
Leather and leather products	30.3	26.8	25.5	24.9	29.9	26.7	25.8	26.3	25.0	24.8
Service-producing	169.6	171.1	169.3	167.4	168.0	169.0	168.4	168.0	168.1	167.3
Transportation and public utilities	142.2	138.8	139.3	136.5	139.6	139.2	138.3	137.8	136.3	135.6
Wholesale trade	133.8	131.7	132.1	130.0	132.4	131.2	130.6	131.0	131.4	129.6
Retail trade	146.3	150.2	146.0	144.1	146.1	146.0	145.7	145.6	145.6	144.9
Finance, insurance, and real estate	139.6	140.9	141.6	138.0	138.7	140.9	139.6	139.6	139.9	139.3
Services	213.9	215.8	213.8	212.4	210.8	213.4	212.8	212.0	212.5	211.8

1 See footnote 1, table B-2.

p = preliminary.

Table B-6. Diffusion indexes of employment change, seasonally adjusted

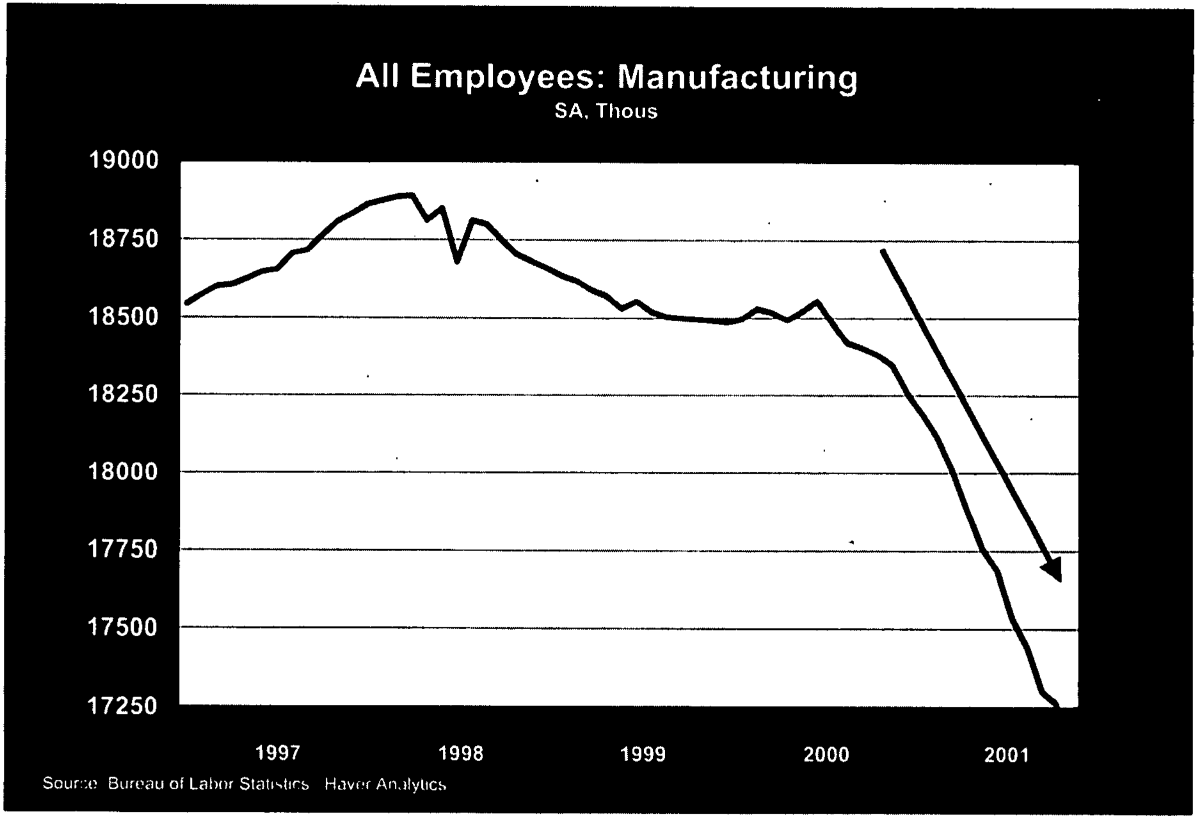
(Percent)

Time span	Jan.	Feb.	Mar.	Apr.	May	June	July	Aug.	Sept.	Oct.	Nov.	Dec.
	Private nonfarm payrolls, 353 industries[1]											
Over 1-month span:												
1997	57.2	58.6	62.5	63.2	59.8	57.2	59.8	59.2	62.7	65.2	61.6	62.2
1998	63.2	56.2	59.3	60.2	58.9	57.1	55.4	58.4	54.8	55.0	58.2	56.4
1999	55.1	59.6	52.8	57.2	58.2	54.2	57.1	54.4	55.2	57.9	59.9	56.8
2000	55.7	59.3	61.0	54.2	47.7	60.5	57.8	55.1	52.0	54.8	55.1	54.2
2001	53.7	50.4	55.8	45.0	46.6	44.3	45.5	43.9	p42.2	p41.1		
Over 3-month span:												
1997	63.5	64.0	66.0	67.0	63.2	63.3	59.8	65.6	67.3	71.1	70.0	69.5
1998	65.3	66.1	64.6	65.7	62.2	57.9	57.5	58.4	59.1	59.2	59.3	59.2
1999	60.8	57.8	58.5	55.8	58.1	57.9	57.2	59.2	59.8	59.1	61.0	60.6
2000	61.6	63.3	61.9	56.2	55.1	57.9	61.5	56.4	54.1	53.3	55.7	53.3
2001	51.7	54.1	48.6	49.2	42.5	42.4	40.5	p38.1	p36.4			
Over 6-month span:												
1997	66.7	68.6	66.1	66.0	65.3	65.9	66.0	69.1	69.4	70.3	71.1	70.7
1998	70.4	67.4	65.0	62.5	63.6	60.5	59.2	58.6	57.9	59.6	60.6	59.9
1999	59.8	59.8	58.2	60.3	56.7	59.2	61.8	60.8	62.2	61.2	62.3	64.9
2000	63.5	60.6	62.6	63.7	61.5	55.5	56.1	58.6	54.2	54.8	51.8	54.2
2001	52.0	50.6	48.6	45.3	44.1	p38.0	p36.1					
Over 12-month span:												
1997	69.3	67.4	68.4	70.0	69.7	70.3	70.1	70.8	71.0	70.5	69.7	70.7
1998	69.7	67.6	67.4	66.0	64.0	62.7	61.9	62.0	60.9	59.3	60.8	58.8
1999	61.2	60.2	58.2	60.8	60.8	61.6	62.2	61.3	63.9	63.0	61.3	60.9
2000	62.5	63.0	61.8	59.5	58.4	56.8	55.7	56.5	54.2	53.4	53.0	51.7
2001	49.6	47.7	p44.9	p42.6								
	Manufacturing payrolls, 136 industries[1]											
Over 1-month span:												
1997	48.2	52.6	55.5	54.8	52.9	53.7	49.3	51.1	57.7	61.8	61.4	54.8
1998	57.4	51.5	53.7	53.3	43.8	48.2	38.2	51.5	41.9	41.5	41.2	43.4
1999	46.0	44.5	43.0	42.3	50.4	39.3	51.5	39.3	45.2	46.3	53.3	46.7
2000	44.9	56.6	55.5	46.7	41.2	54.8	53.7	38.6	34.6	41.5	43.8	44.1
2001	37.9	32.4	41.5	31.3	29.4	33.1	39.0	27.6	p34.2	p31.6		
Over 3-month span:												
1997	50.0	51.5	55.9	55.5	52.9	52.9	50.4	54.8	59.6	70.6	66.5	64.3
1998	59.6	59.6	55.9	50.4	46.7	37.9	41.5	41.5	41.9	38.2	36.8	40.8
1999	41.2	39.0	38.2	41.5	40.8	45.2	39.0	45.2	40.8	44.9	46.3	46.0
2000	50.0	54.0	52.9	42.3	43.0	48.5	48.2	33.8	28.7	30.5	39.0	35.7
2001	28.3	29.4	24.6	26.5	22.4	24.6	21.0	p19.1	p19.5			
Over 6-month span:												
1997	53.7	53.7	51.1	52.9	50.7	50.7	54.8	62.1	61.8	64.3	67.3	65.8
1998	63.2	54.4	50.4	40.4	44.5	40.1	37.5	36.4	34.9	40.1	37.1	34.2
1999	36.0	38.2	37.5	41.2	36.8	39.7	43.0	41.5	46.0	40.4	46.3	51.5
2000	51.5	44.5	48.5	55.1	43.8	34.9	33.5	34.6	30.1	29.4	25.0	27.9
2001	26.8	25.4	19.9	20.6	20.2	p15.1	p13.6					
Over 12-month span:												
1997	55.1	52.6	54.0	54.4	55.5	57.0	57.0	58.8	59.2	57.7	57.4	57.7
1998	54.8	52.2	51.8	46.7	40.4	40.1	38.2	37.5	36.4	34.6	35.7	34.2
1999	38.6	34.6	32.4	36.0	37.9	39.0	40.1	40.4	44.5	46.0	44.9	44.5
2000	46.3	45.2	41.2	37.9	33.8	31.3	31.3	31.3	27.6	25.4	24.3	21.0
2001	19.1	16.5	p14.7	p16.5								

[1] Based on seasonally adjusted data for 1-, 3-, and 6-month spans and unadjusted data for the 12-month span. Data are centered within the span.

p = preliminary.

NOTE: Figures are the percent of industries with employment increasing plus one-half of the industries with unchanged employment, where 50 percent indicates an equal balance between industries with increasing and decreasing employment.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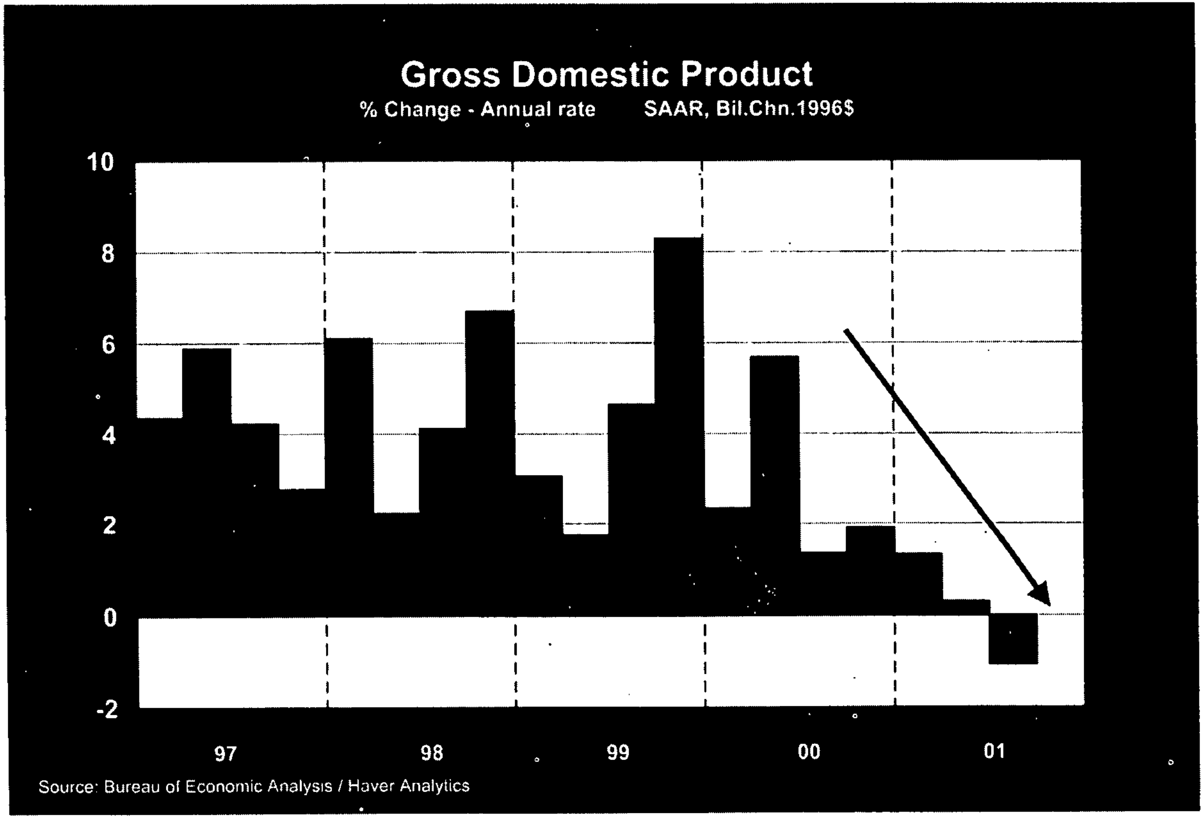

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THE EMPLOYMENT SITUATION: SEPTEMBER 2001

HEARING

before the

JOINT ECONOMIC COMMITTEE
CONGRESS OF THE UNITED STATES

ONE HUNDRED SEVENTH CONGRESS

FIRST SESSION

October 5, 2001

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JOINT ECONOMIC COMMITTEE

[Created pursuant to Sec. 5(a) of Public Law 304, 79th Congress]

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THE EMPLOYMENT SITUATION: SEPTEMBER 2001

Friday, October 5, 2001

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

The Committee met, pursuant to notice, at 9:35 a.m., in Room 1334, Longworth House Office Building, the Honorable Jim Saxton, Chairman of the Committee, presiding.

Present: Representatives Saxton, Smith, and Watt; Senators Sessions and Reed.

Staff Present: Chris Frenze, Robert Keleher, Darryl Evans, Brian Higginbotham, Matthew Salomon, Daphne Clones-Federing, and Russell Comeau.

OPENING STATEMENT OF REPRESENTATIVE JIM SAXTON, CHAIRMAN

Representative Saxton. Good morning. I would like to welcome the Commissioner to the Committee once again to report on the release of new employment and unemployment data for September. According to the most recent economic data, the economic slowdown that began in the middle of 2000 continues. There was a prospect of economic improvement in the near future, but that has been overtaken by the horrific events of September 11. The potential rebound predicted by the consensus forecast and blue chip economists has now been erased by the economic event of the terrorist attacks. However, the American people and the economy have demonstrated tremendous resilience in the face of these terrorist attacks.

The September employment data reflect the weakness of the economy, evident before the terrorist attacks. Payroll employment declined by 199,000 in September. Once again, the payroll declines were focused in the manufacturing sector, as has been the trends for some months, and only add to the previous severe job losses in manufacturing underway since the middle of 2000, bringing the total to over a million jobs lost. The unemployment rate remains at 4.9 percent. The economic situation obviously is reason for concern.

According to a recent Committee report, it is likely that the downward drift in the rate of the real gross domestic product (GDP) growth underway since the middle of 2000 will now probably continue. Unfortunately, this suggests that payroll employment will tend to decline and the unemployment rate will rise in coming months. The terrorist attacks have obviously disrupted the financial markets and overall economy.

In a number of ways, these attacks have created much uncertainty and have also increased security costs. Delays in air and ground transport, higher shipping costs, additional insurance costs, extra costs for security personnel and equipment, fortification of buildings and facilities and other measures will have an effect of imposing something like a "security tax" on an already vulnerable economy. This burden will undermine the economy in the short run and will also adversely affect productivity growth and the economy's long-run growth rate.

The exact size of the burden imposed by this security tax is not known, but we do know that it will have a significant effect. In recent days, private sector economists have begun to consider this cost issue and its potential impact on an already weak economy. Our analysis suggests that one logical policy response would be to offset the costs by relieving some of the tax burden on the private sector. Accelerating the tax relief in the pipeline and other measures to minimize the net impact of the "security tax" should be a high priority of policymakers.

[The prepared statement of Representative Saxton appears in the Submissions for the Record on page 19.]

Senator Reed, do you have an opening statement?

OPENING STATEMENT OF SENATOR JACK REED, VICE CHAIRMAN

Senator Reed. I do, Mr. Chairman. First, Mr. Chairman, let me thank you for holding this hearing. I particularly thank Commissioner Abraham for coming before us once again, and I understand, Commissioner, that this may well be your last hearing, as your term expires on the 13th. I would have preferred that the Secretary of Labor reappoint you so that you could continue to provide the valuable advice you have given this Committee and the Congress over several years. You have served the Bureau of Labor Statistics (BLS) well in what can be a thankless job, and I thank you for all your efforts in overseeing the management of some of the country's most important statistics, and of course, testifying before this Committee over the last five years.

While the numbers before us today give us only a glimpse of the state of our economy since the terrorist attack three and a half weeks ago, they do tell much that we need to know about the underlying economic trends that were at work before the devastating tragedy. The economy was already weak before September 11. Real GDP barely grew during the second quarter and the unemployment rate rose. Your testimony last month before the Committee suggested that labor markets were indeed weakening, especially for the most vulnerable workers.

Since September 11, the temporary disruption of our financial systems and the slump in travel related sectors of the economy have only worsened the situation. The few indicators we have received since the attacks suggest that the employment situation has worsened significantly. Businesses have announced more than 100,000 layoffs, and initial claims for unemployment insurance have risen sharply in the last two weeks in September. The tragedies have redirected our policy focus. Congress has moved swiftly to provide aid to New York and the airline industry.

We must now turn our attention to the larger question of jumpstarting the economy and ensuring that all of our citizens and all Americans participate in a renewed and more robust economy. We have worked hard over the past decade to strengthen our economy, while at the same time fostering more broadly shared prosperity. Now some of that is at risk. Once again, I want to thank you, Commissioner Abraham, for coming to discuss the latest economic developments, and their impacts on working Americans.

As we move forward in designing an appropriate fiscal stimulus, it is critical for us to have the best possible information concerning both the current state of the overall economy, as well as the status of our most vulnerable citizens. We are pleased to have you testify here today and value your insight. Thank you very much, Mr. Chairman.

[The prepared statement of Senator Reed appears in the Submissions for the Record on page 20.]

Representative Saxton. Thank you very much, Senator Reed. Commissioner, the floor is yours.

OPENING STATEMENT OF KATHARINE G. ABRAHAM, COMMISSIONER, BUREAU OF LABOR STATISTICS: ACCOMPANIED BY KENNETH V. DALTON, ASSOCIATE COMMISSIONER, OFFICE OF PRICES AND LIVING CONDITIONS; AND PHILIP L. RONES, ASSISTANT COMMISSIONER OF CURRENT EMPLOYMENT ANALYSIS

Ms. Abraham. Thank you very much, Mr. Chairman. It is a pleasure to have the opportunity today to comment on the September labor market data that we released this morning. Nonfarm payroll employment fell by nearly 200,000 in September. Heavy job losses continued in manufacturing. Wholesale trade employment fell sharply and there was weakening in most major other industries. The unemployment rate at 4.9 percent was unchanged over the month. The tragic events of September 11 occurred during the reference period for both our establishment and household surveys. In the establishment survey, persons who lost a job because of these events but who had worked at all in the pay period that included the 12th of the month or who had received any paid leave would be included in the September job count. Similarly, in the household survey, anyone who worked for even one hour during the week that began on September 9th of who was temporarily absent from a job that week would be counted as employed.

Thus, it is likely that the events of September 11 had little effect on the September employment and unemployment figures. Job loss related directly or indirectly to the events of September 11 should begin to be reflected in the October data, although the staff of the Bureau are doubtful about being able to isolate those effects as distinct from the effects of other economic developments.

Perhaps the most direct measure will come from our mass layoff statistics program, which identifies layoff events affecting 50 or more workers as measured by filings for unemployment insurance. Following the events of September 11, employers have been able to identify layoffs directly or indirectly attributable to nonnatural disasters using a special code added for this purpose, which means that we will be able to look at them separately from other mass layoffs.

The September decline in nonfarm payroll employment was the fourth in the past six months, resulting in a net decline of 488,000 jobs since March. Employment in manufacturing eroded further, as another 93,000 jobs were shed in September. Industrial machinery and electrical equipment continued to post the largest losses within manufacturing with, over the month, declines of 20,000 and 18,000, respectively. Together, these two industries account for nearly two-fifths of the 900,000 manufacturing jobs lost so far this year. Over the month, employment also fell substantially in motor vehicles, printing and publishing, fabricated metals and apparel. Other manufacturing industries generally had smaller losses.

Wholesale trade continued to feel the impact of declining manufacturing activity. Employment in the industry fell by 21,000 in September. Its sharpest decline since peaking last November. Retail trade employment was also down over the month, largely due to job losses in eating and drinking places.

Employment growth in services has faltered in recent months with virtually no net job growth since March, while health services continued to add jobs in September. Employment and business services was down again over the month. Amusement and recreation employment also fell significantly in September.

Average weekly hours from our establishment survey showed no obvious effect of the economic disruptions that followed the September 11 attacks. These data are based on hours paid concept, meaning that the workweek estimates include paid leave. In September, average weekly hours were up by a tenth of an hour.

Turning now to measures obtained from our household survey, both the number of unemployed people and the unemployment rate were unchanged over the month following sharp increases in August. The unemployed numbered seven million in September, an increase of nearly a million and a half since late last year. The unemployment rate remained at 4.9 percent, a full percentage point above the 30-year low recorded last September and October. Civilian employment rose by almost 800,000 over the month, mostly offsetting a large decline in August. The employment series from the household survey is very volatile, and it is not uncommon to get large movements from month to month.

Although there is no reason to think that the civilian employment and unemployment counts were substantially affected by the events of September 11, measures of part-time work from the September household survey confirm that many Americans' hours at work were shortened that week. In particular, the number who usually work full-time but reported working part-time during the reference period was significantly higher than normal.

Before concluding, I would like to provide you with a preliminary estimate of the effect on our payroll employment figures of the benchmark revision scheduled for next June, just explain what that is about.

Once a year the Bureau adjusts the payrolls survey sample-based employment estimates to incorporate the previous year's March universe employment count in a process known as "benchmarking." These universe employment counts are derived principally from state unemployment tax reports that employers are required to file. In the fall of each year, we typically have completed preliminary tabulations of these universe counts for the first quarter of the year, and as soon as we have that information, we routinely share it, in particular, the anticipated size of the benchmark revision for the prior March.

Our preliminary tabulations for the first quarter of 2001 indicate that the estimate of overall payroll employment will require a downward revision of approximately 76,000, which, by historical standards, is a very small revision. What that is saying, in essence, is that at least through March, the payroll survey was doing a good job of what was actually happening to employment in the economy. Historical average for benchmark revisions over the past decade has been plus or minus three-tenths of a percentage point, versus less than one tenth of a percentage point for this year.

In summary, then, with respect to the data for September which is our main focus today, nonfarm payroll employment fell by nearly 200,000 in September, the fourth decline in the past six months. The unemployment rate was unchanged at 4.9 percent.

As always, my colleagues and I would be happy to take questions. Perhaps I might just add that for myself, it is looking, in all likelihood, as though this will be my last opportunity to appear before you as Commissioner of Labor Statistics, and I do want to say how much I have appreciated the opportunity to participate in these hearings and also especially the interest that this Committee has shown in the work of the Bureau of Labor Statistics.

[The prepared statement of Commissioner Abraham appears in the Submissions for the Record on page 21.]

Representative Saxton. Commissioner, thank you, and we also appreciate your attendance here on a regular basis, and I think the information that you have been able to bring to us on a monthly basis has been extremely important to the Congress and to the American people. We thank you very much for your frankness, and sometimes when we ask you questions and it is not your role to answer it, you have been frank and said that, but most of the time we have had a great exchange, and we appreciate the fact that you have been here and played this role for us.

Along the same line, it is extremely important for the Congress of the United States to understand trends in the economy and to take note of what is happening over time. Unlike the events of September 11, which have dominated the news obviously for the last three, almost four weeks, economic events are oftentimes very subtle, and oftentimes out of public view, and one of the things that you have helped us do is to keep the Congress informed on trends that occur in the economy.

And so we thank you for that, and along the same line, let me just point out that as you said, the events of September 11 probably don't have a lot to do with the numbers that we see reflected in the report that you bring us this morning.

Ms. Abraham. Right.

Representative Saxton. But it is part of a continuing trend, and I think it is extremely important for us to make note of that in light of the fact that we are the body that initiates changes that may have some effect on the economy. I note that the Fed again earlier this week reduced interest rates – short-term interest rates by 50 basis points, bringing them to the lowest level since the early 1960s, and there is good reason for that. In fact, I brought some charts this morning to try and demonstrate that trend and to make note of this for Members of the House and the Senate.

The chart that we have here to your right, Commissioner, shows the economic trends that have occurred since the middle of last year, since the middle of 2000. The second and third quarter last year showed remarkable drop in GDP, and that trend, of course, continues today, and so I think it is important that we make note of this and understand that the events of September 11, while they may be a negative effect on the economy, are not even reflected, we don't believe, in your report today, and that the weakness that we see in the economy is now four quarters in length.

[Chart 1 entitled, "Gross Domestic Product," appears in the Submissions for the Record on page 47.]

There is another chart right behind that that continues to demonstrate this trend in the economy. That is, the loss in manufacturing jobs, which we see beginning also in the third quarter of 2000 and it is a rather dramatic drop in manufacturing employment, which causes concern and continues to demonstrate this weakening trend in the economy since the middle of last year.

[Chart 2 entitled, "All Employees: Manufacturing," appears in the Submissions for the Record on page 48.]

And here we have a third graph, which is the nonfarm payroll job decline, which again began in the middle of 2000 and continued through today.

[Chart 3 entitled, "Employees on Nonfarm Payrolls," appears in the Submissions for the Record on page 49.]

So these are trends that have nothing to do with the events of September the 11 and the weakening of the economy continues, and Commissioner, if you will help me out, didn't – the survey that you are reporting today actually took place during the period of time that the terrorist events took place; is that correct?

Ms. Abraham. The reference period for the household survey was the week beginning September 9th. The reference period for the payroll survey, the employers survey, was the week including the 12th of the month. The actual data collection didn't take place until subsequently, but the reference periods for both surveys included that week.

Representative Saxton. And I think you said in your survey that we will likely see the effect of September 11 events in the October numbers.

Ms. Abraham. That's right. I think that the right way to look at the data that we have reported for September is that they are giving us the last clear signal of the trajectory that the economy was on prior to the events of September 11, at least with respect to the employment and unemployment counts. We do not believe the numbers were substantially affected by those events.

Representative Saxton. So it seems to me our task this morning should be to examine the longer term trend in the economy which began in the third quarter of 2000.

Ms. Abraham. Right. And then subsequent months' data will begin to let you look at what the effects of the attacks might have been. I might mention that in addition to the employment data and the unemployment data, the Bureau of Labor Statistics also produces a series on mass layoffs, and that may be something that you want to look at as well, and if you would like, we can tell you more about that.

Representative Saxton. Commissioner, how many jobs have been lost in the manufacturing sector since the middle of 2000?

Ms. Abraham. About 1.1 million jobs since last July.

Representative Saxton. And can you—

Ms. Abraham. July of 2000.

Representative Saxton. Do you have the data there that would show how many jobs have been lost or gained in the high-tech manufacturing sector?

Ms. Abraham. We do produce the series that you are familiar with on high-tech manufacturing employment. I don't have those figures, but I believe Phil does. Do you want to speak to them, Phil?

Mr. Rones. Over the past year, we have a 1.6 percent decline in the high-tech industries, which translates to 168,000 jobs lost in those industries.

Representative Saxton. Now, is that also part of the job loss that the Commissioner just referred to in the manufacturing sector? Is this a subdivision of the million jobs, or is it in addition?

Mr. Rones. In fact, we have a series that just isolates the high-tech jobs within manufacturing, and there the picture is much worse. The job loss is 317,000 over the same period. So that tells you there were actually gains outside of manufacturing.

Representative Saxton. The period you are referring to is from—

Mr. Rones. It is from the past year. So it is September to September.

Representative Saxton. And what about July to July of—

Ms. Abraham. There is a table right behind. It may be easier if we provide that to you for the record, or if we can get the table and calculate it.

Representative Saxton. But let me just ask the question this way: The slowdown in the high-tech industry began in July of 2000, or June or July of 2000; is that correct?

Ms. Abraham. You certainly saw slowing in economic activity beginning in about that time frame. We would have to look at the series to precisely date it, but that sounds about right.

Representative Saxton. Fine. If you could just give us that information, we would appreciate it.

And can you give us some idea of the employment in electrical equipment, in the electrical equipment industry over the same period? I believe you are saying that you have the numbers from September to September. We are interested in a longer term, if you can provide those numbers, either today or—

Ms. Abraham. Electrical equipment, I have the numbers right here. As I mentioned in my statement, I think, electrical equipment, together with industrial machinery, accounts for a big share of the losses in manufacturing. Electrical equipment since last July is down 188,000, and industrial machinery, which includes computer equipment, is down 174,000.

Representative Saxton. So it is a significant loss. Has there been any sector of the economy where job gains have been shown since last July?

Ms. Abraham. Sure. Health services is the one that jumps to my mind. Despite weakening elsewhere in the economy, health services is still continuing to add jobs. Over the last six months from March to September, health services has been adding jobs at a pace of 26,000 a month, which is actually a faster rate of growth than we had been seeing.

Representative Saxton. They would tend to offset some of the job losses in your statistics from some of the other sectors, is that right?

Ms. Abraham. Right. The fact that there are some sectors where you are seeing growth, you are seeing growth in State and local government still. You are seeing some growth, though at a modest pace, in finance, insurance, and real estate. So to the extent that there are some sectors where you are seeing growth, that implies that the losses in other sectors are more than the net that we are reporting.

Representative Saxton. So the losses in some sectors have been offset in the total number by the growth in the health services sector and—

Ms. Abraham. To a certain extent, though it is very striking when you look at these data for years and years, you could count on the services industry to add jobs month in, month out, 100,000 jobs a month. Over the last six months, in the services industry as a whole, that includes health services and a number of other things, we have added essentially no new net jobs.

Representative Saxton. So I guess the point I am trying to make is that in spite of the fact that there have been some sectors of the economy where there has been job growth, we still continue to see the decline in, as is demonstrated on the chart with the nonfarm payrolls, the decline continues.

Ms. Abraham. You are seeing declines in manufacturing, declines elsewhere, and even sectors that historically have been reliable, net adders of jobs, have been flat in many cases.

Representative Saxton. Commissioner, thank you very much.

Senator Reed?

Senator Reed. Thank you very much, Mr. Chairman. Commissioner, wage and salaries as measured by the national accounts declined in August for the first time in six years. Do your numbers on aggregate weekly hours and hourly earnings suggested a decline in private nonfarm payrolls in September?

Ms. Abraham. We are still seeing increases in average hourly earnings, and in September, average weekly hours were actually up slightly. If you take those two together and look at average weekly earnings, roughly, the product of the two, average weekly earnings were up slightly on a seasonally adjusted basis in September.

Senator Reed. One of the issues we confront is the need to continue to stimulate consumer demand in the economy, and declining wages is one break on that kind of consumer demand. Do you have any idea going forward, particularly as we think about various policy decisions, about the potential effect of declining wages and household incomes?

Ms. Abraham. The Bureau will be able to provide information going forward on what is happening to earnings, but that is not something that we can project. Others may use our data to try to project that, but that is not something that we can project, and we also are not in the business of trying to analyze the data with reference to what they might imply for consumer spending.

Senator Reed. But the data that you have shows a slight decline in August in wages and salaries and perhaps a slight increase in September.

Ms. Abraham. Average weekly earnings in our data dropped off in August, consistent with the national account numbers, that not being wholly surprising, since they are not exactly independent. They are looking at our information and putting them together. The earnings figures jump back up in September to above the July level.

Senator Reed. And because of the events of September 11, is your presumption that wage and earning numbers would – as reflected in the next report – show a decline?

Ms. Abraham. I don't really have a prediction about what the earnings numbers are likely to show. I think what seems clear, based on published reports of layoffs across a variety of sectors that when we look at the employment data, it is going to be very surprising if we don't see employment declines registering, but beyond that, I am not really in a position to make a prediction.

Senator Reed. During the recessions of the 1990s and the early 1980s, there was a disparate impact on minority employment. As we go into – and those charts the Chairman have provided are pretty stark in terms of the direction we are heading. Do you also assume that minorities will suffer worse in an economic downturn as they did in the 1980s and 1990s?

Ms. Abraham. If you look at the data on unemployment rates, for example, of blacks, of Hispanics relative to the overall unemployment rate or relative to the unemployment rate for whites, historically, it has long been true that the unemployment rate for blacks, for example, exceeds that for – actually for Hispanics, that both of them exceed the rate for whites. The historical data show a fairly consistent kind of ratios among those rates. So if that historical pattern were to hold, when the overall unemployment rate goes up, the historical pattern would suggest that the absolute magnitude of the increase for blacks and for Hispanics would be exceed that for whites.

We don't know, of course, whether that pattern will hold, but that is what the historical pattern has been.

Senator Reed. Now, in your calculations, you consider, but I don't think include directly, discouraged workers. Could you comment on the situation of both discouraged workers and marginally attached workers, and what impact they would have on your numbers? And also, is either category of worker, discouraged or marginally attached, growing?

Ms. Abraham. Let me start out with answering that question by referring to the range of alternative measures of labor underutilization that we produce. The official unemployment rate counts as unemployed those people who were available for work, and had actively looked for work in the last four weeks. But we also produce more inclusive measures that include additional categories of workers. The most inclusive of those measures includes the marginally attached workers, meaning people who said they would like to work, looked for work sometime in the last year, but just didn't look in the last four weeks. The discouraged workers are a subset of that population. The broadest measure also includes those people who are employed part-time, even though they would have preferred full-time work and said that the reason was that they couldn't find something full time.

In terms of the official unemployment rate, over the last year, that has risen from four percent to 4.9 percent. This broader measure started out at a higher level. It was 6.6 percent a year ago. It has risen to 8.3 percent. So it is both higher and has gone up a bit more over that period.

Senator Reed. Also, with respect to part-time workers, in your statement you mentioned that those who usually work full-time but only worked part-time in September was significantly higher than normal. Can you tell us how much higher this number was and what portion of those who were only able to work part-time did so for economic reasons and what portion did so for non-economic reasons, and is this at all a reflection of September 11?

Ms. Abraham. Really, the reason that we were looking at these data was to try to see whether we could identify any impact of the events of September 11 in the data. As we have already discussed, we do not believe that there was an impact on the employment counts as a result of those events, but to the extent that there were people who were unable to be at work for the full week, there might have been an impact on hours, and we do indeed see that.

Where we have seen an effort is in people who usually work full-time, but worked part-time that week and said it was for some non-economic reason, such as the events of September 11. In an ordinary September, there are about seven million such people. This September there were in excess of 10 million such people. There are three to 3-1/2 million people who said they worked part-time during the week of September 9th and attributed it, by and large, to these events.

Senator Reed. Thank you, Mr. Chairman. Thank you, Commissioner.

Representative Saxton. Thank you, Senator Reed. We will now move over and we will hear from Senator Sessions.

Senator Sessions. Thank you, Mr. Chairman. I remember several years ago when I was first on this Committee, Alan Greenspan was testifying and the economy was roaring along, and he inserted in his remarks, he said, some think we have gone beyond history, but I have been in this business a little too long, and think we still have an economic cycle out there, a business cycle. And these numbers are not good, but our history tells us we go through cycles, and somehow we come out of cycles, so I think we ought to not be too pessimistic, but the numbers do show a consistent downward trend. And I would just – first, Commissioner Abraham, like to thank you for your service. It has been a pleasure for me to work with you and your office, and we thank you for your commitment to integrity and giving us the best numbers that we can get.

Ms. Abraham. Thank you.

Senator Sessions. And getting good numbers and at least knowing how to use them is a real challenge in this town. You would think that everybody could agree on what the circumstances are and what they are likely to be in the future, but it is just not easy to achieve.

Would you – I know you have done that to some degree in your opening statement, but with regard to unemployment, would you tell us the numbers you have and give us cautions about what each reflects and what degree of skepticism we should give to each?

Ms. Abraham. With respect to – with particular reference –

Senator Sessions. Well, like the household survey, it showed an increase in employment, and that is something that we don't want to become too excited about. Tell us about data and any other numbers and where you think we are, as your best judgment.

Ms. Abraham. Maybe the way to answer that question – and I am sure you will come back if I am not telling you what you were asking me – as you know, we have two surveys. We have a survey of employers and a survey of households and we report data from each every month. The survey of employers is, I think, the best thing to look at if you are trying to track what is happening to employment month to month. It is a huge survey. The survey covers employers who employ 40 million people. So if we are getting in that volume of reports every month, it is going to give you a pretty good sense of what is happening with employment.

The household survey, the source of the unemployment rate, is designed for a different purpose. It is designed to tell you about what is going on with people. It has got a sample of 60,000 households roughly, which is a big survey, and it does a very good job of telling you about the unemployment rate, the share of people who would like to be working who are out of work, of telling you about the employment-to-population ratio, those share kind of numbers. But it is just not a big enough survey to do a good job month to month of telling you about what is happening to the level of employment.

So what you see when you look at those data is numbers that jump around from month to month. So we had a drop in employment as measured by the household survey of a million last month, and then it rebounded by 800,000 this month. I don't think any of us believe that that is really what happened to employment. You have to take those numbers over a longer period of time and try to extract some trends from them.

Senator Sessions. That period, if you add them together and divided by two, you would have somewhat of a decline.

Ms. Abraham. You would have a better number. And, if you took the—

Senator Sessions. 100,000 decline—

Ms. Abraham. You would have a more reliable number. And if you took it over an even longer period of time, you would have a still more reliable number.

Senator Sessions. But we did have last month a rather dramatic employment drop under the household survey.

Ms. Abraham. As measured by the household survey. I guess to me what that is really pointing out is the unsuitability of those household survey data for tracking month-to-month movements in employment levels. For that purpose, I really would look at the employer survey.

Senator Sessions. With regard to the household survey, that is the number that we see most often in the papers, the average American sees, is what the unemployment rate is. That is kind of what everybody agrees to is the rate.

Ms. Abraham. That is right. And I think the unemployment rate is reliably measured from that survey. I am trying to draw a distinction between using the survey to estimate rates and proportions, which it does a real good job of, and using it to estimate levels—

Senator Sessions. Actual.

Ms. Abraham. —of things, which it is just not designed to do.

Senator Sessions. So the household survey unemployment rate at this month is 4.9?

Ms. Abraham. Right.

Senator Sessions. And that saw no change from last month?

Ms. Abraham. Right. And—

Senator Sessions. Essentially?

Ms. Abraham. That's right. Up four the month before. It clearly has been trending up.

Senator Sessions. And what about the employer survey? What do you show there? That is less encouraging.

Ms. Abraham. The payroll survey showed a decline in employment this month of 199,000.

Senator Sessions. What percentage of the economy, approximately, does the employer survey cover? What percentage of the employees are covered by the employer survey?

Ms. Abraham. It is designed to represent all nonagricultural wage and salary employment. The total nonagricultural wage and salary employment was just over 130 million; 132,166,000 by our estimates in September. The survey—

Senator Sessions. It includes sole proprietors?

Ms. Abraham. No. It only includes wage and salary employment. It doesn't include the agricultural sector, and it doesn't include people who are self-employed or working in a family business and not getting a paycheck.

Senator Sessions. Does the household survey include—

Ms. Abraham. The household survey includes everybody.

Senator Sessions. And include the—

Ms. Abraham. Self-employed, family businesses.

Senator Sessions. So to that extent it covers a broader sector of the economy.

Ms. Abraham. Yeah, it is broader in its coverage.

Senator Sessions. Thank you.

Representative Saxton. I thank the Senator very much for very thoughtful questions.

Mr. Watt.

Representative Watt. Thank you, Mr. Chairman. Commissioner Abraham, I appreciate you being here. I am sorry I was running a little late and missed your testimony, but I have reviewed it. I want to try to zero in on two things, if I can. My assumption being that in these economic times and times of unemployment, people at the lower end of

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the income spectrum are going to be hit significantly harder. And number two, that these numbers may have some implications for what kind of stimulus package we put together to try to address the adverse impacts of these economic times.

So I want to ask a couple of questions. I am not trying to draw you into any of the policy considerations, but I am trying to get guidance about what your numbers suggest so that we can better make those policy judgments.

First of all, does the Bureau of Labor Statistics maintain or gather any information about – or have you tracked the whole impact of welfare reform and welfare-to-work movement that was going, or seemed to be going pretty well, as long as we had a very robust economy and expanding employment? The reverse of that is one of the presumptions I would make is that those people who went from welfare to work in a robust employment economy would likely be among the first to go back in the ranks of the unemployed. I am wondering whether you have any information at all about that or whether any other department of the Federal Government maintains such information?

Ms. Abraham. We do not have any recent information on the experience of people who had been collecting welfare. The data that we collect as part of our household survey are limited with respect to their potential for being informative about that.

Representative Watt. And when you say you don't have any recent information, does that imply that you have some that is older or did you used to keep that type of information, or what?

Ms. Abraham. There was a research study that was done some years ago now using data that only went through 1998. One of our research staff members looked at people who reported, in March of the relevant years, that as part of their income, they had received some welfare income, and she then looked at what happened to those people over the subsequent year, whether they ended up moving into employment or something else.

Representative Watt. And was that a research project within your department?

Ms. Abraham. It was a research project carried out by one of our researchers.

Representative Watt. Has anybody else in the Federal Government done any work on this issue?

Ms. Abraham. I am certain that there are people who have. I am not well informed as to the whole range of things that might have been done. Your question, though, I think really was what happened to those people who may have left welfare for employment, what is happening to them now, and unfortunately, the data that we collect as part of our household survey wouldn't let us look at that. We would have no way to identify in our survey sample currently employed people who, at some time in the past, might have collected welfare benefits. You will need to look at a different kind of information to get at that. There is information collected by the Census Bureau as part of their survey of program dynamics that might be analyzed to try to shed light on this, but it would be with a considerable lag.

Representative Watt. Okay. I am just wondering whether somebody in your office may have some unique – or greater ability, I guess than I do, to identify what resources are available, because I think this economic downturn is going to have some substantial implications for what, if anything, we need to do to shore up TANF and the whole definition of work and how we deal with those people who have gone off welfare and into the workforce and now face – and the policies that we implemented there really kind of cut the period of time that people could be on welfare. I am not sure those – they may have made sense at the time we were doing them, but I am not sure in this economic time that – so if you could identify somebody who could help me try to understand this better, that would – I guess that is where I am headed to.

Ms. Abraham. Let me go back and ask the staff about that. In response to your question at the August hearing, I would have gone back and asked a narrower question, which was have we done anything, and the answer, except for this one study, was no. But let me ask someone to take a look at what information there might be out there more broadly that someone could take a look at.

Representative Watt. I see my time is out, but I want to do one follow-up on that prior question that I asked at a previous hearing – that either I dropped the ball on or somebody dropped the ball on – because I thought we were going to get some information that would help us make more valid judgments about whether in places where a livable wage or increase in the minimum wage had been adopted, there had been any real impact on unemployment as a result of that, because I think that has substantial implications for the stimulus package also, because part of what a number of us believe is important is to put money in at the consumer level, at the lower income level, and let that income trickle up rather than following the reverse policy.

Ms. Abraham. I have a copy of our letter to you here. I am afraid the answer was that we were not aware of conclusive evidence on this, though we did locate a study that attempted to look at the question.

[The letter from Commissioner Abraham to Representative Watt, accompanied by references on welfare reform, appear in the Submissions for the Record on page 50.]

Representative Saxton. Thank you. The gentleman's time has expired. The gentleman from Texas, Mr. Smith.

Representative Smith. Thank you, Mr. Chairman. I too arrived a little late, and if some of my questions have already been addressed to you, please let me know, Ms. Abraham. Before I get to a couple of questions, let me preface my remarks by saying that I think the – at least in my judgment, the economic times we find ourselves in today are pretty close to being unique. Certainly they are unique in the last 50 years, maybe there was something similar to them in World War II. I don't know. But in any case, the terrorist attacks have put us in a situation that was not foreseen, and as I say, may be unprecedented.

This suggests to me that coming up with solutions to the current economic climate may not be susceptible to the usual analysis, since we don't really have that much of a history or that much of a record in addressing these kinds of situations.

As you know the administration has talked about and is in the process of changing monetary policy. We are in the throes of considering an economic stimulus package which might amount to as much as $75 billion. This is somewhat unprecedented, and I think none of us know the exact impact. However, I would like for you, and if we can't make projections, perhaps we can at least, on the basis of the past, to try to make some calculated guesses as to what we might expect to happen in a couple of areas.

I guess my first question is very general, and that is, do you have any sense of how long it will take us to climb out of the economic hole that we find ourselves? I know you mentioned a while ago that you tend to only look at the figures, and you are not necessarily in the job of making projections, but if you look to the past, how long does an economic recovery usually take, given the current circumstances?

Ms. Abraham. That is not a question I can answer.

Representative Smith. Okay.

Ms. Abraham. I could do what someone else could also do, and go back and look at the duration of prior recessions. And as I think someone already observed, no one has officially yet said we are in a recession, but if it turns out that we are, the information on the duration of prior recessions may be relevant. It certainly is true that when the economy has entered recessions, that typically within a matter of some months, things start to turn around, but I have absolutely no basis for—

Representative Smith. Let me go to a more specific one. This goes to high-tech employment, maybe high-tech manufacturing employment. Traditionally it is the high-tech industry that has been an economic generator for our country, and some ways it is the high-tech industry that sort of leads us into the future and provides a cushion for the future as well. Do you have any figures? And, like I say, you may have covered this earlier, what has happened to the high-tech sector in the last few months, and also, do you have any kind of projections as to what the future holds for the high-tech sector?

Ms. Abraham. We do have figures on high-tech employment that I know my colleague, Mr. Rones, has readily on hand. A question on this had come up earlier, and we do have an answer to your question about what has happened to high-tech manufacturing employment since July of 2000, if we could insert that in the record. But maybe you could speak more generally, Phil.

Mr. Rones. Well, I would just say, the Chairman had asked about the period from July of last year to the current data, and since last July, in high-tech manufacturing the employment decline has been 136,000, but if you look at manufacturing by itself, it has declined 367,000.

So that says elsewhere in what we call high-tech industries, there had been an increase of 231,000. Now, remember, this is covering a longer period of 14 months as we have reported each month. The situation in the job market has generally deteriorated over that period so that it is likely that most of these gains occurred very early in that 14-month period.

Representative Smith. Okay. Let me try to squeeze in one more question, Mr. Chairman. This is in regard to various actions that Congress might take to try to alleviate the increasing unemployment rate. Do you have any feeling or any opinion as to, for example, whether an increase in the minimum wage would help or hurt given the economic situation we find ourself in?

Ms. Abraham. I do not.

Representative Smith. Okay. Why do you not have an opinion on that?

Ms. Abraham. In my capacity as Commissioner of Labor Statistics, I am responsible for producing data that can be broadly viewed by everyone as objective, and in the interest of protecting the reputation of the Bureau of Labor Statistics, or, you know, objectivity—

Representative Smith. So you consider that to be a subjective answer, not an objective answer?

Ms. Abraham. The effect of the minimum wage on employment is not something that we could produce data on. It is something that different analysts applying different methods to data might come to different conclusions about.

Representative Smith. Let me ask you if there is anything on the record or anything from our past experience that were we to increase the minimum wage during times of economic contraction, versus increasing the minimum wage during times of economic expansion, whether you are aware of any adverse impact that it has had on the economy.

Ms. Abraham. I really hate not to be responsive to a very legitimate question that you are raising, but it is not one I can answer.

Representative Smith. Okay. Thank you, Commissioner.

Thank you, Mr. Chairman.

Representative Saxton. Commissioner, thank you very much, and I would like to thank all the Members for being here today. But in particular, Commissioner, we have truly enjoyed the opportunity to have these sessions with you over the past years, and if this does turn out to be your last hearing, we just want you to know how much that we have benefitted from you being here and being as objective and forthcoming as you have over these years. So thank you.

And I thank all the Members for being here this morning, and we appreciate your participation.

Representative Watt. Mr. Chairman, I just wanted to offer Mr. Smith the information that I am going to get. I have asked for background information on minimum wage and historical information, not subjective information, but historical information, and whatever they give me I will be happy to share with you.

Representative Smith. Thank you, Mr. Watt. I will take you up on that offer.

Representative Saxton. Thank you for being here, and the hearing is adjourned.

[Whereupon, at 10:30 a.m., the hearing was adjourned.]

Submissions for the Record

Prepared Statement of Representative Jim Saxton, Chairman

I would like to welcome Commissioner Abraham before the Committee once again to report on the release of new employment and unemployment data for September.

According to the most recent economic data, the economic slowdown that began in the middle of 2000 continues. There was a prospect of economic improvement in the near future, but that has been overtaken by the horrific events of September 11. The potential rebound predicted by the consensus forecast of Blue Chip economists has been now erased by the economic effects of the terrorist attacks. However, the American people and economy have demonstrated tremendous resilience in the face of the terrorist attacks.

The September employment and unemployment data reflect the weakness in the economy evident before the terrorist attacks. Payroll employment declined by 199,000 in September. Once again, the payroll declines were focused in the manufacturing sector, and only add to the previous severe job losses in manufacturing underway since the middle of 2000, bringing the total to over 1 million jobs. The unemployment rate remained at 4.9 percent. The economic situation obviously is reason for concern.

According to a recent Committee report, it appears likely that the downward drift in the rate of real GDP growth underway since the middle of 2000 will now probably continue. Unfortunately, this suggests that payroll employment will tend to decline and the unemployment rate to rise in coming months.

The terrorist attacks have obviously disrupted the financial markets and overall economy in a number of ways. These attacks have created much uncertainty, and have also increased security costs. Delays in air and ground transport, higher shipping costs, additional insurance costs, extra costs for security personnel and equipment, fortification of buildings and facilities, and other measures will have the effect of imposing something like a "security tax" on an already vulnerable economy. This burden will undermine the economy in the short run, and will also adversely affect both productivity growth and the economy's long-run growth rate.

The exact size of the burden imposed by this security tax is not known, but we do know that it will be significant and pervasive. In recent days private sector economists have begun to consider this cost issue and its potential impact on an already weak economy.

Our analysis suggests that one logical policy response would be to offset these costs by relieving some of the tax burden on the private sector. Accelerating tax relief in the pipeline and other measures to minimize the net impact of the security tax should be a high priority of policymakers.

PREPARED STATEMENT OF SENATOR JACK REED, VICE CHAIRMAN

I would like to thank Commissioner Abraham for coming before us once again, and I understand, Commissioner, that this well may be your last hearing, as your term expires on the 13th. I would have preferred that the Secretary of Labor reappoint you so that you could continue to provide the valuable advice you have given this Committee and the Congress over several years. You have served the Bureau of Labor Statistics well in what can be a thankless job, and I thank you for all your efforts in overseeing the management of some of the country's most important statistics, and of course, testifying before this Committee over the last five years.

While the numbers before us today give us only a glimpse of the state of our economy since the terrorist attack 3-1/2 weeks ago, they do tell much that we need to know about the underlying economic trends that were at work before the devastating tragedy. The economy was already weak before September 11. Real GDP barely grew during the second quarter and the unemployment rate rose. Your testimony last month before the Committee suggested that labor markets were indeed weakening, especially for the most vulnerable workers.

Since September 11, the temporary disruption of our financial systems and the slump in travel related sectors of the economy have only worsened the situation. The few indicators we have received since the attacks suggest that the employment situation has worsened significantly. Businesses have announced more than 100,000 layoffs, and initial claims for unemployment insurance have risen sharply in the last two weeks in September. The tragedies have redirected our policy focus. Congress has moved swiftly to provide aid to New York and the airline industry.

We must now turn our attention to the larger question of jumpstarting the economy and ensuring that all of our citizens and all Americans participate in a renewed and more robust economy. We have worked hard over the past decade to strengthen our economy, while at the same time fostering more broadly shared prosperity. Now some of that is at risk. Once again, I want to thank you, Commissioner Abraham, for coming to discuss the latest economic developments, and their impacts on working Americans.

As we move forward in designing an appropriate fiscal stimulus, it is critical for us to have the best possible information concerning both the current state of the overall economy, as well as the status of our most vulnerable citizens.

FOR DELIVERY: 9:30 A.M., E.D.T.
FRIDAY, OCTOBER 5, 2001

Advance copies of this statement are made available to the press under lock-up conditions with the explicit understanding that the data are embargoed until 8:30 a.m. Eastern Daylight Time.

Statement of

Katharine G. Abraham
Commissioner
Bureau of Labor Statistics

before the

Joint Economic Committee

UNITED STATES CONGRESS

Friday, October 5, 2001

Mr. Chairman and Members of the Committee:

I am pleased to have the opportunity to comment on the September labor market data we released this morning.

Nonfarm payroll employment fell by nearly 200,000 in September. Heavy job losses continued in manufacturing, wholesale trade employment fell sharply, and there was weakness in most other major industries. The unemployment rate, at 4.9 percent, was unchanged over the month.

The tragic events of September 11th occurred during the reference periods for both our establishment and household surveys. In the establishment survey, persons who lost a job because of these events but who had worked at all in the pay period that included the 12th of the month, or who had received any paid leave, would be included in the September job count. Similarly, in the household survey, anyone who worked for even one hour during the week that began on September 9th, or who was temporarily absent from a job during that week, would be counted as employed. Thus, it is likely that the events of September 11 had little effect on the September employment and unemployment figures. Job loss related directly or indirectly to the events of September 11th should begin to be reflected in the October data, although we doubt that we will be able to isolate those effects as distinct from the effects of other economic developments. Perhaps the most direct measure will come from our Mass Layoff Statistics program, which identifies layoff events affecting 50 or more workers as measured by filings for unemployment insurance. Following the events of September 11, employers have been able to identify layoffs directly or indirectly attributable to "non-natural disasters," using a special code added for this purpose.

The September decline in nonfarm payroll employment was the fourth in the past 6 months, resulting in a net decline of 488,000 jobs since March. Employment in manufacturing eroded further, as another 93,000 jobs were shed in September. Industrial machinery and electrical equipment continued to post the largest losses within manufacturing, with over-the-month declines of 20,000 and 18,000, respectively. Together, these two industries account for nearly two-fifths of the 900,000 manufacturing jobs lost so far this year. Over the month, employment also fell substantially in motor vehicles (-10,000), printing and publishing (-8,000), fabricated metals (-8,000), and apparel (-6,000); other manufacturing industries generally had smaller losses.

Wholesale trade continued to feel the impact of declining manufacturing activity. Employment in the industry fell by 21,000 in September, its sharpest decline since peaking last November. Retail trade employment also was down over the month, largely due to job losses in eating and drinking places.

Employment growth in services has faltered in recent months, with virtually no net job gains since March. While health services continued to add jobs in September, employment in business services was down again over the month. Amusement and recreation employment also fell significantly in September.

Average weekly hours from our establishment survey showed no obvious effect of the economic disruptions that followed the September 11th attacks. These data are based on an hours paid concept, meaning that the work week estimates include paid leave. In September, average weekly hours were up by one-tenth of an hour.

Turning now to measures obtained from our household survey, both the number of unemployed people and the unemployment rate were unchanged over the month, following sharp increases in August. The unemployed numbered 7.0 million in September, an increase of nearly 1.5 million since late last year. The unemployment rate remained at 4.9 percent, one full percentage point above the 30-year low recorded last September and October. Civilian employment rose by almost 800,000 over the month, mostly offsetting a large decline in August.

Although there is no reason to think that the civilian employment and unemployment counts were substantially affected by the events of September 11th, measures of part-time work from the September household survey confirm that many Americans' hours at work were shortened that week. In particular, the number who usually work full time but worked part time during the reference period was significantly higher than normal.

Before concluding, I would like to provide you with a preliminary estimate of the effect on our payroll employment figures of the benchmark revision scheduled for release next June. Once a year, the Bureau adjusts the payroll survey's sample-based employment estimates to incorporate the previous year's March universe employment counts in a process known as benchmarking. These universe employment counts are derived principally from state unemployment insurance tax reports that nearly all employers are required to file. In the fall of each year, we typically have completed preliminary tabulations of these universe counts for the first quarter of the year. We routinely share our estimate of the anticipated size of the benchmark revision for the prior March in the fall.

Preliminary tabulations for the first quarter of 2001 indicate that the estimate of overall payroll employment will require a downward revision of approximately 76,000, or less than one-tenth of one percent, for the March 2001 reference month. The historical average for benchmark revisions over the past decade has been plus or minus 0.3 percent.

In summary, nonfarm payroll employment fell by nearly 200,000 in September, the fourth decline in the past 6 months. The unemployment rate was unchanged at 4.9 percent.

My colleagues and I now would be glad to answer your questions.

News United States Department of Labor

Bureau of Labor Statistics Washington, D.C. 20212

Technical information:
Household data: (202) 691-6378
http://www.bls.gov/cpshome.htm

Establishment data: 691-6555
http://www.bls.gov/ceshome.htm
Media contact: 691-5902

USDL 01-331

Transmission of material in this release is embargoed until 8:30 A.M. (EDT), Friday, October 5, 2001.

THE EMPLOYMENT SITUATION: SEPTEMBER 2001

Payroll employment fell by 199,000 in September, and the unemployment rate was unchanged at 4.9 percent, the Bureau of Labor Statistics of the U.S. Department of Labor reported today. Sharp job losses continued in manufacturing, and employment also fell in services, wholesale trade, and retail trade.

The terrorist attacks of September 11 occurred during the reference periods for the Bureau's monthly establishment and household surveys. In addition to the tragic loss of life, the attacks caused many businesses to shut down for one or more days. In the establishment survey, however, persons paid for any part of the reference period are considered employed. Similarly, in the household survey, persons working during any part of the reference week, as well as those temporarily absent from their jobs, are considered employed. Thus, it is likely that the events of September 11 had little effect on the September employment and unemployment counts.

Chart 1. Unemployment rate, seasonally adjusted, October 1998 - September 2001

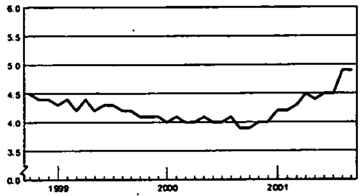
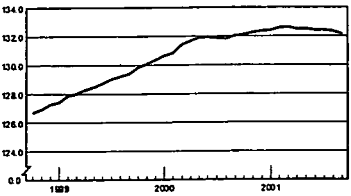


Chart 2. Nonfarm payroll employment, seasonally adjusted, October 1998 - September 2001



Unemployment (Household Survey Data)

The number of unemployed persons was essentially unchanged at 7.0 million in September, seasonally adjusted, and the unemployment rate remained at 4.9 percent. The jobless rate had been about 4.5 percent from April through July of this year and was 3.9 percent a year ago. The unemployment rates for each of the major worker groups—adult men (4.3 percent), adult women (4.4 percent), teenagers (14.7 percent), whites (4.3 percent), blacks (8.7 percent), and Hispanics (6.4 percent)—showed little or no change over the month. (See tables A-1 and A-2.)

Table A. Major indicators of labor market activity, seasonally adjusted
(Numbers in thousands)

Category	Quarterly averages 2001 II	Quarterly averages 2001 III	Monthly data 2001 July	Monthly data 2001 Aug.	Monthly data 2001 Sept.	Aug.-Sept. change
HOUSEHOLD DATA	Labor force status					
Civilian labor force	141,461	141,771	141,774	141,350	142,190	840
Employment	135,130	134,984	135,379	134,393	135,181	788
Unemployment	6,331	6,787	6,395	6,957	7,009	52
Not in labor force	70,072	70,367	70,147	70,785	70,167	-618
	Unemployment rates					
All workers	4.5	4.8	4.5	4.9	4.9	.0
Adult men	4.0	4.2	3.9	4.4	4.3	-0.1
Adult women	3.8	4.2	3.9	4.2	4.4	.2
Teenagers	14.0	15.2	14.8	16.1	14.7	-1.4
White	3.9	4.2	4.0	4.3	4.3	.0
Black	8.2	8.6	7.9	9.1	8.7	-.4
Hispanic origin	6.5	6.2	6.0	6.3	6.4	.1
ESTABLISHMENT DATA	Employment					
Nonfarm employment	132,483	p132,327	132,449	p132,365	p132,166	p-199
Goods-producing[1]	25,310	p24,991	25,122	p24,974	p24,877	p-97
Construction	6,866	p6,863	6,867	p6,863	p6,859	p-4
Manufacturing	17,882	p17,560	17,688	p17,542	p17,449	p-93
Service-producing[1]	107,173	p107,336	107,327	p107,391	p107,289	p-102
Retail trade	23,546	p23,570	23,606	p23,574	p23,530	p-44
Services	41,052	p41,080	41,046	p41,117	p41,076	p-41
Government	20,782	p20,971	20,932	p20,992	p20,989	p-3
	Hours of work[2]					
Total private	34.2	p34.1	34.2	p34.0	p34.1	p0.1
Manufacturing	40.8	p40.7	40.8	p40.7	p40.5	p-.2
Overtime	3.9	p4.0	4.0	p4.0	p3.9	p-.1
	Indexes of aggregate weekly hours (1982=100)[2]					
Total private	151.4	p150.2	150.8	p150.1	p149.7	p-0.4
	Earnings[2]					
Average hourly earnings, total private	$14.25	p$14.40	$14.34	p$14.41	p$14.44	p$0.03
Average weekly earnings, total private	487.46	p490.92	490.43	p489.94	p492.40	p2.46

[1] Includes other industries, not shown separately.

[2] Data relate to private production or nonsupervisory workers.

p=preliminary.

Total Employment and the Labor Force (Household Survey Data)

Total employment rose by about 800,000 in September to 135.2 million, seasonally adjusted. This follows a decline in August of even larger magnitude. Since January, employment has fallen by about 800,000, and the employment-population ratio (63.7 percent in September) has declined by 0.8 percentage point. (See table A-1.)

The civilian labor force rose to 142.2 million in September, and the labor force participation rate increased to 67.0 percent.

The number of persons who worked part time for economic reasons rose by about 860,000 in September to 4.2 million, seasonally adjusted. These persons indicated that they would like to work full time but worked part time because their hours had been cut back or because they were unable to find a full-time job. Most of the September increase was among persons whose hours were cut due to slack work or business conditions, and probably reflects the effect of the terrorist attacks on September 11, as businesses closed or were unable to operate at usual capacity. (See table A-4.)

Persons Not in the Labor Force (Household Survey Data)

About 1.3 million persons (not seasonally adjusted) were marginally attached to the labor force in September, up from 1.2 million a year earlier. These were people who wanted and were available for work and had looked for a job sometime in the prior 12 months but were not counted as unemployed because they had not searched for work in the 4 weeks preceding the survey. The number of discouraged workers was 280,000, essentially unchanged from a year earlier. Discouraged workers, a subset of the marginally attached, were not currently looking for work specifically because they believed no jobs were available for them. (See table A-10.)

Industry Payroll Employment (Establishment Survey Data)

Nonfarm payroll employment fell by 199,000 in September to 132.2 million, seasonally adjusted. This was the largest job loss since February 1991 and followed a decline of 84,000 (as revised) in August. Since March, net job losses have totaled nearly half a million. (See table B-1.)

In the goods-producing sector, the downward trend in manufacturing employment continued, as factories lost 93,000 jobs in September. This was the 14th consecutive month of factory job losses, bringing the decline in employment since July 2000 to 1.1 million. In durable goods manufacturing, large employment declines continued in both industrial machinery (20,000) and electrical equipment (18,000). Since July 2000, employment in industrial machinery has declined by 8 percent and employment in electrical equipment by 11 percent. In nondurable goods manufacturing, employment continued to decline in September in a number of industries including printing and publishing and apparel.

Employment in construction was little changed over the month and has shown no net growth in recent months. Mining employment was unchanged in September. It had risen by 21,000—due largely to increases in oil and gas extraction—during the prior 8 months.

Reflecting the slowdown in manufacturing, wholesale trade employment continued to decline, down by 21,000 in September. Since its last peak in November 2000, the industry has lost 80,000 jobs, with losses concentrated in durable goods distribution in most of those months. In September, however, employment in nondurable goods distribution also experienced a sizable decline.

Retail trade employment declined for the second straight month; in September, the largest losses were in eating and drinking places, apparel stores, and food stores. Both apparel stores and food stores have been on a declining trend in recent months. Employment in eating and drinking places showed no net growth in the third quarter.

The services industry lost 41,000 jobs in September. A primary source of job growth for several decades, services has shown no net gain in employment since March. Business services shed 39,000 jobs in September, matching its average monthly decline so far in 2001; most of the decline this year has been in help supply, which continued to reduce its payrolls in September. Following 2 months of declines, computer services posted a small job gain. Amusement and recreation services experienced a large employment decline in September (26,000). Job growth continued in health services; the industry added 29,000 jobs in September, about half of which was in hospitals. Employment in health services has increased by 230,000 thus far this year.

Employment in finance, insurance, and real estate increased by 14,000 in September. Job growth in security brokerages, insurance, and real estate, however, reflects fewer seasonal reductions than usual following weak hiring in these industries earlier in the year.

Employment in transportation and public utilities edged down in September, following a very large decline in August. So far this year, the industry has lost about 40,000 jobs. Employment has been on a downward trend for much of this year in trucking and air transportation and, in recent months, in communications. Employment in government was little changed over the month.

Weekly Hours (Establishment Survey Data)

The average workweek for production or nonsupervisory workers on private nonfarm payrolls edged up by 0.1 hour in September to 34.1 hours, seasonally adjusted. The manufacturing workweek decreased by 0.2 hour to 40.5 hours. Manufacturing overtime was down by 0.1 hour to 3.9 hours. The weekly hours series measure hours paid rather than hours actually worked. Thus, the hours missed due to the terrorist attacks would still be counted if the workers were paid for those hours. (See table B-2.)

The index of aggregate weekly hours of production or nonsupervisory workers on private nonfarm payrolls fell by 0.3 percent in September to 149.7 (1982=100), seasonally adjusted. The index is down by 1.6 percent since January. The manufacturing index fell by 1.2 percent to 95.5 in September and has fallen by 10.7 percent since July 2000. (See table B-5.)

Hourly and Weekly Earnings (Establishment Survey Data)

Average hourly earnings of production or nonsupervisory workers on private nonfarm payrolls increased by 3 cents in September to $14.44, seasonally adjusted. This follows a gain of 7 cents (as revised) in August. Average weekly earnings rose by 0.5 percent in September to $492.40. Over the year, average hourly earnings increased by 4.3 percent and average weekly earnings grew by 3.4 percent. (See table B-3.)

The Employment Situation for October 2001 is scheduled to be released on Friday, November 2, at 8:30 A.M. (EST).

Explanatory Note

This news release presents statistics from two major surveys, the Current Population Survey (household survey) and the Current Employment Statistics survey (establishment survey). The household survey provides the information on the labor force, employment, and unemployment that appears in the A tables, marked HOUSEHOLD DATA. It is a sample survey of about 60,000 households conducted by the U.S. Census Bureau for the Bureau of Labor Statistics (BLS).

The establishment survey provides the information on the employment, hours, and earnings of workers on nonfarm payrolls that appears in the B tables, marked ESTABLISHMENT DATA. This information is collected from payroll records by BLS in cooperation with State agencies. In June 2001, the sample included about 350,000 establishments employing about 39 million people.

For both surveys, the data for a given month relate to a particular week or pay period. In the household survey, the reference week is generally the calendar week that contains the 12th day of the month. In the establishment survey, the reference period is the pay period including the 12th, which may or may not correspond directly to the calendar week.

Coverage, definitions, and differences between surveys

Household survey. The sample is selected to reflect the entire civilian noninstitutional population. Based on responses to a series of questions on work and job search activities, each person 16 years and over in a sample household is classified as employed, unemployed, or not in the labor force.

People are classified as *employed* if they did any work at all as paid employees during the reference week; worked in their own business, profession, or on their own farm; or worked without pay at least 15 hours in a family business or farm. People are also counted as employed if they were temporarily absent from their jobs because of illness, bad weather, vacation, labor-management disputes, or personal reasons.

People are classified as *unemployed* if they meet all of the following criteria: They had no employment during the reference week; they were available for work at that time; and they made specific efforts to find employment sometime during the 4-week period ending with the reference week. Persons laid off from a job and expecting recall need not be looking for work to be counted as unemployed. The unemployment data derived from the household survey in no way depend upon the eligibility for or receipt of unemployment insurance benefits.

The *civilian labor force* is the sum of employed and unemployed persons. Those not classified as employed or unemployed are *not in the labor force*. The *unemployment rate* is the number unemployed as a percent of the labor force. The *labor force participation rate* is the labor force as a percent of the population, and the *employment-population ratio* is the employed as a percent of the population.

Establishment survey. The sample establishments are drawn from private nonfarm businesses such as factories, offices, and stores, as well as Federal, State, and local government entities. *Employees on nonfarm payrolls* are those who received pay for any part of the reference pay period, including persons on paid leave. Persons are counted in each job they hold. *Hours and earnings* data are for private businesses and relate only to production workers in the goods-producing sector and nonsupervisory workers in the service-producing sector.

Differences in employment estimates. The numerous conceptual and methodological differences between the household and establishment surveys result in important distinctions in the employment estimates derived from the surveys. Among these are:

- The household survey includes agricultural workers, the self-employed, unpaid family workers, and private household workers among the employed. These groups are excluded from the establishment survey.
- The household survey includes people on unpaid leave among the employed. The establishment survey does not.
- The household survey is limited to workers 16 years of age and older. The establishment survey is not limited by age.
- The household survey has no duplication of individuals, because individuals are counted only once, even if they hold more than one job. In the establishment survey, employees working at more than one job and thus appearing on more than one payroll would be counted separately for each appearance.

Other differences between the two surveys are described in "Comparing Employment Estimates from Household and Payroll Surveys," which may be obtained from BLS upon request.

Seasonal adjustment

Over the course of a year, the size of the nation's labor force and the levels of employment and unemployment undergo sharp fluctuations due to such seasonal events as changes in weather, reduced or expanded production, harvests, major holidays, and the opening and closing of schools. The effect of such seasonal variation can be very large; seasonal fluctuations may account for as much as 95 percent of the month-to-month changes in unemployment.

Because these seasonal events follow a more or less regular pattern each year, their influence on statistical trends can be eliminated by adjusting the statistics from month to month. These adjustments make nonseasonal developments, such as declines in economic activity or increases in the participation of women in the labor force, easier to spot. For example, the large number of youth entering the labor force each June is likely to obscure any other changes that have taken place relative to May, making it difficult to determine if the level of economic activity has risen or declined. However, because the effect of students finishing school in previous years is known, the statistics for the current year can be adjusted to allow for a comparable change. Insofar as the seasonal adjustment is made correctly, the adjusted figure provides a more useful tool with which to analyze changes in economic activity.

In both the household and establishment surveys, most seasonally adjusted series are independently adjusted. However, the adjusted series for many major estimates, such as total payroll employment, employment in most major industry divisions, total employment, and

unemployment are computed by aggregating independently adjusted component series. For example, total unemployment is derived by summing the adjusted series for four major age-sex components; this differs from the unemployment estimate that would be obtained by directly adjusting the total or by combining the duration, reasons, or more detailed age categories.

The numerical factors used to make the seasonal adjustments are recalculated twice a year. For the household survey, the factors are calculated for the January-June period and again for the July-December period. For the establishment survey, updated factors for seasonal adjustment are calculated for the May-October period and introduced along with new benchmarks, and again for the November-April period. In both surveys, revisions to historical data are made once a year.

Reliability of the estimates

Statistics based on the household and establishment surveys are subject to both sampling and nonsampling error. When a sample rather than the entire population is surveyed, there is a chance that the sample estimates may differ from the "true" population values they represent. The exact difference, or *sampling error*, varies depending on the particular sample selected, and this variability is measured by the standard error of the estimate. There is about a 90-percent chance, or level of confidence, that an estimate based on a sample will differ by no more than 1.6 standard errors from the "true" population value because of sampling error. BLS analyses are generally conducted at the 90-percent level of confidence.

For example, the confidence interval for the monthly change in total employment from the household survey is on the order of plus or minus 292,000. Suppose the estimate of total employment increases by 100,000 from one month to the next. The 90-percent confidence interval on the monthly change would range from -192,000 to 392,000 (100,000 +/- 292,000). These figures do not mean that the sample results are off by these magnitudes, but rather that there is about a 90-percent chance that the "true" over-the-month change lies within this interval. Since this range includes values of less than zero, we could not say with confidence that employment had, in fact, increased. If, however, the reported employment rise was half a million, then all of the values within the 90-percent confidence interval would be greater than zero. In this case, it is likely (at least a 90-percent chance) that an employment rise had, in fact, occurred. The 90-percent confidence interval for the monthly change in unemployment is +/- 273,000, and for the monthly change in the unemployment rate it is +/- .19 percentage point.

In general, estimates involving many individuals or establishments have lower standard errors (relative to the size of the estimate) than estimates which are based on a small number of observations. The precision of estimates is also improved when the data are cumulated over time such as for quarterly and annual averages. The seasonal adjustment process can also improve the stability of the monthly estimates.

The household and establishment surveys are also affected by *nonsampling error*. Nonsampling errors can occur for many reasons, including the failure to sample a segment of the population, inability to obtain information for all respondents in the sample, inability or unwillingness of respondents to provide correct information on a timely basis, mistakes made by respondents, and errors made in the collection or processing of the data.

For example, in the establishment survey, estimates for the most recent 2 months are based on substantially incomplete returns; for this reason, these estimates are labeled preliminary in the tables. It is only after two successive revisions to a monthly estimate, when nearly all sample reports have been received, that the estimate is considered final.

Another major source of nonsampling error in the establishment survey is the inability to capture, on a timely basis, employment generated by new firms. To correct for this systematic underestimation of employment growth (and other sources of error), a process known as bias adjustment is included in the survey's estimating procedures, whereby a specified number of jobs is added to the monthly sample-based change. The size of the monthly bias adjustment is based largely on past relationships between the sample-based estimates of employment and the total counts of employment described below.

The sample-based estimates from the establishment survey are adjusted once a year (on a lagged basis) to universe counts of payroll employment obtained from administrative records of the unemployment insurance program. The difference between the March sample-based employment estimates and the March universe counts is known as a benchmark revision, and serves as a rough proxy for total survey error. The new benchmarks also incorporate changes in the classification of industries. Over the past decade, the benchmark revision for total nonfarm employment has averaged 0.3 percent, ranging from zero to 0.7 percent.

Additional statistics and other information

More comprehensive statistics are contained in *Employment and Earnings*, published each month by BLS. It is available for $26.00 per issue or $50.00 per year from the U.S. Government Printing Office, Washington, DC 20402. All orders must be prepaid by sending a check or money order payable to the Superintendent of Documents, or by charging to Mastercard or Visa.

Employment and Earnings also provides measures of sampling error for the household survey data published in this release. For unemployment and other labor force categories, these measures appear in tables 1-B through 1-D of its "Explanatory Notes." Measures of the reliability of the data drawn from the establishment survey and the actual amounts of revision due to benchmark adjustments are provided in tables 2-B through 2-H of that publication.

Information in this release will be made available to sensory impaired individuals upon request. Voice phone: 202-691-5200; TDD message referral phone: 1-800-877-8339.

HOUSEHOLD DATA

Table A-1. Employment status of the civilian population by sex and age

(Numbers in thousands)

Employment status, sex, and age	Not seasonally adjusted			Seasonally adjusted[1]					
	Sept. 2000	Aug. 2001	Sept. 2001	Sept. 2000	May 2001	June 2001	July 2001	Aug. 2001	Sept. 2001
TOTAL									
Civilian noninstitutional population	210,161	212,135	212,357	210,161	211,525	211,725	211,921	212,135	212,357
Civilian labor force	140,357	141,862	141,576	140,847	141,272	141,354	141,774	141,350	142,190
Participation rate	66.8	66.9	66.7	67.0	66.8	66.8	66.9	66.6	67.0
Employed	135,033	134,905	134,868	135,310	135,103	134,932	135,379	134,393	135,181
Employment-population ratio	64.3	63.6	63.5	64.4	63.9	63.7	63.9	63.4	63.7
Agriculture	3,510	3,419	3,371	3,356	3,193	2,995	3,045	3,117	3,220
Nonagricultural industries	131,523	131,487	131,497	131,954	131,910	131,937	132,334	131,276	131,961
Unemployed	5,324	6,956	6,708	5,537	6,169	6,422	6,395	6,957	7,009
Unemployment rate	3.8	4.9	4.7	3.9	4.4	4.5	4.5	4.9	4.9
Not in labor force	69,804	70,274	70,781	69,314	70,254	70,370	70,147	70,785	70,167
Persons who currently want a job	4,184	5,062	4,348	4,355	4,535	4,600	4,529	4,858	4,539
Men, 16 years and over									
Civilian noninstitutional population	100,963	101,995	102,110	100,963	101,684	101,786	101,885	101,995	102,110
Civilian labor force	74,983	76,102	75,689	75,305	75,344	75,462	75,719	75,518	76,058
Participation rate	74.3	74.6	74.1	74.6	74.1	74.1	74.3	74.0	74.5
Employed	72,317	72,554	72,284	72,398	71,978	71,926	72,279	71,690	72,333
Employment-population ratio	71.6	71.1	70.8	71.7	70.8	70.7	70.9	70.3	70.8
Unemployed	2,666	3,548	3,405	2,907	3,366	3,535	3,439	3,828	3,724
Unemployment rate	3.6	4.7	4.5	3.9	4.5	4.7	4.5	5.1	4.9
Men, 20 years and over									
Civilian noninstitutional population	92,863	93,810	93,917	92,863	93,541	93,616	93,708	93,810	93,917
Civilian labor force	70,954	71,713	71,750	71,053	71,351	71,346	71,555	71,514	71,894
Participation rate	76.4	76.4	76.4	76.5	76.3	76.2	76.4	76.2	76.6
Employed	68,823	68,828	68,952	68,728	68,595	68,466	68,745	68,402	68,826
Employment-population ratio	74.1	73.4	73.4	74.0	73.3	73.1	73.4	72.9	73.3
Agriculture	2.474	2,301	2,301	2,350	2,169	2,035	2,028	2,140	2,175
Nonagricultural industries	66.349	66,527	66,651	66,378	66,426	66,430	66,717	66,262	66,651
Unemployed	2,130	2,885	2,799	2,325	2,756	2,880	2,810	3,112	3,069
Unemployment rate	3.0	4.0	3.9	3.3	3.9	4.0	3.9	4.4	4.3
Women, 16 years and over									
Civilian noninstitutional population	109,198	110,140	110,247	109,198	109,842	109,939	110,035	110,140	110,247
Civilian labor force	65,374	65,759	65,887	65,542	65,928	65,893	66,055	65,833	66,132
Participation rate	59.9	59.7	59.8	60.0	60.0	59.9	60.0	59.8	60.0
Employed	62,716	62,352	62,584	62,912	63,125	63,006	63,100	62,703	62,848
Employment-population ratio	57.4	56.6	56.8	57.6	57.5	57.3	57.3	56.9	57.0
Unemployed	2,658	3,408	3,303	2,630	2,803	2,887	2,956	3,130	3,284
Unemployment rate	4.1	5.2	5.0	4.0	4.3	4.4	4.5	4.8	5.0
Women, 20 years and over									
Civilian noninstitutional population	101,321	102,165	102,277	101,321	101,938	102,023	102,067	102,165	102,277
Civilian labor force	61,552	61,743	62,230	61,486	62,119	61,890	62,145	62,172	62,242
Participation rate	60.7	60.4	60.8	60.7	60.9	60.7	60.9	60.9	60.9
Employed	59,370	58,851	59,446	59,344	59,766	59,510	59,752	59,562	59,489
Employment-population ratio	58.6	57.6	58.1	58.6	58.6	58.3	58.5	58.3	58.2
Agriculture	787	820	842	764	822	752	773	766	826
Nonagricultural industries	58,583	58,032	58,604	58,580	58,943	58,759	58,978	58,796	58,663
Unemployed	2,182	2,892	2,784	2,142	2,353	2,380	2,394	2,610	2,754
Unemployment rate	3.5	4.7	4.5	3.5	3.8	3.8	3.9	4.2	4.4
Both sexes, 16 to 19 years									
Civilian noninstitutional population	15,977	16,161	16,163	15,977	16,046	16,086	16,145	16,161	16,163
Civilian labor force	7,852	8,406	7,595	8,308	7,802	8,118	8,074	7,664	8,054
Participation rate	49.1	52.0	47.0	52.0	48.6	50.5	50.0	47.4	49.8
Employed	6,840	7,226	6,469	7,238	6,742	6,956	6,883	6,429	6,867
Employment-population ratio	42.8	44.7	40.0	45.3	42.0	43.2	42.6	39.8	42.5
Agriculture	249	299	228	242	201	209	244	211	219
Nonagricultural industries	6,591	6,928	6,242	6,996	6,541	6,748	6,638	6,218	6,648
Unemployed	1,012	1,180	1,126	1,070	1,060	1,162	1,191	1,236	1,187
Unemployment rate	12.9	14.0	14.8	12.9	13.6	14.3	14.8	16.1	14.7

[1] The population figures are not adjusted for seasonal variation; therefore, identical numbers appear in the unadjusted and seasonally adjusted columns.

Table A-2. Employment status of the civilian population by race, sex, age, and Hispanic origin

(Numbers in thousands)

Employment status, race, sex, age, and Hispanic origin	Not seasonally adjusted			Seasonally adjusted[1]					
	Sept. 2000	Aug. 2001	Sept. 2001	Sept. 2000	May 2001	June 2001	July 2001	Aug. 2001	Sept. 2001
WHITE									
Civilian noninstitutional population	174,745	176,069	176,220	174,745	175,653	175,789	175,924	176,069	176,220
Civilian labor force	117,237	118,065	117,853	117,553	117,688	117,733	117,982	117,726	118,290
Participation rate	67.1	67.1	66.9	67.3	67.0	67.0	67.1	66.9	67.1
Employed	113,334	113,084	113,013	113,464	113,185	113,037	113,237	112,703	113,201
Employment-population ratio	64.9	64.2	64.1	64.9	64.4	64.3	64.4	64.0	64.2
Unemployed	3,903	4,981	4,840	4,089	4,503	4,696	4,745	5,024	5,089
Unemployment rate	3.3	4.2	4.1	3.5	3.8	4.0	4.0	4.3	4.3
Men, 20 years and over									
Civilian labor force	60,227	60,648	60,672	60,259	60,512	60,389	60,432	60,575	60,784
Participation rate	76.9	76.8	76.8	76.9	76.8	76.6	76.6	76.7	76.9
Employed	58,660	58,589	58,610	58,529	58,493	58,244	58,362	58,297	58,493
Employment-population ratio	74.9	74.2	74.2	74.7	74.3	73.9	74.0	73.8	74.0
Unemployed	1,567	2,059	2,063	1,730	2,019	2,145	2,069	2,278	2,292
Unemployment rate	2.6	3.4	3.4	2.9	3.3	3.6	3.4	3.8	3.8
Women, 20 years and over									
Civilian labor force	50,355	50,268	50,713	50,256	50,611	50,431	50,684	50,656	50,651
Participation rate	60.1	59.6	60.1	60.0	60.2	59.9	60.2	60.1	60.0
Employed	48,786	48,204	48,773	48,700	48,902	48,749	48,925	48,839	48,724
Employment-population ratio	58.3	57.2	57.8	58.2	58.1	57.9	58.1	57.9	57.8
Unemployed	1,570	2,065	1,941	1,556	1,708	1,682	1,759	1,817	1,927
Unemployment rate	3.1	4.1	3.8	3.1	3.4	3.3	3.5	3.6	3.8
Both sexes, 16 to 19 years									
Civilian labor force	6,654	7,149	6,458	7,038	6,566	6,913	6,866	6,495	6,855
Participation rate	52.4	55.8	50.4	55.4	51.4	54.0	53.6	50.7	53.5
Employed	5,888	6,292	5,630	6,235	5,790	6,044	5,950	5,567	5,984
Employment-population ratio	46.4	49.1	43.9	49.1	45.3	47.2	46.5	43.4	46.7
Unemployed	766	857	837	803	776	869	916	928	870
Unemployment rate	11.5	12.0	12.9	11.4	11.8	12.6	13.3	14.3	12.7
Men	11.9	12.8	13.3	12.2	13.1	14.5	13.7	15.8	13.5
Women	11.1	11.0	12.5	10.6	10.5	10.6	13.0	12.7	11.9
BLACK									
Civilian noninstitutional population	25,299	25,604	25,644	25,299	25,501	25,533	25,565	25,604	25,644
Civilian labor force	16,426	16,788	16,719	16,489	16,639	16,756	16,693	16,712	16,792
Participation rate	64.9	65.6	65.2	65.2	65.2	65.6	65.3	65.3	65.5
Employed	15,244	15,215	15,269	15,304	15,311	15,343	15,374	15,195	15,327
Employment-population ratio	60.3	59.4	59.5	60.5	60.0	60.1	60.1	59.3	59.8
Unemployed	1,182	1,572	1,450	1,185	1,328	1,413	1,320	1,517	1,466
Unemployment rate	7.2	9.4	8.7	7.2	8.0	8.4	7.9	9.1	8.7
Men, 20 years and over									
Civilian labor force	7,285	7,418	7,436	7,307	7,275	7,317	7,395	7,424	7,468
Participation rate	71.8	72.3	72.3	72.0	71.2	71.5	72.1	72.3	72.6
Employed	6,826	6,772	6,897	6,832	6,723	6,744	6,808	6,752	6,904
Employment-population ratio	67.3	66.0	67.1	67.3	65.8	65.9	66.4	65.8	67.1
Unemployed	458	646	538	475	552	573	586	672	564
Unemployment rate	6.3	8.7	7.2	6.5	7.6	7.8	7.9	9.0	7.6
Women, 20 years and over									
Civilian labor force	8,239	8,387	8,433	8,231	8,421	8,491	8,409	8,424	8,424
Participation rate	64.9	65.3	65.5	64.9	65.8	66.3	65.5	65.6	65.4
Employed	7,740	7,756	7,764	7,750	7,882	7,917	7,903	7,842	7,772
Employment-population ratio	61.0	60.4	60.3	61.1	61.6	61.8	61.6	61.0	60.4
Unemployed	499	631	669	481	539	573	506	582	652
Unemployment rate	6.1	7.5	7.9	5.8	6.4	6.8	6.0	6.9	7.7
Both sexes, 16 to 19 years									
Civilian labor force	902	982	851	951	942	948	890	864	901
Participation rate	36.6	39.5	34.2	38.6	38.0	38.2	35.8	34.8	36.2
Employed	677	687	608	722	706	681	663	601	651
Employment-population ratio	27.5	27.7	24.4	29.3	28.5	27.5	26.7	24.2	26.2
Unemployed	225	295	243	229	236	267	227	263	250
Unemployment rate	24.9	30.0	28.5	24.1	25.1	28.2	25.5	30.4	27.7
Men	25.8	32.7	29.8	26.7	30.0	30.7	26.9	32.5	30.5
Women	24.1	27.2	27.1	21.7	20.3	26.0	24.3	28.1	24.8

See footnotes at end of table.

Table A-2. Employment status of the civilian population by race, sex, age, and Hispanic origin — Continued

(Numbers in thousands)

Employment status, race, sex, age, and Hispanic origin	Not seasonally adjusted			Seasonally adjusted[1]					
	Sept. 2000	Aug. 2001	Sept. 2001	Sept. 2000	May 2001	June 2001	July 2001	Aug. 2001	Sept. 2001
HISPANIC ORIGIN									
Civilian noninstitutional population	22,555	23,222	23,288	22,555	23,021	23,090	23,157	23,222	23,288
Civilian labor force	15,525	15,798	15,815	15,513	15,608	15,570	15,788	15,772	15,813
Participation rate	68.8	68.0	67.9	68.8	67.8	67.4	68.2	67.9	67.9
Employed	14,666	14,778	14,817	14,647	14,634	14,538	14,843	14,778	14,802
Employment-population ratio	65.0	63.6	63.6	64.9	63.6	63.0	64.1	63.6	63.6
Unemployed	859	1,020	998	866	975	1,032	945	994	1,010
Unemployment rate	5.5	6.5	6.3	5.6	6.2	6.6	6.0	6.3	6.4

[1] The population figures are not adjusted for seasonal variation; therefore, identical numbers appear in the unadjusted and seasonally adjusted columns.

NOTE: Detail for the above race and Hispanic-origin groups will not sum to totals because data for the "other races" group are not presented and Hispanics are included in both the white and black population groups.

Table A-3. Employment status of the civilian population 25 years and over by educational attainment

(Numbers in thousands)

Educational attainment	Not seasonally adjusted			Seasonally adjusted[1]					
	Sept. 2000	Aug. 2001	Sept. 2001	Sept. 2000	May 2001	June 2001	July 2001	Aug. 2001	Sept. 2001
Less than a high school diploma									
Civilian noninstitutional population	28,346	27,468	27,478	28,346	28,350	28,504	27,679	27,468	27,478
Civilian labor force	12,578	12,034	12,126	12,301	12,319	12,170	12,188	11,799	11,859
Percent of population	44.4	43.8	44.1	43.4	43.5	42.7	44.0	43.0	43.2
Employed	11,872	11,239	11,271	11,542	11,523	11,338	11,380	10,943	10,932
Employment-population ratio	41.9	40.9	41.0	40.7	40.6	39.8	41.1	39.8	39.8
Unemployed	706	795	855	759	797	831	808	856	927
Unemployment rate	5.6	6.6	7.1	6.2	6.5	6.8	6.6	7.3	7.8
High school graduates, no college[2]									
Civilian noninstitutional population	57,244	57,513	57,400	57,244	57,456	57,099	56,947	57,513	57,400
Civilian labor force	36,712	36,674	36,712	36,815	36,952	36,821	36,970	37,096	36,873
Percent of population	64.1	63.8	64.0	64.3	64.3	64.5	64.9	64.5	64.2
Employed	35,534	35,105	35,232	35,574	35,507	35,391	35,468	35,460	35,303
Employment-population ratio	62.1	61.0	61.4	62.1	61.8	62.0	62.3	61.7	61.5
Unemployed	1,178	1,569	1,479	1,241	1,446	1,431	1,502	1,636	1,571
Unemployment rate	3.2	4.3	4.0	3.4	3.9	3.9	4.1	4.4	4.3
Less than a bachelor's degree[3]									
Civilian noninstitutional population	44,191	45,339	45,424	44,191	44,576	44,812	45,444	45,339	45,424
Civilian labor force	32,683	33,440	33,585	32,952	33,192	33,314	33,296	33,481	33,880
Percent of population	74.0	73.8	73.9	74.6	74.5	74.3	73.3	73.8	74.6
Employed	31,866	32,310	32,467	32,093	32,188	32,263	32,301	32,407	32,696
Employment-population ratio	72.1	71.3	71.5	72.6	72.2	72.0	71.1	71.5	72.0
Unemployed	817	1,130	1,117	859	1,004	1,051	994	1,075	1,184
Unemployment rate	2.5	3.4	3.3	2.6	3.0	3.2	3.0	3.2	3.5
College graduates									
Civilian noninstitutional population	45,863	46,734	46,870	45,863	46,271	46,348	46,784	46,734	46,870
Civilian labor force	36,227	36,528	36,998	36,071	36,687	36,592	36,634	36,649	36,896
Percent of population	79.0	78.2	78.9	78.6	79.3	78.9	78.3	78.4	78.7
Employed	35,531	35,547	36,072	35,397	35,915	35,796	35,859	35,870	36,000
Employment-population ratio	77.5	76.1	77.0	77.2	77.6	77.2	76.6	76.8	76.8
Unemployed	696	980	926	674	771	796	775	779	896
Unemployment rate	1.9	2.7	2.5	1.9	2.1	2.2	2.1	2.1	2.4

[1] The population figures are not adjusted for seasonal variation, therefore, identical numbers appear in the unadjusted and seasonally adjusted columns.

[2] Includes high school diploma or equivalent.

[3] Includes the categories, some college, no degree; and associate degree.

Table A-4. Selected employment indicators

(In thousands)

Category	Not seasonally adjusted			Seasonally adjusted					
	Sept. 2000	Aug. 2001	Sept. 2001	Sept. 2000	May 2001	June 2001	July 2001	Aug. 2001	Sept. 2001
CHARACTERISTIC									
Total employed, 16 years and over	135,033	134,905	134,868	135,310	135,103	134,932	135,379	134,393	135,181
Married men, spouse present	43,627	43,215	43,436	43,321	43,733	43,428	43,294	43,172	43,091
Married women, spouse present	33,503	33,129	33,597	33,491	33,686	33,380	33,603	33,805	33,664
Women who maintain families	8,633	8,389	8,381	8,516	8,319	8,529	8,567	8,323	8,240
OCCUPATION									
Managerial and professional specialty	41,106	41,465	41,899	40,938	41,996	41,987	41,917	41,750	41,775
Technical, sales, and administrative support	38,810	38,625	38,645	39,093	38,743	38,998	39,067	38,684	39,114
Service occupations	18,019	18,287	18,210	18,190	18,224	18,576	18,642	18,052	18,357
Precision production, craft, and repair	15,005	15,200	14,866	15,083	14,962	14,794	14,997	15,050	14,941
Operators, fabricators, and laborers	18,482	17,780	17,730	18,472	17,904	17,564	17,571	17,655	17,679
Farming, forestry, and fishing	3,612	3,548	3,517	3,390	3,251	3,136	3,166	3,154	3,306
CLASS OF WORKER									
Agriculture:									
Wage and salary workers	2,141	2,032	2,003	2,018	1,958	1,775	1,786	1,850	1,884
Self-employed workers	1,328	1,349	1,342	1,274	1,201	1,168	1,258	1,239	1,290
Unpaid family workers	42	38	26	38	38	36	22	29	23
Nonagricultural industries:									
Wage and salary workers	122,545	122,866	122,744	123,117	123,416	123,009	123,432	122,686	123,278
Government	18,827	18,566	19,222	19,003	19,067	18,812	18,919	19,219	19,397
Private industries	103,718	104,301	103,522	104,114	104,349	104,197	104,513	103,467	103,881
Private households	784	792	768	824	789	744	790	827	809
Other industries	102,934	103,509	102,754	103,290	103,559	103,453	103,723	102,640	103,072
Self-employed workers	8,878	8,515	8,657	8,788	8,530	8,741	8,574	8,481	8,563
Unpaid family workers	99	108	95	108	103	94	88	113	102
PERSONS AT WORK PART TIME									
All industries:									
Part time for economic reasons	2,854	3,289	3,765	3,188	3,371	3,637	3,468	3,326	4,188
Slack work or business conditions	1,837	1,948	2,561	2,051	2,215	2,299	2,120	2,088	2,861
Could only find part-time work	784	913	1,005	831	900	1,025	999	935	1,081
Part time for noneconomic reasons	18,751	16,434	18,994	18,595	18,581	18,472	18,845	19,153	18,825
Nonagricultural industries:									
Part time for economic reasons	2,724	3,177	3,648	3,030	3,197	3,532	3,336	3,196	4,045
Slack work or business conditions	1,747	1,874	2,480	1,940	2,089	2,234	2,059	2,004	2,759
Could only find part-time work	769	888	988	817	876	1,024	985	911	1,070
Part time for noneconomic reasons	18,147	15,886	18,406	18,024	18,061	18,039	18,309	18,580	18,278

NOTE: Persons at work excludes employed persons who were absent from their jobs during the entire reference week for reasons such as vacation, illness, or industrial dispute. Part time for noneconomic reasons excludes persons who usually work full time but worked only 1 to 34 hours during the reference week for reasons such as holidays, illness, and bad weather.

Table A-5. Selected unemployment indicators, seasonally adjusted

Category	Number of unemployed persons (in thousands)			Unemployment rates[1]					
	Sept. 2000	Aug. 2001	Sept. 2001	Sept. 2000	May 2001	June 2001	July 2001	Aug. 2001	Sept. 2001
CHARACTERISTIC									
Total, 16 years and over	5,537	6,957	7,009	3.9	4.4	4.5	4.5	4.9	4.9
Men, 20 years and over	2,325	3,112	3,069	3.3	3.9	4.0	3.9	4.4	4.3
Women, 20 years and over	2,142	2,610	2,754	3.5	3.8	3.8	3.9	4.2	4.4
Both sexes, 16 to 19 years	1,070	1,236	1,187	12.9	13.6	14.3	14.8	16.1	14.7
Married men, spouse present	916	1,220	1,197	2.1	2.6	2.6	2.6	2.7	2.7
Married women, spouse present	937	1,034	1,165	2.7	2.9	3.0	2.8	3.0	3.3
Women who maintain families	484	600	623	5.4	6.2	6.3	6.2	6.7	7.0
Full-time workers	4,423	5,583	5,908	3.8	4.3	4.4	4.4	4.8	5.0
Part-time workers	1,097	1,370	1,107	4.6	4.6	5.3	5.1	5.6	4.5
OCCUPATION[2]									
Managerial and professional specialty	734	1,071	1,032	1.8	1.9	2.0	2.2	2.5	2.4
Technical, sales, and administrative support	1,390	1,732	1,762	3.4	3.7	4.0	4.0	4.3	4.3
Precision production, craft, and repair	542	753	758	3.5	4.5	4.5	4.2	4.8	4.8
Operators, fabricators, and laborers	1,216	1,478	1,430	6.2	7.3	7.9	7.2	7.7	7.5
Farming, forestry, and fishing	214	299	252	5.9	7.1	6.2	7.5	8.7	7.1
INDUSTRY									
Nonagricultural private wage and salary workers	4,339	5,617	5,707	4.0	4.5	4.8	4.7	5.1	5.2
Goods-producing industries	1,255	1,744	1,725	4.4	5.3	5.5	5.6	6.2	6.2
Mining	25	25	27	5.0	5.5	6.8	3.7	4.3	4.8
Construction	516	626	642	6.4	6.6	6.7	6.8	7.5	7.8
Manufacturing	714	1,092	1,056	3.6	4.8	5.0	5.1	5.7	5.8
Durable goods	381	689	659	3.2	4.9	5.0	4.7	5.8	5.6
Nondurable goods	333	403	397	4.3	4.7	4.9	5.7	5.5	5.4
Service-producing industries	3,084	3,873	3,982	3.9	4.2	4.5	4.4	4.8	4.9
Transportation and public utilities	265	286	311	3.2	3.8	4.4	3.3	3.5	3.9
Wholesale and retail trade	1,316	1,537	1,643	4.8	5.3	5.3	5.2	5.6	5.9
Finance, insurance, and real estate	163	222	228	2.1	2.3	2.6	3.2	2.7	2.8
Services	1,340	1,828	1,800	3.7	3.9	4.4	4.3	4.9	4.8
Government workers	399	410	423	2.1	2.0	2.0	2.1	2.1	2.1
Agricultural wage and salary workers	172	210	143	7.9	8.2	9.6	10.9	10.2	7.1

[1] Unemployment as a percent of the civilian labor force.
[2] Seasonally adjusted unemployment data for service occupations are not available because the seasonal component, which is small relative to the trend-cycle and irregular components, cannot be separated with sufficient precision.

Table A-6. Duration of unemployment

(Numbers in thousands)

Duration	Not seasonally adjusted			Seasonally adjusted					
	Sept. 2000	Aug. 2001	Sept. 2001	Sept. 2000	May 2001	June 2001	July 2001	Aug. 2001	Sept. 2001
NUMBER OF UNEMPLOYED									
Less than 5 weeks	2,547	2,926	2,792	2,498	2,679	2,809	2,612	3,004	2,764
5 to 14 weeks	1,583	2,333	2,127	1,750	2,028	2,084	2,150	2,100	2,361
15 weeks and over	1,194	1,697	1,790	1,247	1,484	1,540	1,587	1,817	1,884
15 to 26 weeks	571	843	1,002	618	852	804	935	982	1,089
27 weeks and over	623	854	787	629	632	737	652	835	795
Average (mean) duration, in weeks	12.1	13.2	13.1	12.1	12.2	13.0	12.5	13.3	13.1
Median duration, in weeks	5.2	6.9	7.2	5.3	6.5	6.2	6.7	6.5	7.4
PERCENT DISTRIBUTION									
Total unemployed	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Less than 5 weeks	47.8	42.1	41.6	45.5	43.3	43.7	41.1	43.4	39.4
5 to 14 weeks	29.7	33.5	31.7	31.8	32.8	32.4	33.9	30.3	33.7
15 weeks and over	22.4	24.4	26.7	22.7	24.0	23.9	25.0	26.3	26.9
15 to 26 weeks	10.7	12.1	14.9	11.2	13.8	12.5	14.7	14.2	15.5
27 weeks and over	11.7	12.3	11.7	11.4	10.2	11.4	10.3	12.1	11.3

Table A-7. Reason for unemployment

(Numbers in thousands)

Reason	Not seasonally adjusted			Seasonally adjusted					
	Sept. 2000	Aug. 2001	Sept. 2001	Sept. 2000	May 2001	June 2001	July 2001	Aug. 2001	Sept. 2001
NUMBER OF UNEMPLOYED									
Job losers and persons who completed temporary jobs	2,258	3,334	3,243	2,502	3,159	3,291	3,252	3,409	3,600
On temporary layoff	595	1,000	786	837	1,084	940	1,003	1,079	1,118
Not on temporary layoff	1,662	2,334	2,457	1,665	2,075	2,351	2,249	2,330	2,482
Permanent job losers	1,104	1,704	1,795	(1)	(1)	(1)	(1)	(1)	(1)
Persons who completed temporary jobs	558	630	663	(1)	(1)	(1)	(1)	(1)	(1)
Job leavers	853	977	893	756	820	810	774	894	800
Reentrants	1,832	2,129	2,137	1,798	1,801	1,906	1,912	2,166	2,106
New entrants	382	516	434	429	482	477	436	495	476
PERCENT DISTRIBUTION									
Total unemployed	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Job losers and persons who completed temporary jobs	42.4	47.9	48.4	45.6	50.4	50.8	51.0	49.0	51.5
On temporary layoff	11.2	14.4	11.7	15.3	17.3	14.5	15.7	15.5	16.0
Not on temporary layoff	31.2	33.5	36.6	30.4	33.1	36.3	35.3	33.5	35.5
Job leavers	16.0	14.0	13.3	13.8	13.1	12.5	12.1	12.8	11.5
Reentrants	34.4	30.6	31.9	32.8	28.8	29.4	30.0	31.1	30.2
New entrants	7.2	7.4	6.5	7.8	7.7	7.4	6.8	7.1	6.8
UNEMPLOYED AS A PERCENT OF THE CIVILIAN LABOR FORCE									
Job losers and persons who completed temporary jobs	1.6	2.4	2.3	1.8	2.2	2.3	2.3	2.4	2.5
Job leavers	.6	.7	.6	.5	.6	.6	.5	.6	.6
Reentrants	1.3	1.5	1.5	1.3	1.3	1.3	1.3	1.5	1.5
New entrants	.3	.4	.3	.3	.3	.3	.3	.4	.3

[1] Not available.

Table A-8. Range of alternative measures of labor underutilization

(Percent)

Measure	Not seasonally adjusted			Seasonally adjusted					
	Sept. 2000	Aug. 2001	Sept. 2001	Sept. 2000	May 2001	June 2001	July 2001	Aug. 2001	Sept. 2001
U-1 Persons unemployed 15 weeks or longer, as a percent of the civilian labor force	.9	1.2	1.3	.9	1.1	1.1	1.1	1.3	1.3
U-2 Job losers and persons who completed temporary jobs, as a percent of the civilian labor force	1.6	2.4	2.3	1.8	2.2	2.3	2.3	2.4	2.5
U-3 Total unemployed, as a percent of the civilian labor force (official unemployment rate)	3.8	4.9	4.7	3.9	4.4	4.5	4.5	4.9	4.9
U-4 Total unemployed plus discouraged workers, as a percent of the civilian labor force plus discouraged workers	4.0	5.1	4.9	(1)	(1)	(1)	(1)	(1)	(1)
U-5 Total unemployed, plus discouraged workers, plus all other marginally attached workers, as a percent of the civilian labor force plus all marginally attached workers	4.6	5.8	5.6	(1)	(1)	(1)	(1)	(1)	(1)
U-6 Total unemployed, plus all marginally attached workers, plus total employed part time for economic reasons, as a percent of the civilian labor force plus all marginally attached workers	6.6	8.1	8.3	(1)	(1)	(1)	(1)	(1)	(1)

[1] Not available.

NOTE: This range of alternative measures of labor underutilization replaces the U1-U7 range published in table A-7 of this release prior to 1994. Marginally attached workers are persons who currently are neither working nor looking for work but indicate that they want and are available for a job and have looked for work sometime in the recent past. Discouraged workers, a subset of the marginally attached, have given a job-market related reason for not currently looking for a job. Persons employed part time for economic reasons are those who want and are available for full-time work but have had to settle for a part-time schedule. For further information, see "BLS introduces new range of alternative unemployment measures," in October 1995 issue of the *Monthly Labor Review*.

Table A-9. Unemployed persons by sex and age, seasonally adjusted

Age and sex	Number of unemployed persons (in thousands)			Unemployment rates[1]					
	Sept. 2000	Aug. 2001	Sept. 2001	Sept. 2000	May 2001	June 2001	July 2001	Aug. 2001	Sept. 2001
Total, 16 years and over	5,537	6,957	7,009	3.9	4.4	4.5	4.5	4.9	4.9
16 to 24 years	2,023	2,544	2,448	8.9	9.9	10.4	10.1	11.5	10.7
16 to 19 years	1,070	1,236	1,187	12.9	13.6	14.3	14.8	16.1	14.7
16 to 17 years	515	559	498	15.7	15.5	16.0	19.3	19.1	16.2
18 to 19 years	559	701	694	11.1	12.2	13.1	11.8	14.7	13.9
20 to 24 years	953	1,308	1,262	6.6	7.9	8.2	7.5	9.0	8.5
25 years and over	3,520	4,423	4,558	3.0	3.3	3.5	3.4	3.7	3.8
25 to 54 years	3,012	3,884	3,933	3.0	3.5	3.6	3.6	3.9	3.9
55 years and over	488	573	626	2.7	2.6	2.8	2.8	3.0	3.3
Men, 16 years and over	2,907	3,828	3,724	3.9	4.5	4.7	4.5	5.1	4.9
16 to 24 years	1,125	1,435	1,353	9.5	11.0	11.8	10.4	12.4	11.3
16 to 19 years	582	716	656	13.7	15.3	15.9	15.1	17.9	15.8
16 to 17 years	292	335	288	17.5	17.4	18.0	19.0	22.7	18.3
18 to 19 years	288	391	370	11.2	13.9	14.5	13.0	15.4	14.3
20 to 24 years	543	720	697	7.1	8.7	9.5	7.9	9.5	8.9
25 years and over	1,790	2,384	2,373	2.8	3.3	3.4	3.5	3.7	3.7
25 to 54 years	1,522	2,086	2,047	2.9	3.5	3.5	3.6	3.9	3.8
55 years and over	259	345	343	2.6	2.9	3.0	3.0	3.3	3.3
Women, 16 years and over	2,630	3,130	3,284	4.0	4.3	4.4	4.5	4.8	5.0
16 to 24 years	898	1,108	1,096	8.2	8.8	8.9	9.7	10.4	10.1
16 to 19 years	488	520	531	12.0	11.8	12.7	14.4	14.2	13.6
16 to 17 years	223	224	209	13.8	13.6	14.0	19.6	15.5	13.9
18 to 19 years	271	310	324	11.0	10.4	11.6	10.6	13.9	13.5
20 to 24 years	410	588	565	6.0	7.1	6.7	7.1	8.4	8.2
25 years and over	1,730	2,039	2,185	3.2	3.4	3.5	3.4	3.7	3.9
25 to 54 years	1,490	1,798	1,886	3.2	3.6	3.8	3.6	3.8	4.0
55 years and over	229	229	285	2.8	2.2	2.5	2.5	2.7	3.3

[1] Unemployment as a percent of the civilian labor force.

Table A-10. Persons not in the labor force and multiple jobholders by sex, not seasonally adjusted

(Numbers in thousands)

Category	Total		Men		Women	
	Sept. 2000	Sept. 2001	Sept. 2000	Sept. 2001	Sept. 2000	Sept. 2001
NOT IN THE LABOR FORCE						
Total not in the labor force	69,804	70,781	25,980	26,421	43,824	44,361
Persons who currently want a job	4,184	4,348	1,863	1,949	2,321	2,400
Searched for work and available to work now[1]	1,158	1,325	594	659	564	666
Reason not currently looking:						
Discouragement over job prospects[2]	250	280	168	164	81	116
Reasons other than discouragement[3]	908	1,045	425	495	483	550
MULTIPLE JOBHOLDERS						
Total multiple jobholders[4]	7,471	7,246	3,930	3,825	3,541	3,421
Percent of total employed	5.5	5.4	5.4	5.3	5.6	5.5
Primary job full time, secondary job part time	4,072	3,897	2,338	2,244	1,734	1,653
Primary and secondary jobs both part time	1,566	1,576	527	516	1,039	1,060
Primary and secondary jobs both full time	336	265	239	165	96	100
Hours vary on primary or secondary job	1,447	1,484	805	888	642	596

[1] Data refer to persons who have searched for work during the prior 12 months and were available to take a job during the reference week.

[2] Includes thinks no work available, could not find work, lacks schooling or training, employer thinks too young or old, and other types of discrimination.

[3] Includes those who did not actively look for work in the prior 4 weeks for such reasons as child-care and transportation problems, as well as a small number for which reason for nonparticipation was not determined.

[4] Includes persons who work part time on their primary job and full time on their secondary job(s), not shown separately.

Table B-1. Employees on nonfarm payrolls by industry

(In thousands)

Industry	Not seasonally adjusted				Seasonally adjusted					
	Sept. 2000	July 2001	Aug. 2001p	Sept. 2001p	Sept. 2000	May 2001	June 2001	July 2001	Aug. 2001p	Sept. 2001p
Total	132,411	132,300	132,181	132,511	132,046	132,530	132,431	132,449	132,365	132,166
Total private	112,019	112,495	112,408	111,737	111,463	111,760	111,603	111,517	111,373	111,177
Goods-producing	26,014	25,464	25,431	25,205	25,696	25,324	25,186	25,122	24,974	24,877
Mining	556	575	578	576	547	564	565	567	569	569
Metal mining	40.6	34.9	35.3	35.4	40	37	35	34	35	35
Coal mining	76.1	78.8	79.6	80.0	76	76	78	79	80	80
Oil and gas extraction	319.8	344.4	346.3	344.9	316	339	340	341	342	343
Nonmetallic minerals, except fuels	119.3	117.1	116.8	115.6	115	112	112	113	112	111
Construction	6,973	7,213	7,200	7,101	6,728	6,881	6,864	6,867	6,863	6,859
General building contractors	1,572.0	1,621.0	1,621.9	1,597.6	1,538	1,556	1,551	1,554	1,556	1,564
Heavy construction, except building	972.5	1,007.1	1,007.8	1,003.7	900	923	925	935	932	932
Special trade contractors	4,428.7	4,584.9	4,569.9	4,499.6	4,290	4,402	4,388	4,378	4,375	4,363
Manufacturing	18,485	17,676	17,653	17,528	18,421	17,879	17,757	17,688	17,542	17,449
Production workers	12,631	11,870	11,877	11,790	12,559	12,066	11,956	11,900	11,789	11,702
Durable goods	11,139	10,602	10,562	10,480	11,129	10,778	10,692	10,624	10,525	10,460
Production workers	7,583	7,069	7,048	6,990	7,568	7,235	7,157	7,102	7,024	6,966
Lumber and wood products	837.3	808.5	808.4	808.7	826	797	798	797	792	797
Furniture and fixtures	560.6	523.9	522.8	517.7	560	540	532	531	521	516
Stone, clay, and glass products	586.5	580.2	577.5	575.2	579	574	572	569	568	567
Primary metal industries	694.0	645.3	644.4	640.0	695	660	654	648	643	640
Blast furnaces and basic steel products	222.1	208.5	208.3	207.2	(1)	(1)	(1)	(1)	(1)	(1)
Fabricated metal products	1,540.9	1,465.7	1,472.2	1,464.0	1,540	1,488	1,478	1,478	1,468	1,460
Industrial machinery and equipment	2,116.0	2,004.6	1,981.0	1,958.1	2,121	2,054	2,031	2,007	1,983	1,963
Computer and office equipment	364.6	355.4	351.7	345.1	364	366	357	353	350	344
Electronic and other electrical equipment	1,735.0	1,588.8	1,567.3	1,547.4	1,736	1,656	1,624	1,589	1,565	1,547
Electronic components and accessories	697.0	636.1	620.2	609.0	698	670	650	634	618	610
Transportation equipment	1,816.9	1,733.9	1,744.0	1,730.9	1,822	1,757	1,749	1,752	1,747	1,738
Motor vehicles and equipment	992.4	916.8	927.8	916.6	994	939	931	936	928	918
Aircraft and parts	463.9	465.3	464.9	465.2	464	465	465	466	465	466
Instruments and related products	857.5	866.9	861.9	854.2	858	865	865	865	859	854
Miscellaneous manufacturing	394.4	384.1	382.3	383.3	392	387	389	388	379	380
Nondurable goods	7,346	7,074	7,091	7,048	7,292	7,101	7,065	7,064	7,017	6,989
Production workers	5,048	4,801	4,829	4,800	4,991	4,831	4,799	4,798	4,765	4,736
Food and kindred products	1,716.3	1,704.1	1,731.9	1,726.1	1,674	1,684	1,685	1,680	1,675	1,676
Tobacco products	33.1	31.1	33.5	33.3	33	33	33	33	35	33
Textile mill products	526.5	469.3	467.7	463.6	523	480	472	471	464	461
Apparel and other textile products	625.4	562.9	557.4	554.2	620	579	567	571	556	550
Paper and allied products	655.7	634.1	631.3	629.7	655	639	635	632	628	627
Printing and publishing	1,546.9	1,490.0	1,484.5	1,473.4	1,547	1,502	1,495	1,489	1,484	1,476
Chemicals and allied products	1,035.8	1,040.2	1,037.3	1,027.8	1,037	1,033	1,033	1,039	1,035	1,030
Petroleum and coal products	129.3	130.7	130.3	130.0	127	127	128	128	127	128
Rubber and misc. plastics products	1,006.7	949.7	953.8	948.4	1,006	959	953	957	951	947
Leather and leather products	70.7	61.6	62.9	61.0	70	65	64	64	62	61
Service-producing	106,397	106,836	106,750	107,306	106,350	107,206	107,245	107,327	107,391	107,289
Transportation and public utilities	7,105	7,095	7,074	7,121	7,062	7,130	7,118	7,108	7,076	7,069
Transportation	4,598	4,538	4,523	4,587	4,553	4,584	4,571	4,561	4,535	4,536
Railroad transportation	236.6	227.3	227.8	228.1	235	230	227	226	226	227
Local and interurban passenger transit	490.4	422.2	423.7	503.9	478	483	483	485	486	491
Trucking and warehousing	1,889.9	1,886.3	1,876.1	1,873.2	1,861	1,867	1,867	1,863	1,844	1,843
Water transportation	205.4	214.2	210.1	207.1	199	203	201	203	199	201
Transportation by air	1,285.1	1,304.6	1,303.7	1,294.8	1,291	1,315	1,310	1,304	1,303	1,297
Pipelines, except natural gas	13.6	14.2	14.3	14.1	14	14	14	14	14	14
Transportation services	477.2	469.6	466.9	465.3	475	472	469	466	463	463
Communications and public utilities	2,507	2,557	2,551	2,534	2,509	2,546	2,547	2,547	2,541	2,533
Communications	1,657.4	1,702.3	1,697.6	1,688.1	1,660	1,699	1,700	1,700	1,693	1,687
Electric, gas, and sanitary services	849.2	854.5	853.3	846.0	849	847	847	847	848	846
Wholesale trade	7,050	7,052	7,034	6,995	7,042	7,038	7,022	7,017	7,011	6,990
Durable goods	4,200	4,169	4,154	4,123	4,203	4,174	4,166	4,149	4,134	4,125
Nondurable goods	2,850	2,883	2,880	2,872	2,839	2,864	2,856	2,868	2,877	2,865

See footnotes at end of table.

Table B-1. Employees on nonfarm payrolls by industry—Continued

(In thousands)

Industry	Not seasonally adjusted				Seasonally adjusted					
	Sept. 2000	July 2001	Aug. 2001p	Sept. 2001p	Sept. 2000	May 2001	June 2001	July 2001	Aug. 2001p	Sept. 2001p
Retail trade	23,403	23,715	23,724	23,556	23,371	23,546	23,561	23,606	23,574	23,530
Building materials and garden supplies	1,010.6	1,042.7	1,032.5	1,012.4	1,012	1,006	1,014	1,008	1,015	1,014
General merchandise stores	2,786.9	2,740.3	2,747.0	2,758.8	2,834	2,821	2,818	2,810	2,799	2,805
Department stores	2,444.8	2,397.7	2,407.4	2,418.1	2,487	2,473	2,471	2,458	2,449	2,456
Food stores	3,519.0	3,561.6	3,548.7	3,517.6	3,529	3,553	3,544	3,536	3,528	3,521
Automotive dealers and service stations	2,431.3	2,460.3	2,461.8	2,449.1	2,420	2,428	2,431	2,435	2,441	2,439
New and used car dealers	1,124.3	1,135.8	1,138.6	1,139.9	1,120	1,126	1,128	1,131	1,133	1,136
Apparel and accessory stores	1,190.7	1,214.0	1,226.6	1,198.5	1,202	1,231	1,227	1,219	1,222	1,215
Furniture and home furnishings stores	1,128.6	1,127.5	1,128.2	1,124.2	1,138	1,136	1,136	1,137	1,137	1,138
Eating and drinking places	8,257.9	8,469.7	8,466.8	8,383.7	8,138	8,216	8,241	8,310	8,279	8,242
Miscellaneous retail establishments	3,077.7	3,099.1	3,112.1	3,131.4	3,098	3,155	3,150	3,151	3,153	3,156
Finance, insurance, and real estate	7,554	7,710	7,698	7,634	7,556	7,644	7,631	7,618	7,621	7,635
Finance	3,711	3,781	3,778	3,755	3,718	3,770	3,767	3,755	3,756	3,759
Depository institutions	2,018.7	2,053.5	2,050.3	2,033.0	2,024	2,037	2,041	2,039	2,037	2,038
Commercial banks	1,420.3	1,436.2	1,432.9	1,420.1	1,424	1,426	1,428	1,426	1,423	1,423
Savings institutions	252.4	256.9	256.8	255.2	253	255	256	255	255	256
Nondepository institutions	675.0	705.5	710.3	707.8	677	697	699	703	708	708
Mortgage bankers and brokers	302.6	322.1	324.4	321.7	304	313	317	321	324	323
Security and commodity brokers	763.9	763.4	760.3	757.9	762	776	766	755	753	756
Holding and other investment offices	253.4	258.7	257.5	255.8	255	260	261	258	258	257
Insurance	2,330	2,368	2,363	2,355	2,335	2,358	2,356	2,357	2,357	2,361
Insurance carriers	1,575.6	1,606.4	1,602.8	1,595.8	1,580	1,598	1,598	1,599	1,598	1,600
Insurance agents, brokers, and service	753.9	761.4	760.2	759.3	755	760	758	758	759	761
Real estate	1,513	1,561	1,557	1,524	1,503	1,516	1,508	1,506	1,508	1,515
Services[2]	40,893	41,459	41,447	41,226	40,736	41,078	41,085	41,046	41,117	41,076
Agricultural services	844.8	918.8	906.5	880.0	804	834	833	834	837	840
Hotels and other lodging places	1,977.7	2,089.3	2,076.6	1,970.8	1,924	1,935	1,920	1,922	1,911	1,913
Personal services	1,221.3	1,231.7	1,238.4	1,245.4	1,257	1,277	1,279	1,281	1,285	1,282
Business services	10,092.7	9,629.5	9,695.6	9,676.4	9,965	9,702	9,666	9,592	9,584	9,545
Services to buildings	1,000.3	1,005.3	1,003.9	996.1	995	1,013	1,008	998	997	992
Personnel supply services	4,061.7	3,525.8	3,605.6	3,611.0	3,947	3,590	3,556	3,517	3,518	3,500
Help supply services	3,641.7	3,140.9	3,208.4	3,215.8	3,547	3,198	3,161	3,127	3,109	3,100
Computer and data processing services	2,115.8	2,204.5	2,196.0	2,187.9	2,124	2,200	2,205	2,202	2,193	2,197
Auto repair, services, and parking	1,260.3	1,319.0	1,314.7	1,306.7	1,260	1,309	1,303	1,312	1,308	1,307
Miscellaneous repair services	365.4	363.5	364.8	363.7	366	363	361	360	362	363
Motion pictures	580.7	607.7	604.6	575.2	590	587	602	595	587	583
Amusement and recreation services	1,821.1	2,098.1	2,059.5	1,827.8	1,738	1,787	1,768	1,772	1,771	1,745
Health services	10,121.3	10,380.2	10,404.5	10,401.7	10,131	10,296	10,329	10,354	10,385	10,414
Offices and clinics of medical doctors	1,929.5	1,986.9	1,995.2	1,985.8	1,933	1,973	1,981	1,983	1,990	1,989
Nursing and personal care facilities	1,798.5	1,826.9	1,831.5	1,830.4	1,797	1,814	1,821	1,823	1,825	1,831
Hospitals	3,997.8	4,111.7	4,118.3	4,124.0	4,001	4,071	4,086	4,098	4,114	4,129
Home health care services	644.6	647.6	652.0	654.6	645	645	648	647	653	655
Legal services	1,007.6	1,043.2	1,034.6	1,024.6	1,013	1,027	1,027	1,026	1,028	1,032
Educational services	2,299.8	2,133.8	2,118.0	2,388.9	2,344	2,431	2,426	2,432	2,450	2,434
Social services	2,924.8	3,019.6	3,030.4	3,065.9	2,928	3,039	3,056	3,048	3,075	3,082
Child day care services	724.6	690.8	701.2	747.0	719	745	756	760	763	747
Residential care	809.1	853.8	856.4	850.1	813	842	845	847	850	853
Museums and botanical and zoological gardens	107.6	121.3	119.4	111.9	107	110	111	111	111	111
Membership organizations	2,458.6	2,562.3	2,540.2	2,482.8	2,482	2,496	2,501	2,493	2,503	2,506
Engineering and management services	3,438.4	3,566.7	3,564.5	3,529.2	3,455	3,512	3,529	3,540	3,545	3,544
Engineering and architectural services	1,032.2	1,082.5	1,084.0	1,072.1	1,030	1,057	1,059	1,064	1,067	1,070
Management and public relations	1,104.4	1,128.7	1,129.4	1,124.1	1,102	1,121	1,124	1,119	1,124	1,127
Services, nec	49.7	52.7	52.9	53.0	(1)	(1)	(1)	(1)	(1)	(1)
Government	20,392	19,805	19,773	20,774	20,583	20,770	20,828	20,932	20,992	20,989
Federal	2,619	2,644	2,627	2,612	2,623	2,612	2,621	2,626	2,617	2,618
Federal, except Postal Service	1,762.7	1,795.7	1,781.3	1,768.7	1,762	1,754	1,772	1,772	1,770	1,770
State	4,790	4,645	4,652	4,900	4,813	4,854	4,881	4,909	4,906	4,934
Education	2,017.2	1,809.6	1,821.2	2,088.6	2,051	2,066	2,089	2,117	2,115	2,134
Other State government	2,772.9	2,835.4	2,831.0	2,811.3	2,762	2,788	2,792	2,792	2,791	2,800
Local	12,983	12,516	12,494	13,262	13,147	13,304	13,326	13,397	13,469	13,437
Education	7,281.1	6,377.8	6,447.5	7,457.2	7,439	7,512	7,515	7,575	7,650	7,629
Other local government	5,701.7	6,137.7	6,046.7	5,804.8	5,708	5,792	5,811	5,822	5,819	5,808

[1] These series are not published seasonally adjusted because the seasonal component, which is small relative to the trend-cycle and irregular components, cannot be separated with sufficient precision.

[2] Includes other industries, not shown separately.

p = preliminary.

Table B-2. Average weekly hours of production or nonsupervisory workers[1] on private nonfarm payrolls by industry

Industry	Not seasonally adjusted				Seasonally adjusted					
	Sept. 2000	July 2001	Aug. 2001p	Sept. 2001p	Sept. 2000	May 2001	June 2001	July 2001	Aug. 2001p	Sept. 2001p
Total private	34.5	34.6	34.4	34.3	34.4	34.2	34.2	34.2	34.0	34.1
Goods-producing	41.3	40.4	40.7	40.6	40.7	40.5	40.4	40.5	40.3	40.1
Mining	43.8	43.7	43.7	44.2	43.0	43.9	43.3	43.3	43.5	43.8
Construction	40.1	40.4	40.2	39.7	38.9	39.7	39.4	39.4	39.3	39.0
Manufacturing	41.8	40.3	40.8	40.9	41.4	40.7	40.7	40.8	40.7	40.5
Overtime hours	4.9	3.9	4.2	4.3	4.4	3.9	3.9	4.0	4.0	3.9
Durable goods	42.3	40.5	41.1	41.1	41.8	41.0	40.9	41.2	41.0	40.7
Overtime hours	4.9	3.8	4.1	4.1	4.5	3.9	3.9	4.0	4.0	3.8
Lumber and wood products	41.1	40.8	41.0	41.4	40.8	40.6	40.4	41.1	40.7	41.2
Furniture and fixtures	40.5	39.3	39.7	39.1	39.7	38.6	38.4	39.7	39.4	38.4
Stone, clay, and glass products	43.8	44.3	44.3	44.9	42.9	43.9	44.0	44.0	43.6	44.0
Primary metal industries	44.9	43.4	43.7	44.6	44.7	43.5	43.9	44.1	43.8	44.1
Blast furnaces and basic steel products	45.8	44.9	44.9	46.8	45.8	44.6	45.1	44.7	44.9	46.3
Fabricated metal products	42.8	40.8	41.5	41.4	42.2	41.4	41.2	41.6	41.5	41.0
Industrial machinery and equipment	42.0	40.3	40.0	40.2	41.9	40.7	40.4	40.8	40.1	40.1
Electronic and other electrical equipment	41.2	38.3	39.1	39.5	40.7	39.1	39.3	38.9	39.0	39.2
Transportation equipment	43.8	40.7	42.6	41.4	42.9	42.4	41.9	42.2	42.7	40.8
Motor vehicles and equipment	45.0	41.0	44.2	42.4	43.8	43.6	43.0	43.0	44.5	41.6
Instruments and related products	41.0	40.4	40.2	41.0	41.1	41.0	40.8	40.8	40.2	41.1
Miscellaneous manufacturing	39.1	37.8	38.3	37.9	38.5	37.9	38.4	38.4	38.2	37.6
Nondurable goods	41.1	40.0	40.3	40.6	40.7	40.3	40.4	40.3	40.2	40.1
Overtime hours	4.8	4.1	4.4	4.6	4.3	4.0	3.9	4.0	4.1	4.1
Food and kindred products	42.5	40.9	41.6	42.0	41.6	41.1	41.2	40.9	41.1	40.9
Tobacco products	41.9	40.3	40.5	40.3	41.0	39.1	40.4	40.5	40.3	39.4
Textile mill products	41.2	39.1	40.2	40.3	40.8	40.3	40.4	39.7	39.9	39.9
Apparel and other textile products	37.7	37.2	37.1	36.5	37.6	37.8	37.5	37.7	36.9	36.5
Paper and allied products	42.7	41.7	41.3	42.2	42.4	41.6	41.7	41.9	41.3	41.7
Printing and publishing	38.6	38.0	38.2	38.4	38.2	38.0	38.0	38.2	38.0	38.0
Chemicals and allied products	42.4	42.3	42.1	42.3	42.4	42.4	42.2	42.7	42.2	42.1
Petroleum and coal products	42.2	43.3	42.9	42.8	(2)	(2)	(2)	(2)	(2)	(2)
Rubber and misc. plastics products	41.7	40.0	40.4	41.0	41.3	40.6	40.7	40.6	40.4	40.7
Leather and leather products	37.9	35.2	36.7	36.3	37.3	35.9	36.2	35.7	36.4	35.9
Service-producing	32.7	33.2	32.9	32.8	32.8	32.7	32.8	32.6	32.6	32.6
Transportation and public utilities	38.7	38.5	38.2	38.3	38.5	38.1	38.1	37.8	37.9	37.8
Wholesale trade	38.4	38.5	38.2	38.7	38.4	38.2	38.3	38.2	38.2	38.5
Retail trade	28.8	29.5	29.3	28.7	28.8	28.8	28.7	28.6	28.6	28.6
Finance, insurance, and real estate	36.1	36.7	36.1	36.7	36.4	36.2	36.5	36.2	36.2	36.2
Services	32.5	33.1	32.8	32.7	32.7	32.7	32.8	32.7	32.5	32.6

[1] Data relate to production workers in mining and manufacturing; construction workers in construction; and nonsupervisory workers in transportation and public utilities; wholesale and retail trade; finance, insurance, and real estate; and services. These groups account for approximately four-fifths of the total employees on private nonfarm payrolls.

[2] This series is not published seasonally adjusted because the seasonal component, which is small relative to the trend-cycle and irregular components, cannot be separated with sufficient precision.

p = preliminary.

Table B-3. Average hourly and weekly earnings of production or nonsupervisory workers[1] on private nonfarm payrolls by industry

Industry	Average hourly earnings				Average weekly earnings			
	Sept. 2000	July 2001	Aug. 2001p	Sept. 2001p	Sept. 2000	July 2001	Aug. 2001p	Sept. 2001p
Total private	$13.89	$14.27	$14.28	$14.50	$479.21	$493.74	$491.23	$497.35
Seasonally adjusted	13.84	14.34	14.41	14.44	476.10	490.43	489.94	492.40
Goods-producing	15.61	16.01	16.06	16.14	644.69	646.80	653.64	655.28
Mining	17.16	17.67	17.51	17.65	751.61	772.18	765.19	780.13
Construction	18.17	18.32	18.44	18.53	728.62	740.13	741.29	735.64
Manufacturing	14.51	14.84	14.89	15.00	606.52	598.05	607.51	613.50
Durable goods	14.96	15.25	15.38	15.46	632.81	617.63	632.12	635.41
Lumber and wood products	12.07	12.32	12.38	12.45	496.08	502.66	507.58	515.43
Furniture and fixtures	11.88	12.24	12.32	12.28	481.14	481.03	489.10	480.15
Stone, clay, and glass products	14.77	15.12	15.18	15.19	646.93	669.82	672.47	682.03
Primary metal industries	16.54	17.11	17.07	17.27	742.65	742.57	745.96	770.24
Blast furnaces and basic steel products	19.83	20.48	20.64	20.81	908.21	919.55	926.74	973.91
Fabricated metal products	13.99	14.27	14.35	14.42	598.77	582.22	595.53	596.99
Industrial machinery and equipment	15.69	15.90	15.95	16.05	658.98	640.77	638.00	645.21
Electronic and other electrical equipment	13.91	14.59	14.71	14.86	573.09	558.80	575.16	586.97
Transportation equipment	18.77	18.80	19.09	19.19	822.13	765.16	813.23	794.47
Motor vehicles and equipment	19.12	19.04	19.39	19.49	860.40	780.64	857.04	826.38
Instruments and related products	14.58	14.98	15.01	15.07	597.78	605.19	603.40	617.87
Miscellaneous manufacturing	11.66	12.12	12.25	12.36	455.91	458.14	469.18	468.44
Nondurable goods	13.80	14.23	14.17	14.32	567.18	569.20	571.05	581.39
Food and kindred products	12.59	12.93	12.87	12.98	535.08	528.84	535.39	545.16
Tobacco products	22.13	23.63	21.94	21.41	927.25	952.29	888.57	862.82
Textile mill products	11.30	11.37	11.37	11.41	465.56	444.57	457.07	459.82
Apparel and other textile products	9.36	9.40	9.44	9.51	352.87	349.68	350.22	347.12
Paper and allied products	16.37	16.99	16.86	17.05	699.00	708.48	696.32	719.51
Printing and publishing	14.56	14.83	14.88	15.00	562.02	563.54	568.42	576.00
Chemicals and allied products	18.32	18.69	18.53	18.94	776.77	790.59	780.11	801.16
Petroleum and coal products	22.06	22.02	22.20	22.20	930.93	953.47	952.38	950.16
Rubber and misc. plastics products	12.96	13.38	13.43	13.54	540.43	535.20	542.57	555.14
Leather and leather products	10.31	10.25	10.35	10.24	390.75	360.80	379.85	371.71
Service-producing	13.34	13.76	13.74	14.01	436.22	456.83	452.05	459.53
Transportation and public utilities	16.31	16.89	16.95	16.97	631.20	650.27	647.49	649.95
Wholesale trade	15.33	15.88	15.76	16.02	588.67	611.38	602.03	619.97
Retail trade	9.58	9.77	9.78	9.92	275.90	288.22	286.55	284.70
Finance, insurance, and real estate	15.11	15.85	15.84	16.07	545.47	581.70	571.82	589.77
Services	14.00	14.46	14.45	14.76	455.00	478.63	473.96	482.65

[1] See footnote 1, table B-2.

p = preliminary.

ESTABLISHMENT DATA

Table B-4. Average hourly earnings of production or nonsupervisory workers[1] on private nonfarm payrolls by industry, seasonally adjusted

Industry	Sept. 2000	May 2001	June 2001	July 2001	Aug. 2001p	Sept. 2001p	Percent change from: Aug. 2001-Sept. 2001
Total private:							
Current dollars	$13.84	$14.24	$14.31	$14.34	$14.41	$14.44	0.2
Constant (1982) dollars[2]	7.88	7.93	7.95	8.00	8.04	N.A.	(3)
Goods-producing	15.47	15.86	15.90	15.93	16.02	16.03	.1
Mining	17.24	17.54	17.73	17.74	17.67	17.59	-.5
Construction	17.97	18.22	18.28	18.26	18.36	18.37	.1
Manufacturing	14.44	14.78	14.81	14.86	14.93	14.95	.1
Excluding overtime[4]	13.73	14.09	14.13	14.18	14.24	14.28	.3
Service-producing	13.34	13.76	13.84	13.87	13.93	13.97	.3
Transportation and public utilities	16.31	16.76	16.91	16.88	16.93	16.92	-.1
Wholesale trade	15.33	15.70	15.86	15.84	15.82	15.97	.9
Retail trade	9.54	9.79	9.83	9.84	9.86	9.86	.0
Finance, insurance, and real estate	15.19	15.74	15.86	15.91	15.99	16.05	.4
Services	14.01	14.49	14.54	14.61	14.70	14.75	.3

[1] See footnote 1, table B-2.
[2] The Consumer Price Index for Urban Wage Earners and Clerical Workers (CPI-W) is used to deflate this series.
[3] Change was .5 percent from July 2001 to August 2001, the latest month available.
[4] Derived by assuming that overtime hours are paid at the rate of time and one-half.
N.A. = not available.
p = preliminary.

Table B-5. Indexes of aggregate weekly hours of production or nonsupervisory workers[1] on private nonfarm payrolls by industry

(1982=100)

Industry	Not seasonally adjusted				Seasonally adjusted					
	Sept. 2000	July 2001	Aug. 2001p	Sept. 2001p	Sept. 2000	May 2001	June 2001	July 2001	Aug. 2001p	Sept. 2001p
Total private	153.0	154.2	153.3	151.6	151.7	151.5	151.2	150.8	150.1	149.7
Goods-producing	119.3	113.3	113.8	112.6	115.4	112.8	111.5	111.5	110.3	109.1
Mining	53.6	56.5	56.8	56.6	51.6	55.4	55.0	55.1	55.5	55.2
Construction	197.7	206.7	204.7	199.3	183.6	192.5	190.1	190.3	188.9	187.2
Manufacturing	106.5	96.6	97.7	97.3	104.7	99.1	98.1	98.0	96.7	95.5
Durable goods	111.8	100.0	101.0	100.3	110.4	103.6	102.2	102.1	100.5	99.0
Lumber and wood products	148.4	140.7	141.5	142.4	145.0	138.2	137.6	139.5	137.3	139.4
Furniture and fixtures	142.2	127.3	128.7	125.2	139.2	129.5	127.1	130.1	127.3	122.8
Stone, clay, and glass products	122.7	122.1	120.7	122.3	118.3	119.4	118.9	118.9	116.2	117.8
Primary metal industries	92.4	81.6	82.2	83.4	92.0	84.4	84.4	83.4	82.4	82.4
Blast furnaces and basic steel products	71.2	64.8	64.7	67.2	71.5	65.6	65.6	64.2	64.5	66.1
Fabricated metal products	123.3	110.1	112.7	111.7	121.5	114.0	112.5	113.7	112.5	110.1
Industrial machinery and equipment	101.8	90.1	88.3	87.6	101.8	94.0	92.0	91.5	88.7	87.6
Electronic and other electrical equipment	109.8	90.6	90.9	90.1	108.6	97.4	95.9	92.4	90.5	89.4
Transportation equipment	121.3	105.3	111.4	107.7	119.2	112.8	110.0	111.2	112.4	106.3
Motor vehicles and equipment	163.1	134.1	147.3	139.8	159.2	147.7	143.2	145.1	149.3	137.7
Instruments and related products	74.8	73.0	72.3	73.0	75.4	74.2	73.6	73.8	72.2	73.1
Miscellaneous manufacturing	99.6	91.7	92.3	92.3	97.5	93.8	95.0	94.3	91.0	90.2
Nondurable goods	99.2	91.9	93.1	93.2	97.0	93.0	92.5	92.4	91.4	90.8
Food and kindred products	122.5	115.9	120.4	121.2	115.3	114.8	115.3	114.0	114.6	113.3
Tobacco products	50.2	44.1	49.6	48.9	48.7	46.5	48.0	48.1	51.9	46.9
Textile mill products	75.5	64.0	65.6	65.1	74.4	67.1	66.3	65.3	64.7	64.0
Apparel and other textile products	54.1	47.2	46.6	45.7	53.5	49.5	48.0	48.6	46.0	45.3
Paper and allied products	103.9	97.8	96.7	98.6	102.7	98.4	97.8	97.8	95.8	96.8
Printing and publishing	121.5	114.2	114.5	114.4	120.3	115.4	114.6	114.7	113.8	113.2
Chemicals and allied products	99.0	97.9	97.0	96.4	99.4	98.1	97.4	99.1	97.3	96.3
Petroleum and coal products	71.3	74.4	73.9	74.7	69.8	70.1	71.6	71.8	72.3	72.8
Rubber and misc. plastics products	148.5	132.8	135.2	136.2	147.0	137.0	136.4	136.4	134.9	134.9
Leather and leather products	31.1	24.5	26.7	25.3	30.4	27.0	26.7	25.8	26.3	24.8
Service-producing	168.1	172.6	171.1	169.2	168.0	168.9	169.0	168.4	167.9	168.0
Transportation and public utilities	140.7	140.5	138.9	140.1	138.9	139.4	139.2	138.3	138.0	137.3
Wholesale trade	132.3	132.7	131.3	131.9	132.1	131.0	131.2	130.6	130.6	131.2
Retail trade	146.0	151.3	150.2	145.6	145.7	146.5	146.0	145.7	145.5	145.0
Finance, insurance, and real estate	137.9	143.7	140.9	141.9	139.2	140.2	140.9	139.6	139.5	140.0
Services	211.1	217.4	215.7	213.4	211.4	212.9	213.4	212.8	211.9	212.2

[1] See footnote 1, table B-2.

p = preliminary.

ESTABLISHMENT DATA

Table B-6. Diffusion indexes of employment change, seasonally adjusted

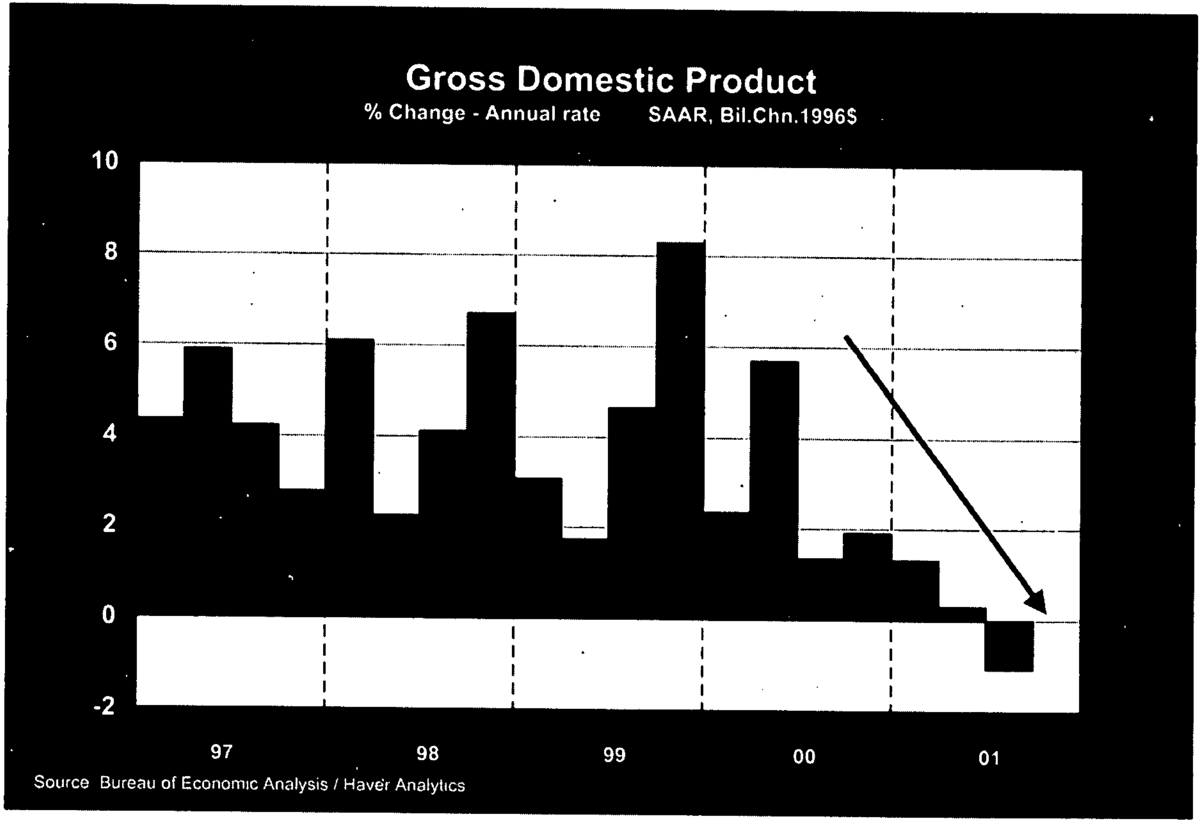
(Percent)

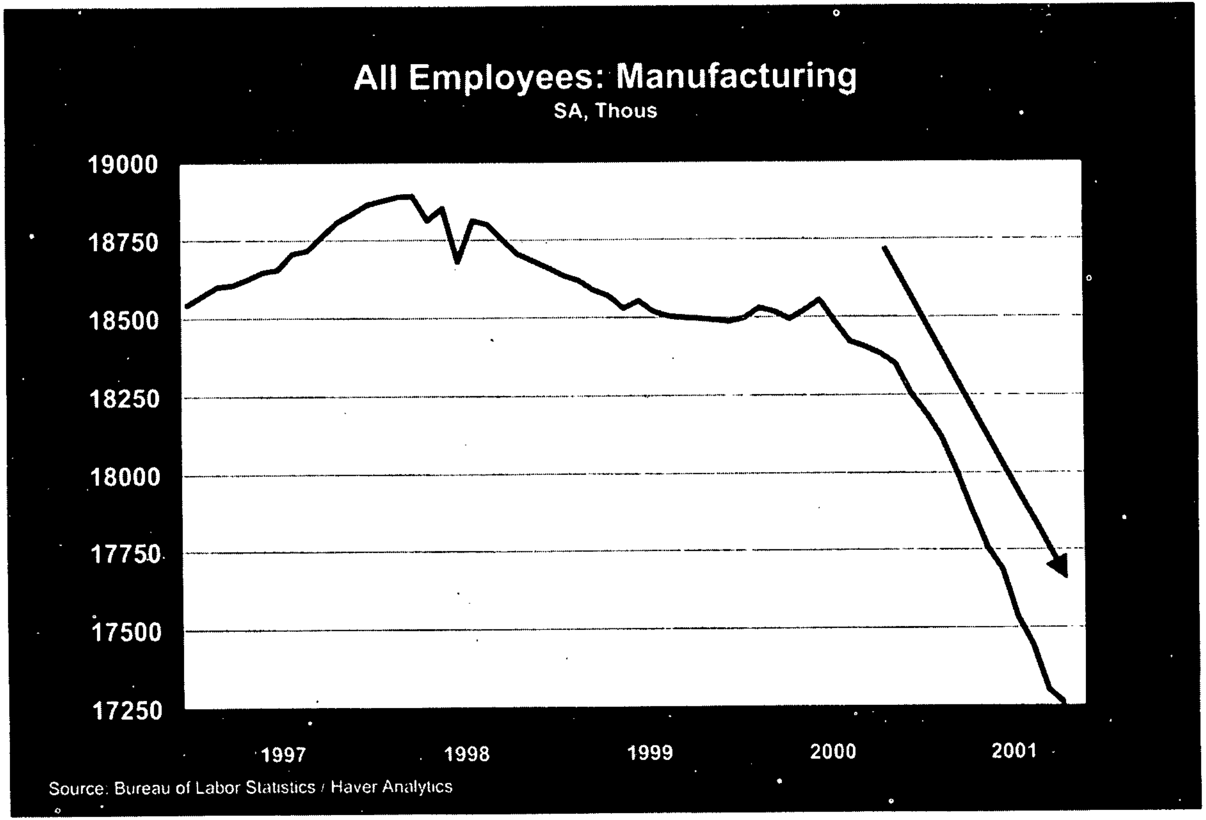
Time span	Jan.	Feb.	Mar.	Apr.	May	June	July	Aug.	Sept.	Oct.	Nov.	Dec.
	Private nonfarm payrolls, 353 industries[1]											
Over 1-month span:												
1997	57.2	58.6	62.5	63.2	59.8	57.2	59.8	59.2	62.7	65.2	61.6	62.2
1998	63.2	56.2	59.3	60.2	58.9	57.1	55.4	58.4	54.8	55.0	58.2	56.4
1999	55.1	59.6	52.8	57.2	58.2	54.2	57.1	54.4	55.2	57.9	59.9	56.8
2000	55.7	59.3	61.0	54.2	47.7	60.5	57.8	55.1	52.0	54.8	55.1	54.2
2001	53.7	50.4	55.8	45.0	46.6	44.3	45.5	p43.5	p45.3			
Over 3-month span:												
1997	63.5	64.0	66.0	67.0	63.2	63.3	59.8	65.6	67.3	71.1	70.0	69.5
1998	65.3	66.1	64.6	65.7	62.2	57.9	57.5	58.4	59.1	59.2	59.3	59.2
1999	60.8	57.8	58.5	55.8	58.1	57.9	57.2	59.2	59.8	59.1	61.0	60.6
2000	61.6	63.3	61.9	56.2	55.1	57.9	61.5	56.4	54.1	53.3	55.7	53.3
2001	51.7	54.1	48.6	49.2	42.5	42.4	p40.7	p41.5				
Over 6-month span:												
1997	66.7	68.6	66.1	66.0	65.3	65.9	66.0	69.1	69.4	70.3	71.1	70.7
1998	70.4	67.4	65.0	62.5	63.6	60.5	59.2	58.6	57.9	59.6	60.6	59.9
1999	59.8	59.8	58.2	60.3	56.7	59.2	61.8	60.8	62.2	61.2	62.3	64.9
2000	63.5	60.6	62.6	63.7	61.5	55.5	56.1	58.6	54.2	54.8	51.8	54.2
2001	52.0	50.6	48.6	45.3	p43.5	p39.4						
Over 12-month span:												
1997	69.3	67.4	68.4	70.0	69.7	70.3	70.1	70.8	71.0	70.5	69.7	70.7
1998	69.7	67.6	67.4	66.0	64.0	62.7	61.9	62.0	60.9	59.3	60.8	58.8
1999	61.2	60.2	58.2	60.8	60.8	61.6	62.2	61.3	63.9	63.0	61.3	60.9
2000	62.5	63.0	61.8	59.5	58.4	56.8	55.7	56.5	54.2	53.4	53.0	51.7
2001	49.6	p47.5	p44.8									
	Manufacturing payrolls, 136 industries[1]											
Over 1-month span:												
1997	48.2	52.6	55.5	54.8	52.9	53.7	49.3	51.1	57.7	61.8	61.4	54.8
1998	57.4	51.5	53.7	53.3	43.8	48.2	38.2	51.5	41.9	41.5	41.2	43.4
1999	46.0	44.5	43.0	42.3	50.4	39.3	51.5	39.3	45.2	46.3	53.3	46.7
2000	44.9	56.6	55.5	46.7	41.2	54.8	53.7	38.6	34.6	41.5	43.8	44.1
2001	37.9	32.4	41.5	31.3	29.4	33.1	39.0	p28.3	p37.5			
Over 3-month span:												
1997	50.0	51.5	55.9	55.5	52.9	52.9	50.4	54.8	59.6	70.6	66.5	64.3
1998	59.6	59.6	55.9	50.4	46.7	37.9	41.5	41.5	41.9	38.2	36.8	40.8
1999	41.2	39.0	38.2	41.5	40.8	45.2	39.0	45.2	40.8	44.9	46.3	46.0
2000	50.0	54.0	52.9	42.3	43.0	48.5	48.2	33.8	28.7	30.5	39.0	35.7
2001	28.3	29.4	24.6	26.5	22.4	24.6	p21.3	p22.4				
Over 6-month span:												
1997	53.7	53.7	51.1	52.9	50.7	50.7	54.8	62.1	61.8	64.3	67.3	65.8
1998	63.2	54.4	50.4	40.4	44.5	40.1	37.5	36.4	34.9	40.1	37.1	34.2
1999	36.0	38.2	37.5	41.2	36.8	39.7	43.0	41.5	46.0	40.4	46.3	51.5
2000	51.5	44.5	48.5	55.1	43.8	34.9	33.5	34.6	30.1	29.4	25.0	27.9
2001	26.8	25.4	19.9	20.6	p20.6	p16.2						
Over 12-month span:												
1997	55.1	52.6	54.0	54.4	55.5	57.0	57.0	58.8	59.2	57.7	57.4	57.7
1998	54.8	52.2	51.8	46.7	40.4	40.1	38.2	37.5	36.4	34.6	35.7	34.2
1999	38.6	34.6	32.4	36.0	37.9	39.0	40.1	40.4	44.5	46.0	44.9	44.5
2000	46.3	45.2	41.2	37.9	33.8	31.3	31.3	31.3	27.6	25.4	24.3	21.0
2001	19.1	p16.9	p15.1									

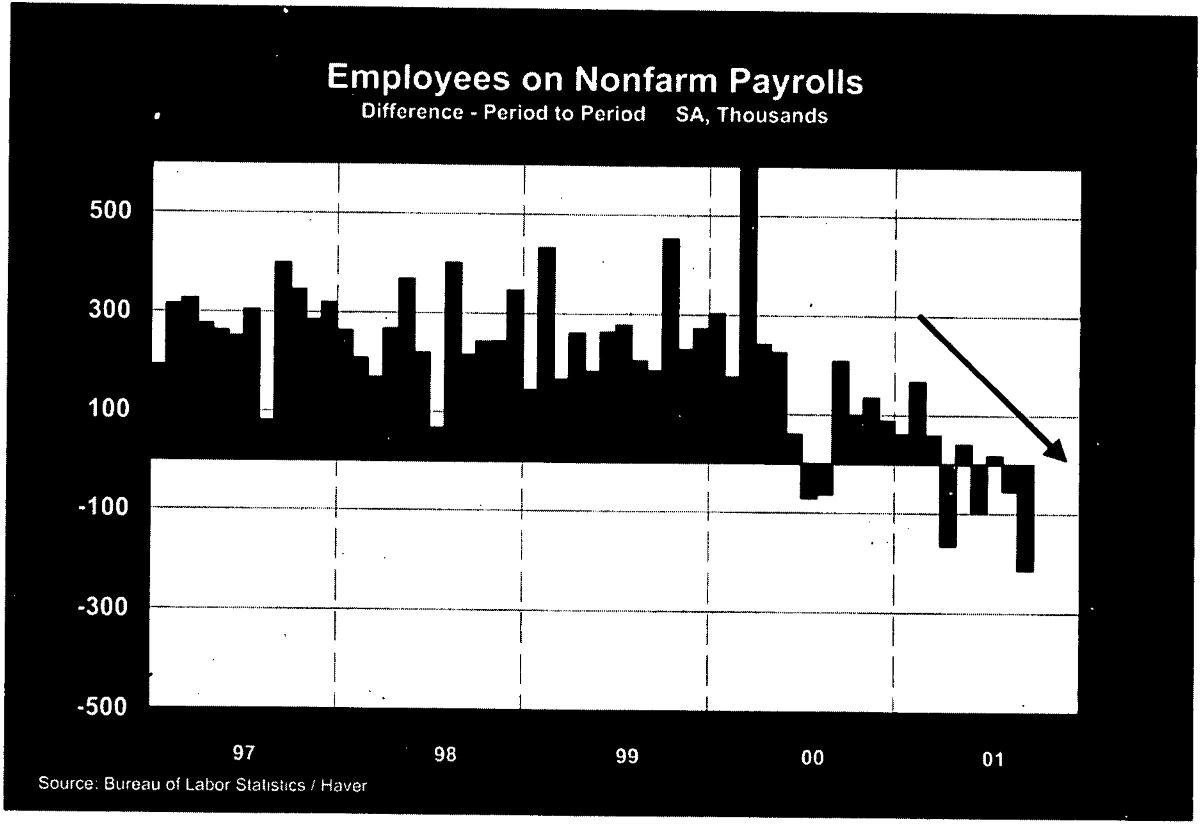
[1] Based on seasonally adjusted data for 1-, 3-, and 6-month spans and unadjusted data for the 12-month span. Data are centered within the span.

p = preliminary.

NOTE: Figures are the percent of industries with employment increasing plus one-half of the industries with unchanged employment, where 50 percent indicates an equal balance between industries with increasing and decreasing employment.


Gross Domestic Product
% Change - Annual rate
SAAR, Bil.Chn.1996$
10
8
6
4
2
0
-2
97
98
99
00
01
Source Bureau of Economic Analysis / Haver Analytics


All Employees: Manufacturing
SA, Thous
19000
18750
18500
18250
18000
17750
17500
17250
1997
1998
1999
2000
2001
Source: Bureau of Labor Statistics / Haver Analytics



Employees on Nonfarm Payrolls
Difference - Period to Period SA, Thousands
500
300
100
-100
-300
-500
97
98
99
00
01
Source: Bureau of Labor Statistics / Haver

OCT 30 2001

The Honorable Melvin L. Watt
Joint Economic Committee
House of Representatives
Washington, D.C. 20515

Dear Congressman Watt:

At the Joint Economic Committee hearings on October 5, you requested information about the experience of individuals who have left the welfare rolls. We have examined some of the literature related to this question, and a selected list of studies you may find of interest is enclosed. In addition, we are enclosing copies of some of the briefer studies.

A myriad of studies of the effects of welfare reform, and the situation of "welfare leavers" in particular, have been sponsored by government agencies, private non-profit organizations, and academic institutions using a variety of methodological approaches. An examination of States' administrative records has been carried out by, among others, the National Conference of State Legislatures, the Department of Health and Human Services, and different State agencies. Follow-up surveys of States' welfare leavers have been sponsored by various State agencies. The Manpower Demonstration Research Corporation randomly assigned welfare recipients to various types of intervention programs in order to evaluate those programs' effectiveness.

In addition, the Census Bureau and the Urban Institute are conducting nationally representative surveys. The Census Bureau's survey, called the Survey of Program Dynamics, is a longitudinal survey that, in conjunction with the Survey of Income and Program Participation, will allow the experience of low-income families to be examined for the time period from 1992 to 2001. The Urban Institute's survey, the National Survey of America's Families, is a cross sectional survey that was conducted both in 1997 and 1999.

Caution needs to be used in summarizing the results of these studies due to differences in how leavers are defined, the length of time individuals have been off welfare prior to

The Honorable Melvin L. Watt--2

OCT 30 2001

inclusion in a study, and how employment and earnings are defined. In general, however, our limited review of these studies indicate that among individuals leaving welfare:

· About 3 out of 5 work at a given point in time after initially leaving welfare (almost all studies report employment rates over 50 percent, with the majority lying between 60 to 75 percent).

· About 3 out of 4 work at some point in the first year after initially leaving welfare.

· A sizable minority of welfare leavers return to Temporary Assistance for Needy Families (TANF)cash assistance at some point in the first 12 months after initially exiting (estimates generally range between 18 to 35 percent).

· When leavers work, they usually work full time (more than 35 hours a week) and earn between $6 to $8 an hour.

· Since the majority of leavers work intermittently, their quarterly earnings generally range between $1,900 and $3,500.

· The family income of the majority of leavers hovers around the poverty line.

· There are large variations in the employment and income among welfare leavers, that are obscured when group averages are examined.

· There is little evidence that recent leavers are more disadvantaged than earlier leavers. However, until very recently, the economic conditions faced by later leavers were significantly better than those faced by earlier leavers.

The Honorable Melvin L. Watt--3

OCT 30 2001

I hope this summary is helpful. Should you have additional questions, please feel free to contact Mr. Philip Rones, Assistant Commissioner for Current Employment Analysis, at 202-691-6378.

Sincerely yours,

LOIS ORR
Acting Commissioner

Enclosures

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S. HRG. 106–290

TAX CUTS AND THE BUDGET SURPLUS

HEARING

before the

JOINT ECONOMIC COMMITTEE
CONGRESS OF THE UNITED STATES

ONE HUNDRED SIXTH CONGRESS

FIRST SESSION

September 13, 1999

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TAX CUTS AND THE BUDGET SURPLUS

Monday, September 13, 1999

Congress of the United States,
Joint Economic Committee,
Washington, D.C.

The Committee met at 10:00 a.m., in Room SD-124 of the Dirksen Senate Office Building, the Honorable Connie Mack, Chairman of the Committee, presiding.

Present: Senator Mack. Representative Stark.

Staff present: Shelley S. Hymes, Chris Edwards, Joseph Pasetti, Kevin Doyle, Stephen Schultz, Kurt Schuler, Kerry Fennelly, Victor Wolski, Lawrence Whitman, Daphne Clones, Howard Rosen, James D. Gwartney, Chuck Skipton and Colleen J. Healy.

OPENING STATEMENT OF SENATOR CONNIE MACK, CHAIRMAN

Senator Mack. Let me call the Committee to order.

I came down the hallway and there was another hearing apparently getting ready to start, with a huge crowd outside. I thought for a moment, could this possibly be the interest in the country beginning to focus on some economic questions?

I was disappointed to find out that apparently it must be a hearing in which the issue is about who gets how much of the tax dollars, how much of the new spending. So there's more interest, which is not surprising. It has always been that way and always will be.

Anyway, I want to thank each of you. We do have another panel member and I suspect we will have a member or two showing up as well. Here comes Congressman Stark now.

I do want to thank each of you for coming.

Welcome.

Again, I want to welcome you to this hearing of the Joint Economic Committee on the very timely topic of Tax Cuts and the Budget Surplus.

There has been a lot of loose talk in the past few months concerning this Congress's tax relief package, with adjectives like "reckless" and "risky" being tossed about by opponents of tax relief. I am confident that the distinguished panel we have assembled can substitute some light for the heat that has been generated in this debate.

One thing that has gone unnoticed in the budget debate is that both ends of Pennsylvania Avenue agree on the size of the surpluses over the next decade. The nonpartisan Congressional Budget Office, and the President's Office of Management and Budget, this summer released surplus calculations that are only $20 billion apart, and I say, only 20 billion in the context of three plus trillion dollars. When the budget baselines are adjusted to freeze discretionary spending at the 2002 caps, these surpluses total roughly $3.4 trillion over the next ten years.

So, all parties agree that the Federal Government will be overcharging the taxpayers by $3.4 trillion. The only real debate concerns what the government should do with these overpayments. This summer, the Congress passed a tax bill that would provide $792 billion in tax relief for the American people. This is less than 25 percent of the tax overpayments, a relatively modest portion. But despite the modest size of this tax cut, the President and his supporters have characterized or criticized the tax relief package as "too big," and have argued that the government cannot part with that much money.

But if you stop and think about it, every single argument being made against the tax cut is just plain wrong.

Some argue, from a Keynesian demand-side perspective, that tax cuts will overstimulate the economy. But even after a $792 billion tax cut, the Federal Government will run up over two trillion dollars in surpluses over the next ten years, and from a Keynesian viewpoint, two trillion in surpluses is not considered a stimulus, it is considered a drag on the economy. And with all of the lags, the delays, and the phase-ins, the bulk of the tax cuts will not arrive until years 2007, 2008, and 2009.

Can anyone seriously think that, in a nine trillion dollar economy, a $5.3 billion net tax cut for fiscal year 2000 will overstimulate consumer demand? This is just six hundredths of one percent of GDP. The net tax cut for fiscal year 2001 is barely noticeable, it is $1.1 billion. How can that possibly overheat the economy?

Clearly, the facts do not support the argument. In any event, from the demand-side perspective, the tax cut should be irrelevant. If we do not cut taxes by $792 billion, it is safe to say that spending will increase by $792 billion over the next decade—spending by the government, that is. That is what President Clinton means when he says we cannot afford to cut taxes. His bureaucrats are working overtime to dream up new ways to spend the money. In fact, including his Medicare proposal, the President has already proposed an increase in spending of $1.3 trillion over the next decade—all but $54 billion of the on-budget surpluses, according to the CBO.

Furthermore, a tax cut that removes government barriers to savings and investment is not an "artificial stimulus" that the Federal Reserve Board would seek to offset with tighter money. Inflation, after all, is caused by too many dollars chasing too few goods, not by too many investors creating wealth and opportunity. An even stronger economy, fueled by the freedom and enthusiasm of our entrepreneurs, is not something to fear.

The argument is also raised that a $792 billion tax cut leaves no money to meet some other important government goals. But we still have about $2 trillion in Social Security surpluses that will be in a "lock-box" to retire debt and shore up our seniors' retirement security, and another $505 billion in non-Social Security surpluses that can be used for Medicare, National Defense, and other priorities.

There appear to be no good economic arguments against the tax relief package. The opposition to tax relief is based not on economics, but on philosophy. This all boils down to one basic, fundamental question: who has first claim on the income of Americans—does it belong to the government or to the individuals who create the income through the sweat of their brows and the genius of their intellect?

The current Administration acts like the money belongs to the government. It rejects our tax relief bill as "too big," as if taxpayers earn income at the sufferance of the government. Under this view, Uncle Sam does not live under a budget, he sets the budget for every American family, which must be content with the table scraps after the enormous appetite for Washington spending has been satiated.

This President and his supporters in the Congress just don't get it. The tax burden on our citizens is at an all-time, peacetime high—20.6 percent of the economy. At the same time, we will be overcharging the taxpayers by more than three trillion dollars. A Nation that trusted its people, that protected their liberty, would not flinch from doing the right thing: cutting taxes so that our families can enjoy the fruits of their labor, instead of the greedy Federal Government.

We must remember that tax cuts are not about numbers, they are about people. The true measure of the merit of tax relief is not the revenue loss estimate by the bean counters—the value of tax relief is the gain in freedom and the enhancement of opportunity for our people. There can be no denying that the American people would be helped tremendously by the tax relief that we have passed. Consider some of the ways in which our tax relief bill would make a difference in the lives of

Americans. We make health and long-term care insurance fully deductible, and allow a dependent deduction for elderly family members. Education is more affordable through enhanced savings vehicles—savings accounts and pre-paid tuition plans. Tax rates are lowered across-the-board. We eliminate the marriage penalty for taxpayers in the lowest tax bracket and repeal the Alternative Minimum Tax for individuals.

According to analysis by the Heritage Foundation, once the tax relief is fully phased-in, a blue-collar family of four earning in the low $50,000s would save $381 on their tax bill, and a typical, unmarried teacher earning under $40,000 would see his or her tax bill shrink by 782 dollars. These are not trivial amounts. We cut taxes because of the 67 year old owner of a family business in Florida's panhandle, who is discouraged from reinvesting his hard-earned profits because the specter of the Federal death tax is hovering, waiting to swoop down and scoop up 55 percent of the increased value of his business.

We cut taxes because of the two-earner family, struggling to make ends meet, that has to pay over $1000 extra in taxes just because they are married. We cut taxes so that waitresses, truck drivers, teachers and carpenters can put an extra $1000 in their IRAs each year, to build a better nest egg for retirement. We cut taxes to enable a biomedical company to budget that one additional research project that just might lead to a breakthrough in the treatment of glaucoma or a cure for cancer. And we cut taxes to reduce government barriers to saving and investment, so the capital is available for the American entrepreneurs of the 21st Century to develop markets in technologies we cannot even imagine today.

High taxes are an infringement on the liberty of our families, who should not be straggling to make ends meet while their Federal servants hoard the wealth our families have created. When the question comes down to whether we trust the Federal Government or the family to use money wisely, I choose the family every time.

Now I will turn to my colleague and welcome you.

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

Opening Statement of Representative Pete Stark, Ranking Minority Member

Representative Stark. Thank you, Mr. Chairman. After that introduction I hardly know what to say. As usual, I have this brilliant opening statement.

Senator Mack. We probably can just put it in the record.

Representative Stark. I do not think I can let you get away quite that easily.

I have a couple of concerns. Although everybody is talking about an on-budget surplus, and I do not dispute your numbers, there are many of us who are not so sure that that surplus will materialize over the next ten years.

It seems to me that we, the House and the Senate, would have to cut 15 to 20 percent out of discretionary spending in order to finance a large tax cut. That would not leave any money to fix Florida's hurricane that is about to hit in the next week or so, although I hope it misses the whole east coast. If it does, there will be no money to repair that damage.

The on-budget surplus, I suspect, depends on the actions of Congress for the next ten years and if the past ten years are any record, and that's all we have to go on, it's not likely to appear. So if there is any diminution of the on-budget surplus, we will not have any money to fix Social Security or will run deficits, and we won't have any money to keep Medicare solvent. I submit that 40, 50, 60 percent of this proposed tax cut would go to the wealthiest one or two percent in the country. My sense is that we ought to perhaps not give it to them and to spend some of that money to see that the 10 to 12 million children in this country who don't have health insurance get it. There's still 45 million uninsured for any health care in this country, and not having health insurance in this country means you get second-rate or no medical care.

We are certainly not the only industrialized nation in the world that would have a sixth of our population uninsured and receiving substandard medical care; we may be the only nation in the world to not provide medical care as a matter of right. Albeit, in some countries it is not very good, but everybody gets it.

I think that is unconscionable. I think that is far less conscionable than spending some of your or my tax dollars, Mr. Chairman, and members of Congress who would be well-to-do enough to get a fairly substantial cut and lower income people wouldn't. I don't think we should do that. I think we should spend our money first to insure Social Security, second to make sure that Medicare is solvent, and third to expand health care to all. And we have all kinds of problems like education and crime, where I think there's bipartisan agreement that those are programs that the Government should support. Now, maybe we shouldn't.

One of the problems is that if we make the tax cut we all know that it's somewhere between 10—and I will let the economists answer this—somewhere between 10 and 100 times easier to cut taxes than it is to raise taxes.

Senator Mack. That's certainly not been my experience.

Representative Stark. Yes, it is. It's an easier vote, let's put it that way; it is a more comfortable political position. And I see nothing wrong with saying if those extra surpluses develop after we've taken care of Social Security, Medicare and the uninsured, be my guest. But why put it in cement for ten years out?

Some people would say, and some of these expert economists might say, well, business needs to plan. Business is doing pretty well without the tax cuts. They can use a few pleasant surprises and I'm not sure business needs to plan as much for good news as they do for bad. The idea that you can't plan ahead, I think is a marginal issue. Basically we're not very sure that that surplus is going to arrive. If it doesn't, a major tax cut on the order of $300 billion or $500 billion is going to be devastating in my opinion to the programs that on a bipartisan basis we want to support.

I'd like to do a couple of things. I have a letter from 50 economists, we wouldn't have all 50 of them here to testify this morning, but they all signed a letter suggesting a view that's supported by Alan Greenspan and that is that we don't need a tax cut now. I would like for us to put that letter in the record.

Senator Mack. Without objection.

Representative Stark. And I would like to ask the four witnesses before us today, first of all, how does a large tax cut proposal improve the long-term security of Social Security and Medicare? And, then, does that proposal extend the benefits of the economic prosperity to more people than are enjoying it currently? And, how does the proposal improve the long-term health of the U.S. economy? If you could just kind of address your remarks to those as we go along, I would be quite interested in your conclusions, and thank you for holding the hearing.

[The prepared statement of Representative Stark and Dear Colleague appear in the Submissions for the Record.]

Senator Mack. Thank you, Congressman Stark.

Again I want to welcome the panel.

We have four panel members this morning. We will start with Dr. Jim Miller, Counselor, Citizens for a Sound Economy and former Director of the Office of Management and Budget. He will be followed by Dr. James Gwartney who is the Chief Economist for the Joint Economic Committee and a Professor of Economics at Florida State University. And then Mr. Bob Greenstein who is Director for the Center for Budget and Policy Priorities, and then with Wayne Angell, Chief Economist and Senior Managing Director of Bear Stearns and Company and former member of the Board of Governors at the Federal Reserve batting clean up.

And so with that, Jim, we'll start with you.

STATEMENT OF DR. JIM MILLER, COUNSELOR, CITIZENS FOR A SOUND ECONOMY AND FORMER DIRECTOR OF THE OFFICE OF MANAGEMENT AND BUDGET

Dr. Miller. Thank you, Mr. Chairman and Mr. Stark. I appreciate the opportunity to be here. I am Counselor to Citizens for a Sound Economy, which has a quarter of a million members and supporters, and on their behalf as well as my own, I welcome this opportunity to respond to you.

I have a short piece of testimony that I would ask you to put in the record.

Senator Mack. Without objection.

Dr. Miller. Thank you, sir.

The first point I want to make is that we give all these numbers undue credibility, credibility they don't deserve. We don't know these numbers with great precision. Estimates of budget surpluses or deficits don't take into account changes in asset values of the Federal Government, change in liabilities of the Federal Government. You see these numbers aggregated over a ten- year period. They are not discounted, they don't discriminate between a big tax cut the first year and little tax cuts thereafter or vice versa.

Frankly, from experience doing some forecasting myself, and I'm sure the members of the panel here would agree with this, you can have a lot more confidence in the first year or the second year than you can in the so-called "out years"; I wouldn't bet the farm on anything past two or three years. Keep in mind that the budget surplus or budget deficit is the small difference between two very, very large numbers. And swings in those two numbers from just mistakes or errors in forecasting can result in big swings in those deficit or surplus numbers.

Also, both agencies, the Office of Tax Assessment in the Department of Treasury and the Joint Committee on Taxation here in the Congress still use quasi static models. There have been some improvements in the last few years, but it's basically static. So, for example, these models tend to overestimate the revenue hit of a tax cut. So those are sources of errors in these forecast numbers and I think that is important for us to bear in mind when we talk about a $792 billion surplus roughly you know, give or take a couple of hundred billion.

I think we can be more confident of the following two things. One is that taxes restrict economic growth. I gave some testimony last March where I talked about this, building on— among other things — the work of Professor Gwartney and some of his colleagues.

Secondly, if Congress has the money, Congress will spend the money. And so we are talking about whether to put the money back in the pockets of taxpayers where it originates or whether to have Congress spend the money. I offer here today's Washington Post as Exhibit 1, pointed out to me by Mr. James Carter who is on the Committee staff, at page A-9. It's an advertisement by the Gateway Computing Company. And it says, "It's our annual 'spend your budget before it's gone' sale." It goes on, "With only weeks left before the end of the Federal Government's fiscal year, Gateway is making it easy for your agency to get the best technology at the best prices."

Another example: When I came to work for Herb Stein, who unfortunately passed away last week—a great economist and a great patriot — at the Counsel of Economic Advisors as a senior staff economist, my office had some wonderful drapes that I liked very much—paisley drapes. I came in one day and they were cut down on the floor. I said, "What happened to these drapes?" They said, "Well, it's the end of the fiscal year and we had money left over and we had to spend it." Now, that's a mindset. And I think that mindset permeates Washington's thinking about money, about taxpayers' money, and so it's a question of who is going to spend it — the government or the taxpayer?

So the third point I want to make is I urge you to stand firm on the tax cut package that you passed, and I hope the President will sign it. Not only because yours is a bigger tax cut than what the President has indicated he would accept, $300 billion or so over ten years, but because it is different in kind. There are two extremes in taxes. One is an across-the-board kind of tax cut which empowers people to make their own decisions. The other is like tax expenditures or what the Administration likes to call "targeted tax cuts" where basically the government channels you into certain kinds of activities, determining what they think is good for you and what is not so good for you.

And, of course, the other thing is that the President's budget incorporated dramatic increases in spending. And, for reasons that I outlined before this Committee in March, I think that government spending is too large a fraction of gross national product and ought to be curtailed.

Briefly in answer to you, Mr. Stark, I think the answer, and I'm sure my colleagues here on the panel will be responding in more detail, is that if you have a tax cut, you unbridled the economy, you enable the economy to grow faster and that this larger gross national product will make it easier for people to obtain health insurance, and it will be easier for the government to solve the Social Security problem and to affirm Medicare. And to do these things, a tax cut is essential.

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

Representative Stark. But as the—

Senator Mack. If I could ask you to wait until we have had heard from the panel.

Senator Mack. Dr. Gwartney.

STATEMENT OF DR. JAMES GWARTNEY, CHIEF ECONOMIST, JOINT ECONOMIC COMMITTEE AND PROFESSOR OF ECONOMICS, THE FLORIDA STATE UNIVERSITY

Dr. Gwartney. Mr. Chairman and Congressman Stark, it is a pleasure for me to have the opportunity to address this Committee. My background as Chairman Mack mentioned is that as a Professor of Economics at Florida State University and I'm used to speaking 50 minutes. So the question is whether I will be able to say anything in five minutes or not? Some people might argue college professors don't say very much in 50 minutes, so we'll see what they can do about five.

Well, I would like to provide some background related to the tax cut legislation. If you listen to the media, you would get the idea that two propositions permeated this debate. One of the propositions would be that the tax cut would essentially result in very few funds being used to pay down the national debt. We've got this big national debt and doesn't it make more sense to pay down the national debt rather than to cut taxes.

And the second would be that the President wants to pay down the national debt and the Republicans want to cut taxes rather than pay down the national debt.

Now, both of those propositions are false. And to indicate why they're false I would like to look a little bit closer at the data.

If you look at the size of the tax cut, and I think that you have some packets before you that have some exhibits in them, and I will make a few references to some of the exhibits that were in my packet. Figure 3 in that particular packet gives the size of the tax cut in relationship to GDP. The tax cut in the first five years is four-tenths of a percent of GDP. In the second five years it is 1 percent of GDP. So it's small relative to the size of the economy. It is small relative to the surpluses that are being projected by both the President and the CBO.

In the first five years the size of this tax cut ($156 billion) is only about 15 percent of the one trillion dollar surplus that is projected during that period.

In the second five years it's about a $600 billion tax cut and figures to be about 40 percent of the $1.5 trillion surpluses that are projected during the second five years. So the tax cut is small relative to the size of the surplus.

The tax cut is also small relative to the size of the national debt, and what is going to happen to the national debt—particularly net private debt. Exhibit 5 shows net privately held debt, which is the portion of the debt that the Federal Government really pays interest on. As the exhibit shows, net private debt is going to be paid down over the next ten years to the lowest level in the last 80 years. You would have to go all the way back to World War I in order to have a lower private debt. In the figure here, by the way, the projected figure for net private debt as a share of GDP assumes only the Social Security surplus (which is $1.9 trillion over this period) is used to pay off the debt and that we have a continuation of the Fed's holdings of bonds as they have been in the last five years. If there's no additional surplus, the net privately held debt will be paid down to less than 10 percent of GDP, its lowest level that it will have been since World War I.

Having argued that the tax cut is small and the debt is going to be paid down, the second point that I would like to make in relationship to the size of this tax cut, is that there is almost certainly an underestimate of the size of tax revenues that are going to come in and thus the size of these surpluses. There is an underestimate whether you look at either the CBO or the President's figures. The reason why it's a vast underestimate, not just a small underestimate, but a vast underestimate in the revenues that will be generated is because of the CBO's assumption of making its projections on the basis of a .94 tax revenue GDP elasticity. That is to say that if income increases by 10 percent, for example, the CBO says that the Federal Government's revenues are only going to increase by 9.4 percent. So, over the ten-year period, even though the CBO projects a 53 percent increase in revenue, they say tax revenues are only going to go up by 49 percent. We've got a progressive tax system. As incomes rise in real terms (sure, we've indexed for inflation, inflation will not do it) as they will do over this next ten years, the revenues derived by the Federal Government will increase more than proportionately.

As a result of the understatement of revenue, revenues in the first five years are $250 billion below what they would have been had the CBO anticipated or made their projections on the basis of a far more realistic income elasticity. In fact, 1.1 may even be on the low side, some would argue tax revenue elasticity would be as high as 1.3, in which case these projections for the next five years will be $500 billion on the low side.

And when you look at it over a ten-year period, given an elasticity of 1.1, revenues are understated by $950 billion.

If this is not bad enough, the CBO's growth estimate assumes a 2.5 percent, ten-year annual growth rate. Now, there are only four years out of the last 44 that we have had that low of real growth rate of GDP. The CBO is potentially taking an unrealistically low growth rate. If you low-balled it and took, by way of comparison, the last 15 years growth of real GDP in the United States has averaged 3.1 percent. If you look at the last 20 years or so, it has been still higher than the 2.5 percent period.

A more realistic growth assumption would be 2.8, or in the three point range, and with such, again there is an understatement of around $100 billion or more in the first five years, and around $300 billion or so on out into the next five years. So the revenue figures are understated.

Now, finally you might say, well, maybe we're undertaxed. Well, if you will look at Figure 9 in your packet, we look at tax revenues as a share of national income. We go all the way back in this figure to 1949, but you could go back prior to that into World War II, tax revenues as a share of national income are currently at an all-time high. There are only three periods that are at all close to that: during the Korean War, the other time was during the height of the Vietnam War, and most recently in the period just prior to the Reagan tax reduction in 1981. Those are the only three periods that are even close to that. Now, if you—even after you have the tax cut, and even with the very conservative assumptions that I am talking about, as a share of national income the tax revenues are going to be at or very near their all-time high during the next ten years.

Let me just pose this question to you; suppose that the—

Senator Mack. Jim, I am going to have to ask you to wrap this up, you are well over your time.

Dr. Gwartney. Oh, excuse me. I guess I was a Professor—

[Laughter.]

I will close with a question. Suppose the state of the economy was such that our growth rate—that our size of surpluses in the next five years were shaping up to be $200 billion under very conservative projections, and in the next five years $300 billion under very conservative projections, and that tax rates were at their all-time high, would you in fact vote under those kinds of circumstances for a roughly $800 billion increase in taxes? Most would not think that to be a prudent strategy, and I would not think it would be a prudent strategy. That is exactly what the conditions will be if the tax cut is in fact passed. So if we do not pass the tax cut, those figures will be much higher than otherwise would be the case.

Thank you.

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

Senator Mack. Thank you.

Mr. Greenstein.

STATEMENT OF MR. ROBERT GREENSTEIN, DIRECTOR, THE CENTER ON BUDGET AND POLICY PRIORITIES

Mr. Greenstein. Thank you, Mr. Chairman.

As I think you know, I hold a different view on this from other members of the panel.

I think there are three problems with the pending tax cut. Now, the first is that there is no non-Social Security surplus at the present time and it is unclear whether any significant one will materialize.

I think, as I will explain in a moment, a tax cut of the magnitude being discussed would be very likely to bring back substantial deficits in the non-Social Security budget, rather than resulting in paying down the debt.

Secondly I think it does pose problems in terms of resources for other high priority issues; Social Security and Medicare are two that Mr. Stark mentioned. And third, the tax cut is too heavily skewed towards the well-to-do.

Let me start by reviewing the budgetary situation. You said there was a three trillion dollar overpayment of taxes. But two trillion dollars of that is in Social Security and it isn't really an overpayment. It is collected because the baby boomers are in their peak earnings years and we are taking in more in Social Security taxes now than we are paying out in benefits. But every dollar of those Social Security so-called "additional payments" will be used for Social Security when the boomers retire, and, as you know, we are still short on Social Security.

So we then go to the non-Social Security side and that is where there is said to be a projected one trillion dollar surplus over the next ten years. That is the CBO figure.

As this chart shows, and I also have it in the charts in front of you, the CBO forecast assumes that Congress will comply with the discretionary caps and CBO assumes not only that the Congress will comply with the caps, but that there will be zero—zero—in emergency spending outside the caps through 2002, and for all years after 2002, Congress will simply stay with the 2002 cap adjusted for inflation.

The Congressional Budget Office has asked and answered the question: Of this trillion dollar surplus forecast, how much does that forecast assume that discretionary spending will be cut over the next ten years below the fiscal year 99 non-emergency level adjusted for inflation only? And the answer is $595 billion. So if Congress can't do those kinds of cuts in discretionary spending, $595 comes back.

Now, if that $595 billion comes back, we also then get to the emergency area. Have we ever had a year where there was zero emergency spending? No. If we discard 1999 with extra emergency spending, we rule out Desert Storm in the early 1990s, we still have an average of eight billion dollars a year in emergency spending. So the question we asked was, suppose we simply take the 1999 level of discretionary spending adjusted for inflation and we limit the emergency spending, it's only 8 billion a year, the post non-Desert Storm, non- 99 average. What happens if you make those two assumptions? As the graph shows, between those costs and the interest payments on the debt associated with them, the surplus shrinks from a trillion dollars to $112 billion. There is no trillion dollars available for a tax cut.

Now, some people look at this and say to me, well, don't assume that there won't be any of these discretionary cuts made. We don't want to do big spending. But, Mr. Chairman, you're part of a Republican majority. If you look at the numbers that Congress is passing now, your party—and this is not a partisan statement—I agree Democrats would probably spend more. If you look at these amounts your party is passing in the appropriations bills moving through, they are on target to be above the 1999 level adjusted for inflation. My assumption may be conservative here.

There seems to be a misunderstanding. Some members think that if you designate something as an emergency, or if you direct CBO not to count outlays as outlays which has happened in two bills so far this year, that because they don't count against the caps, they don't count in figuring surpluses and deficits. But spending is spending, label it emergency or label it not, it counts in figuring out how much is left in the surplus.

The Congressional Budget Office reported last week, we're on target for a non-Social Security deficit again in fiscal year 2000.

The next chart that I have in the handouts, I don't have a board on this chart, what it shows you is that the Congressional budget resolution that made room for this $800 billion tax cut not only assumes the $595 billion over the next ten years in discretionary cuts below the 1999 level adjusted for inflation, but assumes another $180 billion in discretionary reductions on top of that. All of these are CBO numbers, not mine, CBO numbers. The CBO says the budget resolution assumes $775 billion in discretionary reductions over the next ten years.

Now, I'm not here to debate the merits or demerits of various levels of spending. The point I am simply trying to make is that the forecast of a non-Social Security surplus on which this tax cut is based is not realistic. It is based on assumptions of large cuts that Congress is very unlikely to make. Since Congress is unlikely to make those cuts, that means two things. Number one, it puts us on track towards deficits in the non-Social Security budget, and eventually when the Social Security surplus disappears, when the boomers retire, towards deficits in the unified budget which also means less debt repayment.

Secondly, since the tax cut would consume more than 100 percent of the non-Social Security surplus when you take into account reasonable assumptions for discretionary spending, that means zero money will be allowed to transfer to either Medicare or Social Security to help shore up those programs. I'm in favor of some cost reforms in both Social Security and Medicare, but I know of no one on Capitol Hill—or almost no one—who favors changes in Medicare and Social Security which would truly restore solvency without any benefit cuts or payroll tax increases. And if we make no transfers at all from the non-Social Security budget into Social Security or into Medicare, the level of benefit cuts or payroll tax increases that would be required to restore long-term solvency exceed what either party is willing to pass.

The final point I would make is that in thinking about priorities, if surpluses eventually materialize or the economy goes down and we do want to consider tax cuts, I think they ought to be more equitably distributed than in this particular bill which gives 79 percent, according to the Treasury, 79 percent of the tax cuts to the top fifth and only 7.5 percent of the tax cuts to the bottom 60 percent of the population.

The CBO data which we released an analysis on about two weeks ago shows that the gap between the very wealthy and the middle class as well as the poor is wider now than at any time in recent memory, but the richest 1 percent of the population—about 2.7 million people— now has as much income as the bottom 100 million Americans. Given that, my top choice for a national priority would not be do a very large tax cut, which as of now it appears that we can't afford, and certainly don't give a large majority of benefits to the one group in the country that has done the best in the last 20 years and is pulling away from everybody else.

Thank you.

[Informational materials submitted by Mr. Greenstein appear in the Submissions for the Record.]

Senator Mack. Thank you.

Mr. Angell.

STATEMENT OF WAYNE ANGELL, CHIEF ECONOMIST AND MANAGING DIRECTOR, BEAR STEARNS AND COMPANY AND FORMER MEMBER OF THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

Mr. Angell. Mr. Chairman and Mr. Stark, I would like to address specifically Mr. Stark's question of how the tax cut improves Social Security and Medicare, I am suggesting that the tax cut is essential to maintain the growth of the economy at the 3.9 percent real growth we have experienced over the last three and a half years, and there is nothing we can do better for Social Security and Medicare than have an economy with a real growth rate just shy of four percent.

We have one major imbalance in the U.S. economy that threatens our future. Up to now the Federal Reserve has been able to concentrate its monetary policy on domestic price stability considerations. But the risk that we have is that this high-tech capital spending economy generates fast growth in the demand for capital goods. Non-residential capital that was 8.8 percent of the GDP at the beginning of this expansion last quarter came in at 13.3 percent of GDP in 1999. Gross private domestic investment, valued in current dollars, is 16 percent of GDP and there is where the problem arises.

Savings—national savings rates including the Social Security fund surpluses, have fallen from 15.8 percent of GDP in 1985 to 13.3 percent of GDP today. Over the last several years savings is growing at the same rate as dollar GDP, about 5 percent per annum.

But gross private domestic investment in current dollar terms is growing at about a 9 percent annual rate. This flow of spending on capital goods above our national savings rate makes this country dependent upon the willingness of foreign central banks and foreign investors to hold dollars; at the current time our net obligations to foreigners is about $1.5 trillion. Under the best assumption over the next ten years our net external obligation is likely to grow to $4.3 trillion.

Our current net external debt is 17 percent of GDP. Even with a 5 percent nominal growth in GDP, that 4.3 trillion will rise to 30 percent of GDP.

Now, all of you know that I consider monetary policy to be a very important and underlying factor in our prosperity. I do not want the Federal Reserve to have to be under the cloud of having to have interest rates high enough to offset any imagined weakness in the dollar due to our continued unwillingness to save enough money.

Now, saving is an economic activity. People act in their best interest. We are going to have the after-tax rate of return on savings go higher one way or the other.

So the question is, do we want to imagine a future over the next ten years in which interest rates have to move higher in order to get the rest of the world to supply this under-saving as compared to our capital investments and don't we all understand that the growth rate and level of labor productivity is dependent upon the growth rate of capital. It is capital that increases labor productivity and thus provides the basis for increasing real wages.

So I am suggesting that this country has an unacceptable risk of not making alterations in the tax structure that will increase the savings rate.

Many of you know that I support the National Retail Sales Tax advocated by the Americans for Fair Taxation. I do that because I know it will alter our savings rate, and at the same time, increase our exports versus our imports. I am suggesting to you that I am not an individual that gives to crying the blues very easily. Among economists I have had the most optimistic forecast of economic growth and the most optimistic forecast on the equity market. But I am here to suggest to you that we are at risk if we do not alter the high tax rates that penalize savings, and we can go into the detail as the Committee sees fit.

Thank you.

[The prepared statement of Mr. Angell appears in the Submissions for the Record.]

Senator Mack. I thank you, Mr. Angell.

Dr. Gwartney, let me first raise a question with you. A recent study by the OECD found that most major countries substantially cut their tax rates between the mid-1980s and the late 1990s. For the 25 OECD countries, the average top individual tax rate fell by 12 percent and the average corporate income tax rate fell 10 percent. After cutting taxes in the 1980s the United States reversed course and raised its tax rates again in 1993. What do other countries know that apparently we don't? Should we cut rates again in order to retain our leadership position?

Dr. Gwartney. Well, let me respond to what the other countries know that we don't. I think the answer to that question is that some of the other countries have learned a lesson from the school of hard knocks. The lesson that they are beginning to learn is that high taxes and big government (large government expenditures as a share of GDP) is hard on economic growth. This debate is not about taxes, it is about spending.

On the one hand you have individuals who want more growth, and on the other hand you want individuals who want more spending. And that spending retards growth.

The study of the OECD countries and a short analysis of it is in my prepared remarks for the record, but my work in this area indicates that for every 10 percent increase in government expenditures as a share of GDP that economic growth is retarded by 1 percent.

So, as Dr. Angell referred to here, the key thing is, if you want to improve Social Security, if you want to improve the economic climate for Medicare (and those are things we all want) what you need to do is have more economic growth. And the way that you do that is control spending.

Senator Mack. I want to go back, Wayne, to your comments with respect to savings. I remember the debates through the 1980s and the 1990s that we heard from economists that if we could ever get to a situation where we eliminated Federal budget deficits that it would be a panacea with respect to savings.

Now we find ourselves in a situation where the Federal Government budget is in surplus, and likely will be in the future, and yet we now find out that the savings rate has declined. Why is that?

Mr. Angell. Yes. I call it the fallacy of the twin deficits. There was never such a thing as twin deficits. Each one stood on its own basis. Our new era economy generates huge appetites for capital goods. And there is only one way that we can be free from dependence upon foreign preference, and that is to save the money ourselves.

We, as a nation, we don't talk and advocate high savings. We ought to do that.

I talked to an individual representing a labor union. He says, laborers can't save money; and, yet the people of China with low, low incomes have a savings rate in the 25 to 40 percent range. So they save. People around the world save because they believe that their well-being is connected with saving.

Now, the problem is that as our external debt rises, there will be a shortage of Treasury debt to satisfy Federal Reserve and other central bank needs. We are not going to have enough Treasury debt even if we balanced the general government budget, to have a 1.9 trillion hogging of the non-publicly held debt by the Social Security trust fund, which is half of what we now have. So publicly held debt is now down to 41 percent of GDP, down from 50 percent a few years ago. If we balance the general government and 1.9 trillion surplus in Social Security over ten years we are not going to have enough government debt for the Federal Reserve and central banks to do their monetary function.

So I think we have not only misplaced this notion about a twin deficit, but we have really gone off the deep end in thinking that the optimum debt ratio for our Federal Government some deficits is zero. And I find that really absurd. These are two different issues; our reliance upon foreign savers is dependent upon our altering the tax conditions surrounding savings.

Senator Mack. Congressman Stark.

Representative Stark. Thank you, Mr. Chairman. And I want to thank the panel. I guess just some comments. Mr. Angell, if you would dedicate that Federal sales tax and make it somewhat progressive and dedicate it to health care, I will introduce the bill and sponsor it for you. I think that may very well be what we will have to come to just as a political reality, and to have a distinguished economist like you suggest that it may not destroy the economy, makes me want to go back and look at it again. Because I think perhaps we could get more bipartisan support for raising the funds than would be necessary for universal health care coverage. And I'm intrigued with the idea.

Jim, the only problem with the idea of growing economy is that it hasn't worked. Over the last ten years basically employers have dropped about three or four percentage points in the number of workers they cover with health insurance. Maybe because of the higher costs, but the growing economy has not helped them, and the uninsured has grown from 40 to 45 million. So as this economy has expanded, it has not brought any more health insurance with it. Which leads me to turn to Dr. Greenstein's issue. I believe that it is the cap system, to a large extent, which is responsible for the huge income gap. And my question would be, would a huge tax cut redistribute income—at least from my standpoint—the wrong way? It would be making that very small group of very wealthy people far more wealthy and either hammering down the lowest 20 percent or more, making their incomes flat or reduced and thereby exacerbating this discrepancy. Would you comment on that? You alluded to it a little earlier.

I was talking to Mr. Greenstein.

Mr. Greenstein. First let me say the report is on the widening of the income gap. Most of the widening of the income gap stems from trends in the national and international economy rather than national policy, but the point we did make in the paper was that when that occurs, at a minimum, government policy shouldn't exacerbate the trend.

In the case of tax policy, if you look at the effective tax rate on the richest 1 percent in the country—the people who now have income equal to the bottom 38 percent or lowest-income 100 million in the country—

you find that they have effectively a gotten tax cut averaging about $41,000 a year compared to what they would be paying if effective tax rates on people at the top were the same today as in 1977. Those changes in tax policy took an income gap that was widening primarily because of trends in the private economy and widened it further.

Now, a tax cut could either widen that gap further or narrow it a bit. depending on the contours of the tax cut. This particular tax cut is disproportionately geared towards the top. Even if you talk about percentage of tax paid, the top fifth of the population pays 59 percent of Federal taxes and would get 79 percent of this tax cut. I don't think that's the best measure, but even if you use that measure, this tax cut definitely would widen disparities.

One last point on this thought is, I noted the only way you can afford this tax cut is if you do large cuts in discretionary programs. Discretionary programs tend to provide services and benefits primarily for middle income and lower income families. So if you cut their benefits and services to give a tax cut highly disproportionately to people at the top, I don't think there's much question but that you widen disparities further.

The counter-argument might be, you boost the economy and everybody benefits. I would challenge that. I think if you pour more money—whether through a tax cut or big new spending— into an economy as hot as the current one is, you make it more likely the FED will raise interest rates and that does not benefit anybody.

Representative Stark. Well, that brings me to my next question for the rest of the panel. I guess I would start with Dr. Angell and ask the others, you were a colleague of Chairman Greenspan's and he has said time, and time, and time again that we should be paying down the national debt before enacting any large tax cuts. Don't beat up on me, I know that most of you don't agree with that. What's wrong with his routine, or why do you differ from the Chairman?

Mr. Angell. Mr. Stark, I am not going to find fault in Alan Greenspan's reasoning. Alan Greenspan said, the worst of all of the possible cases is to maintain tax rates and for the Congress to spend it. So Alan Greenspan does not disagree with the position that Dr. Gwartney has laid out here. The worst of all the cases is to maintain our tax rates and have the government spend it because then we will have no savings benefit.

Representative Stark. So what you are really saying is—

Mr. Angell. Alan Greenspan knows—

Representative Stark. —we need to protect ourselves from ourselves?

Mr. Angell. Yes. Alan Greenspan knows, as I know, that if tax rates are lowered, and tax rates on high income individuals being lowered is the most efficient way to increase the savings. You can't increase national savings by lowering the tax rates on individuals that don't have any propensity to save. So he knows that lowering tax rates will provide more national savings.

So, Mr. Stark, I was six and a half years next to Alan Greenspan in the office and what we agree upon is sort of 99.7 percent of the time and I'll allow three-tenths of a percent for disagreement.

Representative Stark. Are tax rates lower now than they were in 1981?

Mr. Angell. Tax rates are lower than they were in 1981 because the folks—

Representative Stark. And personal savings rates have just fallen out of bed. In other words, every year since 1981 personal savings rates have gone down regardless of tax rates or the growth of the economy. I have heard -- maybe it was Modigliani or somebody like that say that tax rates don't have any effect on personal savings. How do you comment on that?

Mr. Angell. But, Mr. Stark, we really know, don't we, all of us know intuitively that if we tax the income from savings we will get this—all of us know intuitively that if we shifted to a consumption tax that's progressive as you and I both want, if you shift to such a tax system, we know that savings will rise dramatically and interest rates will thereby fall. It is in the interest of the working man and woman to have lots of capital that increases labor productivity. We as a nation have to have the savings to keep this marvelous economy going and I am just not willing to risk all that we have achieved—

Representative Stark. I asked—it just hasn't worked. Dr. Gwartney, go ahead.

Dr. Gwartney. Yes, let me speak to the issue about whether or not we need to protect ourselves from ourselves.

Representative Stark No, just the Congress. Not you; you're doing fine.

[Laughter.]

Dr. Gwartney. Well, let me just say this, the next ten years are going to be a valley of temptation from the standpoint of Congress. And the reason why that is true is because of demographics. During next ten years there are going to be very substantial revenues coming in and very substantial growth in income. The reason why is because we are going to have such a large percentage of our population between the ages of 40 and 60, and those are the prime earning years.

The major reason, at least a major contributing factor about why we have gone from having relatively low growth of revenues and budget deficits to having budget surpluses is because of this vast increase of individuals in their prime earning years. In the next ten years those revenues are going to be very high. What is likely to happen is the Congress is going to choose to spend about the same proportion of them that they have in the past and come the year 2009 or 2010 the government expenditures as a share of GDP will be about the same that they are now. If that happens, then as Mr. Greenstein referred to, when the baby boomers move into their retirement phase, the share of population 65 and older will rise from 12 percent of the total population to 18 percent of the total population. This is going to drive the expenditures targeted toward the elderly as a share of GDP up by 6 to 8 percentage points. That means then that total government expenditures, rather than being 33 percent of GDP as they currently are, are going to rise to 40 percent of GDP in the United States. No country has been able to maintain that and sustain 2.5 percent growth or better over an extended period of time. We will be Euro-ized. What I mean by that is, we will have the same size of government as the European countries, and as a result we'll have the same growth rates as the European countries—that is, 1 to 1.5 percent. That's what I want to avoid.

Mr. Greenstein. I want to avoid that too. And one of the ways I want to avoid it is by reducing as much as possible and nearly eliminating the part of government spending, now $230 billion a year, that is interest payments on the national debt. For that reason, and because we don't even know if surpluses outside of Social Security are going to materialize to any degree, this is not the time to do a big new tax cut like this, and, frankly, it wouldn't be the time to do its equivalent in new spending either.

In addition to that, cutting down more debt is the virtue of being the best way to promote—

Representative Stark. It's just that Chairman Mack is leaving and he is not going to leave town and retire with me having the purse here, and he wants to cut the taxes before he goes home so I don't have the money to spend. He is not going to leave anything to chance.

Mr. Greenstein. Could I say one more thing? People can come down on different sides of the debate, and the debate right now will be different a few years from now, but the debate right now isn't tax cuts versus big new spending. It's really tax cuts versus <u>existing</u> spending. And I happen to think it would be a mistake to do overly large cuts in education and certain areas. I think Congress will increase defense spending on a bipartisan basis more than I particularly would recommend. But the point I'm simply making is neither party in Congress is going to vote for the kinds of reductions in existing spending that you would need to make room for the tax cut.

I also think that if we are unable to transfer any money from the non-Social Security surplus to Medicare or Social Security, then the choices in Medicare and Social Security will be so stark that Congress —both parties—will avoid them and let more years go by. If you look at—I don't happen to be in agreement with Chairman Archer's Social Security proposal, it's an interesting proposal, it's worthy of study, I would go a different route, but his proposal—which is a partial privatization proposal—entails taking large amounts of the non-Social Security surplus and transferring them into the retirement system to help with the transition costs to a privatized system. If you use it all up in a tax cut, you don't have money for transition costs for privatization.

So these are the kinds of issues—I agree with Mr. Gwartney that in the long run we have to deal with Social Security and Medicare, I actually think we need some lubrication money now in order to do the plan to get to those reforms and we are not going to do the kinds of cuts in discretionary that the budget resolution assumes.

Senator Mack. I think Jim Miller wanted to respond to your question.

Dr. Miller. I want—

Senator Mack. But before you do that, let me just say, I am more concerned than you are, Mr. Greenstein. I would hope the debate was just a question about present spending programs versus tax cuts, but the President has already proposed, I think, something like $1.3—1.4 trillion in new spending programs. Every day we hear him speak around the country he is telling one group after the other what additional Federal spending he is going to provide for them. So I think it's much more serious than just the debate between those two points.

Jim.

Dr. Miller. Yes. I wanted to respond to Congressman Stark. We ought to keep things in perspective about the tax fairness issue and redistributional issues. A Steve Moore piece in the August 6th Washington Times points out that the top 1 percent of income earners earn 17 percent of national income but they pay 32 percent of income taxes. The top 5 percent earn 31 percent but pay 51 percent of the taxes. So it is a very progressive income tax rate that we have.

Your own Joint Committee on Taxation did this table on distributional effects of the conference agreement which indicates there is actually very little change in tax rates. It is true that the tax rate reductions affect the upper levels, but they are not very significant.

On Mr. Greenstein's presentation, it seems to me his major argument is that there are all these dramatic cuts in discretionary spending that would have to take place in order for the money to be there to have a tax cut.

Now, let me ask a question. Do you think Congress will be more inclined to make those cuts if you plan a tax cut or if you don't? My argument is that Congress would be far less likely to restrain spending if it had the money coming in no plans to put a tax cut into effect.

Secondly, let's bear in mind that we're talking about current services spending. Most people beyond the beltway understand a cut in spending to mean that you spend less in nominal terms next year than you spent this year. That's not what Mr. Greenstein is talking about. He's talking about current service budgeting.

Finally, I haven't read Mr. Greenstein's analysis, but if I heard you correctly I would bet you, Bob, that if you freeze spending for 2000 and 2001 and then meet the budget caps and contrast that with adjusting for inflation after 2000 you won't get anything like $5 billion, you'll only get about 40 percent of that, 50 percent of that.

Mr. Greenstein. May I respond?

Senator Mack. Yes, after I make a comment.

Mr. Greenstein. Thank you.

Senator Mack. Because that's exactly one of the points that I was going to make. It appears that the $969 billion on-budget surplus number assumes discretionary spending increases for inflationary year after 2002. It appears that there is double counting going on and there's about $420 billion in that green pie slice. So I just don't accept your numbers.

Mr. Greenstein. My numbers are not mine, they are the Congressional Budget Office's. I would be happy to provide you their official tables. There is not a dime of double counting in there. Again the $595 billion is CBO's number. CBO says that its forecast of the trillion dollar surplus rests on an assumption that entails $595 billion less in discretionary spending than the 1999 level adjusted for inflation. No double counting, not my numbers, these are Dan Crippen's numbers.

Now, let me continue.

Dr. Miller. Can you give us a cite?

Mr. Greenstein. I would be happy to give you five cites. I don't happen to have them with me. Or, Jim, if you call Dan on the phone, he will tell you these are right.

There was some testimony, I'll give you a cite, there is testimony that Dan Crippen submitted for the record in July to the Senate Budget Committee, if you look at the tables in the back and you simply subtract the baseline number that is the $996 billion surplus from what happens if discretionary stays even with inflation the $595 billion is there.

In that testimony, in the text, Dan Crippen also said that if discretionary spending simply grew at the nominal rate of 3 percent per year a little bit, but not much faster than the inflation rate, that the entire non-Social Security surplus for the next ten years would disappear. These are Dan Crippen's statements.

Dr. Miller. Well, you could make it 5 percent and have a big deficit. I mean—

Mr. Greenstein. The point that I am making is that Congress isn't going to do that. Just add up the numbers in the appropriations bills that your party is passing. Again, I'm not trying to make a partisan statement—I am just trying to make a factual statement about what is in these bills. There is extra for defense, there is extra for veterans' health care, above last year plus inflation. There is extra for NIH research, additional funding was agreed to last year in the highway bill. When you add these up plus what is very likely to happen in the Labor-HHS bill, this Congress is on track to be spending more than I'm assuming. When Bob Reischauer, who I think is one of the straightest shooters on numbers in town, looked at my analysis, he called me up and he said, "Greenstein, the problem with your analysis is you assume discretionary will only keep even with inflation and there's too much pent up demand and it's going to go up faster than that."

Senator Mack. Jim.

Dr. Miller. Could I make the point, and Bob surely will agree with this, that even though Congress—and I'm not trying to defend Congress's appropriating more than the caps—busts the caps, under current law there would be a sequester.

Mr. Greenstein. Not true.

Dr. Miller. So the spending level will not exceed the caps.

Mr. Greenstein. Not true, because what I—

Senator Mack. Okay. We've carried this discussion, as far as I'm concerned, far enough. I've got a couple of other points I want to make.

The first thing is this issue of whether the tax cuts should go to people who make lots of money. It's a very simple thing. The reason tax cuts have this result is because taxpayers with high incomes make most of the tax payments. There has been a general acceptance of the idea, and I'm not sure I embrace it, of the progressive Tax Code—that is, if you make more money, you pay the government a greater percentage of your income in taxes. I don't embrace the idea, and clearly reject the notion of a so-called progressive tax cut. That is, that you have to give up more of the tax cut because you make more money. It's just fundamentally unfair and fundamentally wrong.

Are there other points you wanted to pursue? If not, I have a couple of others.

Representative Stark No, I don't, go ahead.

Senator Mack. This goes back now to the economic aspect of this issue. The Keynesian economists have lectured for decades that large budget surpluses could act as a fiscal drag on the economy. Now that the CBO is projecting a unified budget surplus in the neighborhood of three trillion dollars over the next ten years, why aren't the Keynesians warning us of a risk to the economy? Does anybody want to approach that?

Mr. Angell. Because they're—

Senator Mack. Maybe I've misstated it.

Mr. Angell. —because their model is wrong, wrong, wrong, and it doesn't work.

[Laughter.]

Mr. Greenstein. I think there is a disagreement among Keynesians and there are some who have raised concerns about that. A former staff director of this Committee, Jim Galbraith, Professor of Economics, University of Texas, I think has raised some concerns in articles he's written about overly-contractionary fiscal policy. It's not the point of view I have.

I think the point of view a number of people have, and I don't know what we all term ourselves these days, partial Kenseyians, pure Kenseyians, whatever, is that it will be very important to stimulate the economy when the economy is weak. I don't think given how strong the economy is now with a 4.2 percent unemployment rate the FED is concerned enough that it has raised interest rates twice in the last, what, ten weeks or so. I think the view is clearly the kind of surpluses we have now are not a drag on the economy. Our big problem now is not that the economy is sluggish, but a point of view I share with most on the panel, that the savings rate is too low. And one of the things that helps increase the savings rate is national saving through budget surpluses.

So I think a number of people, who years ago in periods when the economy was sluggish and wasn't growing that fast, unemployment which seemed stuck, remember, we had seven straight years from 1980 through 1986 where the average unemployment was rate was about, what, 7 percent a year for seven straight years. We are in a different era now. Given the marvelous performance of the economy, that was clear instances of the—

Senator Mack. I want to pick up on that point and then I'll turn to you, Wayne.

Clearly we're in a different economy. Nobody knows exactly how this is all going to play out over a period of time, but we're hearing that kind of a statement from everyone who has been pursuing economics either as a profession or as an interest. People have recognized that there is something that's changed in our economy. I'm going to get back to Dr. Gwartney for a minute after Wayne, but I think that's the point he's making with respect to what we're seeing as far as Federal Government revenue growth. The CBO and the OMB have been underestimating revenues to the Federal Government for quite some time now.

Wayne.

Mr. Angell. Yes. There have been statements made that suggest that taking the national debt to zero eliminated interest payments and I believe that is incorrect reasoning. Our economy is a credit-based economy. We do not want to contract credit by thereby having private debt not grow as government debt shrinks. So our nation will see if credit is to expand, which is essential for economic growth, our nation will see a big shift to private borrowing. And so private borrowing will take place at much higher interest rates. Foreigners who are lending us their money buying Treasury Bills today at 5 percent are going to end up lending their money buying corporates at 7 percent. So we cannot operate under the assumption that somehow or other interest payers have a reduced burden.

The fact of the matter is that the interest burden will rise, not fall.

Senator Mack. Dr. Gwartney.

Dr. Gwartney. Well, as I was just sort of reflecting on our discussion here, including the exchange between Congressman Stark and Senator Mack. It seems to me the difference is whether or not there are going to be surpluses off out into the future and whether or not it would be more likely or less likely to have surpluses if in fact we cut taxes. But let me remind you that the President has essentially proposed over a trillion dollars additional increases in expenditures. The Republicans have proposed a $792 billion reduction in taxes and that essentially works out as about a wash.

One of the things I've learned rapidly in the couple of months that I've been here is that 10, 15, 20 billion dollars doesn't mean much up here, it's an adjustment for me to think like that. But what my position is, is that these revenue figures are grossly understated and that we are going to see very large budget surpluses in the future, both in the Social Security system as well as in the on-budget side of the budget. And I would like to propose a compromise position here, if we want to pay down the debt, whether or not these funds belong to the taxpayers and should be returned, why doesn't Congress pass legislation that essentially says that all of the on-budget surpluses that occur will be rebated back to the taxpayer in proportion to the amount of funds that they paid in taxes. If we overcharged them, let's rebate these funds back to them. If the surpluses do not occur, there will be no reduction in taxes; but if they do occur, and if they occur at a very sizeable level, these funds will go back to the American taxpayer where they belong.

And on the Social Security side, my own view is, I think much the same thing should take place. Rather than allow that $1.9 trillion to accumulate, I think, again, we could come up with a rather creative plan, allocate that $1.9 trillion into, or at least largely into private savings, personal savings accounts with which individuals would be saving for their own retirement. Rather than have the government manage those funds, we would again have individuals managing the funds and have a more secure future than otherwise should be the case.

So wouldn't that be a compromise position? If in fact these surpluses materialize as I'm saying that they will materialize, let's rebate the funds back to the taxpayer who paid in the first place.

Senator Mack. On that compromised spirit, the hearing is adjourned.

[Laughter.]

[Whereupon, at 11:20 a.m., the hearing was adjourned.]

Submissions for the Record

Prepared Statement of Senator Connie Mack, Chairman

There has been a lot of loose talk in the past few months concerning this Congress's tax relief package, with adjectives like "reckless" and "risky" being tossed about by opponents of tax relief. I am confident that the distinguished panel we have assembled can substitute some light for the heat that has been generated in this debate.

One thing that has gone unnoticed in the budget debate is that both ends of Pennsylvania Avenue agree on the size of the surpluses over the next decade. The nonpartisan Congressional Budget Office, and the President's Office of Management and Budget, this summer released surplus calculations that are only $20 billion apart. When the budget baselines are adjusted to freeze discretionary spending at the 2002 caps, these surpluses total roughly $3.4 trillion over the next ten years.

So, all parties agree that the .Federal Government will be overcharging the taxpayers by $3.4 trillion. The only real debate concerns what the government should do with these overpayments. This summer, the Congress passed a tax bill that would provide $792 billion in tax relief for the American people. This is less than 25% of the tax overpayments, a relatively modest portion. But despite the modest size of this tax cut, the President and his supporters have criticized the tax relief as "too big," and have argued that the government cannot part with that much money.

But if you stop to think about it, every single argument being made against the tax cut is just plain wrong.

Some argue, from a Keynesian demand-side perspective, that tax cuts will overstimulate the economy. But even after a $792 billion tax cut, the Federal Government will run up over $2 trillion in surpluses over the next ten years — from a Keynesian viewpoint, $2 trillion in surpluses is not considered a stimulus, it is considered a drag on the economy. And with all of the lags, the delays, and the phase-ins, the bulk of the tax cuts will not arrive until years 2007, 2008, and 2009.

Can anyone seriously think that, in a $9 trillion economy, a $5.3 billion net tax cut for fiscal year 2000 will overstimulate consumer demand? This is just six hundredths of one percent of GDP. The net tax cut for fiscal 2001 is barely noticeable — just $1.1 billion. How can that possibly overheat the economy? Clearly, the facts do not support the argument that our tax relief will overheat the economy. In any event, from the demand-side perspective, the tax cut should be irrelevant. If we do not cut taxes by $792 billion, it is safe to say that spending will increase by $792 billion over the next decade — spending by the government, that is. That is what President Clinton means when he says we cannot afford a tax cut — his bureaucrats are working overtime to dream up new ways to spend the money. Indeed, including his Medicare proposal, the President has proposed an increase in spending of $1.3 trillion over the next decade — all but $54 billion of the on-budget surpluses, according to the CBO.

Furthermore, a tax cut that removes government barriers to savings and investment is not an "artificial stimulus" that the Federal Reserve Board would seek to offset with tighter money. Inflation, after all, is caused by too many dollars chasing too few goods, not by too many investors creating wealth and opportunity. An even stronger economy, fueled by the freedom and enthusiasm of our entrepreneurs, is not something to fear.

The argument is also raised that a $792 billion tax cut leaves no money to meet some other important government goals. But we still have about $2 trillion in social security surpluses that will be in a "lock-box" to retire debt and shore up our citizens' retirement security, and another $505 billion in non-social security surpluses that can be used for Medicare, national defense, and our other priorities. There appear to be no good economic arguments against the tax relief package. The opposition to tax relief is based not on economics, but on philosophy. This all boils down to one basic, fundamental question: who has the first claim on the income of Americans — does it belong to the government or to the individual families who create the income through the sweat of their brows and the genius of their intellect?

The current Administration acts like the money belongs to the government. It rejects our tax relief bill as "too big," as is taxpayers earn income at the sufferance of the government. Under this view, Uncle Sam does not live under a budget, he sets the budget for every American family, which must be content with the table scraps after the enormous appetite for spending in D.C. has been satiated.

This President and his supporters just don't get it. The tax burden on our citizens is at an all-time, peacetime high — 20.6% of the economy. At the same time, we will be overcharging the taxpayers by more than $3 trillion. A nation that trusted its people, that protected their liberty, would not flinch from the right thing to do: cut taxes so that our families can enjoy the fruits of their labor, instead of the greedy Federal Government.

We cannot forget that tax cuts are not about numbers, they are about people. The true measure of the merit of tax relief is the gain in freedom and the enhancement of opportunity for our people. There can be no denying that the American people would be helped tremendously by the tax relief that we have passed.

Consider some of the ways in which our tax relief bill would make a difference in the lives of Americans. We make health and long-term insurance fully deductible, and allow a dependent deduction for elderly family members. Education is more affordable through enhanced savings vehicles — savings accounts and pre-paid tuition plans. Tax rates are lowered across-the-board. We eliminate the marriage penalty for taxpayers in the lowest bracket and repeal the Alternative Minimum Tax for individuals. According to analysis by the Heritage Foundation, once the tax relief is fully phased-in, a blue-collar family of four earning in the low $50,000s would save $381 on their tax bill, and a typical unmarried teacher earning under $40,000 would see her tax bill shrink by $782. These are not trivial amounts. We cut taxes because of the 67-year old owner of a family business in Florida's panhandle, who is discouraged from reinvesting his hard-earned profits because the specter of the death tax is hovering, waiting to swoop down and scoop up 55% of the increased value of his business. We cut taxes because of the two-earner family, struggling to make ends meet, that has to pay over $1000 extra in taxes just because they are married.

We cut taxes so that waitresses, truck drivers, teachers and carpenters can put an extra $1000 in their IRAs each year, to build a better nest egg for retirement. We cut taxes to enable a biomedical company to budget that one additional research project that just might lead to a breakthrough in the treatment of glaucoma or a cure for cancer. And we cut taxes to reduce government barriers to saving and investment, so the capital is available for the American entrepreneurs of the 21st Century to develop markets in technologies we cannot even imagine today.

High taxes are an infringement on the liberty of our families, who should not be struggling to make ends meet while their Federal servants hoard the wealth our families have created. When the question comes down to whether we trust the Federal Government or the family to use money wisely, I choose the family every time.

Prepared Statement of Representative Pete Stark, Ranking Minority Member

I would like to thank the Chairman for calling this hearing this morning and I would like to welcome all of the witnesses to the Committee.

The US economy is at an important crossroad.

For the past seven years, we have watched as the Federal Government moved from deficits "for as far as the eye can see" into surplus. We may disagree on which administration was responsible for the build-up in the deficit and the elimination of the deficit. But o one thing we should agree — it was hard-working Americans and their families who made the sacrifices which were necessary to bring the budget into surplus.

At the same time the budget moved into surplus, the US economy was experiencing its longest peace-time expansion. The economy's performance under the Clinton Administration is so remarkable it deserves being repeated.

- The unemployment rate fell from 7.5 percent in 1992 to an historic low of 4.2 percent last month. In fact, the unemployment rate has been below 5 percent for more than 2 years.
- Despite all the doomsday warnings, the drop in the unemployment rate has not been accompanied by any significant increase in inflation. On the contrary, inflation as measured by changes in the Consumer Price Index, has been growing at an annual rate of a little more than 2 percent this year. Inflation has averaged 2.4 percent since President Clinton took office in 1992.
- Most importantly, after 20 years of declines and stagnation, American workers are once again enjoying improvements in their standards of living. In 1979, real average wages for private nonagricultural workers were approximately $290.00 per week. By 1992-93, average weekly earnings fell to their lowest level — approximately $255.00. A 12 percent drop over 14 years. Only recently have real average weekly earnings begun to recover, increasing by 6 percent over the last 6 years to $270.00. Good economic performance has helped raise living standards for many, but average workers' wages are still not back to where they were 20 years ago. Real average weekly wages are still $20.00 below their 1979 level.

Overall, the economy is performing very well for many Americans, but we are not out of the woods yet when it comes to the average working family.

With this sound economy as a backdrop, we need to begin addressing some of the hard economic choices before us. Projected surpluses make this job a little easier.

I believe three principles should guide us as we confront these choices.

First and foremost, we must secure our long-term obligations to the most vulnerable people in our society — the elderly, the sick and the poor. Our first priority must be to make Social Security and Medicare financially sound and prepared to meet the needs of their beneficiaries.

Second, we need to focus on ways to share more of the benefits of the current economic expansion with more people. For example, as I have already mentioned above, average working people have benefitted somewhat from the current expansion. Yet, at $5.15, the minimum wage remains 22 percent below its inflation-adjusted level in 1979. In other words, minimum wage workers will earn $3,000 less this year than they would have earned 20 years ago. I don't think any of the tax cut proposals being discussed would give enough relief to the low income workers to offset this kind of real earnings loss. If you really want to help US workers, let's raise the minimum wage.

Third, what policies are most likely to insure the long-term health of the economy? And here, the policy choices are clear. Is now the time for a large tax cut, or should we begin paying down the large debt which the government has been accumulating over the last several decades? I applaud my colleagues on te other side of the aisle for their willingness to take this question to the American people. Over the last month the American people have had a chance to consider both options, and they have spoken loud and clear. The American people believe we should postpone any major tax cuts now, in order to follow the more fiscally prudent step of paying down the national debt. This view is supported by no other than Federal Reserve Chairman Greenspan and by dozens of reputable economists, including several Nobel Laureates, who have signed a letter which I would like to have entered into the record.

So I would ask the 4 distinguished witnesses before us today to address these 3 questions in their remarks:

1. How does the current tax proposal improve the long-term security of Social Security and Medicare?
2. Does the current tax proposal extend the benefits of the robust economy to more people? And

3. How does the current tax proposal improve the long-term health of the US economy?

I look forward to your comments and the ensuing discussion. Thank you.

FORTNEY PETE STARK (CA)
RANKING MEMBER

JEFF BINGAMAN (NM)
PAUL S. SARBANES (MD)
EDWARD M. KENNEDY (MA)
CHARLES S. ROBB (VA)
CAROLYN B. MALONEY (NY)
MELVIN L. WATT (NC)
DAVID MINGE (MN)

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HOWARD ROSEN
STAFF DIRECTOR

August 2, 1999

Dear Colleague:

As we debate an $800 billion tax cut, I would like to bring this very important letter (printed on the opposite side) to your attention. Fifty leading economists, including six Nobel laureates have joined together to denounce any large tax cuts at the current time.

This distinguished group claims that a massive tax cut would not be good economic policy. They argue that a large tax cut would **"drain government resources just when the aging population starts to put substantial stress on Social Security and Medicare."** Their letter goes on to suggest that a large tax cut at this time would stimulate more consumption, thereby causing the economy to overheat.

In sum, these economists agree that a large tax cut is the wrong policy at the wrong time.

On the other hand, this group of noted economists state that the Administration's proposal sets the correct road to take. Under the President's plan, we would begin paying down the national debt, enabling interest rates to fall, and freeing up more capital for productive investment. This in turn will allow us to extend the recent increases in wages and incomes that we have been experiencing.

Sincerely,

Pete Stark
Ranking Member

Letter from Fifty Economists

The federal budget is projected to show substantial surpluses over the next 15 years. These surpluses offer an exceptional opportunity to pay down government debt and thereby strengthen Social Security and Medicare in order to prepare for the retirement of the baby boomers.

President Clinton's budget proposal makes the correct decision, to save most of these surpluses. The Administration estimates that its plan would entirely pay off the publicly held debt by saving over $4 trillion in projected surpluses by 2015. This dramatic contribution to national saving would reduce interest rates, boost business investment in plant and equipment, lead to a more productive workforces, and raise the standard of living.

In contrast, a massive tax cut that encourages consumption would not be good economic policy. With the unemployment rate at its lowest point in a generation, now is the wrong time to stimulate the economy through tax cuts. Moreover, an ever growing tax cut would drain government resources just when the aging of the population starts to put substantial stress on Social Security and Medicare. Further, the projections assume substantial undesirable reductions in real spending for non-entitlement programs, including important public investments. Given the uncertainty of long-term budget projections, committing to a large tax cut would create significant risks to the budget and the economy.

Nobel Laureates:

Kenneth Arrow, Stanford University
Lawrence R. Klein, U of P
Franco Modigliani, MIT
Paul A. Samuelson, MIT
Robert M. Solow, MIT
James Tobin, Yale University

Other Economists:

Henry J. Aaron, Brookings Institution
George A. Akerlof, Brookings and UC - Berkeley
Alan Auerbach, University of California, Berkeley
Robert Barsky, University of Michigan
Susanto Basu, University of Michigan
Olivier Blanchard, MIT
Rebecca Blank, University of Michigan
John Bound, University of Michigan
Christopher Carroll, University of Michigan
Karl E. Case, Wellesley College
J. Bradford De Long, UC - Berkeley
William F. Dickens, Brookings Institution
Christopher L. Foote, Harvard University
Pierre-Olivier Gourinchas, Princeton University
Donald D. Hester, University of Wisconsin, Madison
E. Philip Howrey, University of Michigan
Shane Hunt, Boston University
Erik Hurst, University of Chicago
Saul Hymans, University of Michigan
Paul L. Joskow, MIT
Phillip B. Levine, Wellesley College
Robert E. Litan, Brookings Institution
Anna Lusardi, Dartmouth and University of Chicago
Louis Maccini, Johns Hopkins University
Alicia H. Munnell, Boston College
Maurice Obstfeld, University of California, Berkeley
Janet Rothenberg Pack, U of P and Brookings
Howard Pack, University of Pennsylvania
Uwe Reinhardt, Princeton University
Susan Rose-Ackerman, Yale University
Robert W. Rosenthal, Boston University
Shinichi Sakata, University of Michigan
Charles L. Schultze, The Brookings Institution
Matthew D. Shapiro, University of Michigan
Robert J. Shiller, Yale University
Robert Shimer, Princeton University
Jonathan Skinner, Dartmouth College
Peter Temin, Massachusetts Institute of Technology
Laura Tyson, University of California, Berkeley
David N. Weil, Brown University
David Weiman, Social Science Research Council
Kenneth D. West, University of Wisconsin, Madison
Barbara L. Wolfe, University of Wisconsin, Madison
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Prepared Statement of James C. Miller III before the Joint Economic Committee of the United States Congress September 13, 1999

Since serving as Director of the Office of Management and Budget during most of President Reagan's second term, I have been associated with Citizens for a Sound Economy (CSE), a research, education, and advocacy organization with a quarter-million members and supporters.[1] On their behalf as well as mine, I welcome this opportunity to discuss the desirability of tax cuts in an era of budget surpluses.

Let's start by clarifying certain matters that are often overlooked in discussions of fiscal policy.

First, whether at any time we have a budget surplus or a budget deficit is subject to debate because the federal accounts make only limited provision for changes in liabilities and assets. Yearly swings can amount to tens, if not hundreds, of billions of dollars.

Second, it is usual today for the effects of any major tax or expenditure program to be aggregated over 10 years. For example, Congress has passed a $792 billion tax cut; the President says he is willing to accept only a $300 billion tax cut. This was not always the case. When I was budget director, the time frame was five years. Why not make the time frame 20 years, or 50 years? This would run up the numbers and confuse people even more. Also, these aggregates are not discounted; they fail to distinguish between a tax cut that is $10 billion each of the first nine years and then

[1]Neither CSE nor CSE Foundation receive any money from the Federal government — nor, to the best of my knowledge, have I during the relvant time period.

$100 billion in the tenth year, and a tax cut that is $100 billion the first year and $10 billion annually in years two through 10.

Third, forecasts are just that. Actual fiscal aggregates may be more or less. However, there is far more reason to place confidence in forecasts of next year's performance or maybe the next two year's performance than in any of the "out years." I certainly wouldn't bet the farm on the forecasts for years six through 10.

Fourth, the deficit or surplus is the difference between two very large numbers, revenues and outlays. If the forecasters are off just a little bit in either or both — especially in ways that don't offset — there can be substantial differences between the deficit/surplus forecasts and actual performance.

Fifth, although some progress has been made, the major federal revenue forecasting agencies — Office of Tax Analysis (OTA) and Joint Committee on Taxation (JCT) — still utilize what may be characterized as basically "static," as opposed to "dynamic," forecasting methodologies. Accordingly, they overestimate the size of any revenue "hit" from a tax rate decrease, and they also overestimate the size of any revenue "bump" from a tax rate increase. Thus, everything else equal, the surplus is likely to be larger with the tax cut than forecast by OTA and JCT.

I make these points to emphasize that we don't know with great precision what the deficit or surplus will be — with or without a tax cut. What we can be more confident about is the following.

First, as I explained in my testimony before this committee last March, government is so large that it constitutes a significant drag on the rate of economic growth. In particular, taxes -- some more than others -- restrict economic activity. By lowering taxes, you encourage (allow) the economy to be more robust.

Second, it reasonably clear that to the extent a tax cut reduces the government's revenue — and for most aggregate tax cuts this is the case in the short run — it also constrains spending. For evidence on this proposition, look within your own hearts. Are you more or less likely to vote for a spending increase if you know there's a deficit looming or a smaller surplus, than if the reverse were true? Q.E.D.

That's why James Carter, of the Senate staff, and I recently wrote a piece in USAToday (see attached) indicating that surpluses can be as problematic as deficits. With deficits, because of "fiscal illusion," people underestimate the cost of government and therefore demand too much of it. With surpluses, elected officials are more eager to increase spending. Either way, government expands beyond the size which is optimal!

So, if you want to see the economy continue to expand, and expand at an even faster rate,[2] you will opt for a tax cut, the larger the better. In particular, I urge you to stand firm and insist on the tax package that recently passed both Houses and reject the tax program outlined by the President. I make this recommendation not only because your tax cut is larger, but because yours is of a better type. Let me explain.

One view of taxes is that they are necessary to raise the money the government requires to operate. A conflicting view is that taxes should not only raise money, but should be an instrument of social policy: "bads" should be discouraged with higher taxes, and "goods" should be encouraged through tax breaks. This view may work in theory, but experience shows it doesn't work very well in practice. The data show that "tax expenditures" have ballooned way out of control. The tax code is riddled with special-interest breaks and punitive features. Such a tax code slows economic growth and is felt, by the public, to be unfair overall.

Although your tax cut contains an assortment of provisions that benefit special interests, by and large it is a straightforward, "clean" cut in tax rates. In particular, it would cut income tax rates across the board, including the "death tax," and it would remedy the anomaly of taxing two people more if they are married than if they are simply living together. On the other hand, as the President and the Vice President have repeatedly indicated, their preference is for "targeted" tax cuts — in other words, tax cuts designed to achieve certain policy goals.

Finally, it should be stressed that while both tax plans envision "saving" social security by "banking" the social security surplus, the President's budget proposal explicitly envisions a far greater increase in outlays than does your budget, of which the tax cut is a part. Obviously, the President's plan, if adopted, would lead to further increases in the size of government, while your plan poses a lower risk. For these reasons, your tax plan should be enacted, and the President's plan should not.

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[2]The argument that increasing aggregate demand through tax cuts will lead to inflation has little empirical support and contracts common sense in view of how the effects on demand of changes in monetary policy altogether swamp the fiscal effects at issue.

Citizens for a Sound Economy Foundation
CSE Commentary
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Op-Ed by James C. Miller III ** Wednesday, July 14, 1999 ** *USA Today*

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Uncle Sam's got extra money, and that may be bad news

By James Carter and James Miller

Just when you thought everything about the federal budget was hunky-dory, given its huge expected surpluses, along come some economic party poopers like us to remind you that, in the words of President John F. Kennedy, "deficits are sometimes dangerous — and so are surpluses."

Sadly, even a surfeit of money can be bad news. Economics truly is the dismal science, isn't it?

To understand why budget surpluses are risky, ask:

▶ Why has the budget suddenly shifted into surplus?

Four years ago, the Congressional Budget Office projected a deficit of $1.6 trillion for 1999 through 2003. Now, it says there will be a $1 trillion surplus. Although Congress and the White House both claim credit for this neck-snapping turnaround, less than 9% of the change is due to legislation. Instead, it stems from revised economic assumptions.

Even a tiny change in these assumptions can produce a big budget swing: If CBO is just 10% too optimistic in its revenue growth forecast, it will overstate the surplus by more than $100 billion.

In short, we may indeed get a big surplus. Just don't count on it.

▶ Do we have a budget surplus because the government is spending less or because it is taking more of our money?

The budget is in surplus primarily because the tax burden has ballooned and spending on national defense has been curtailed. Neither is a cause for joy.

Taxes from your pockets

The government has prospered even more than the economy. Last year, taxes were the greatest fraction of gross domestic product since 1944. Why? Partly because taxes were increased during the early 1990s, but mainly because the growing economy pushes people into higher tax brackets.

Recent federal spending has fallen as a portion of total GDP, but most of this cut has come out of the hide of the military, which is already short of critical materials and fielding low-paid soldiers. Adjusted for inflation, federal spending on things other than national security was 11.5% higher last year than in 1993 — and this is a time of overall plenty, when one would expect reduced social safety net costs.

Spending cuts? Ha!

▶ What do our elected officials intend to do with the surplus?

We'll answer that with another question: Does it surprise anyone that few on Capitol Hill are seriously advocating that Congress resume its efforts to pare spending?

Without a deficit to combat, Congress has splintered among those who want to cut taxes, those who want to repay the federal debt and those who want to spend the surplus on new and expanded government programs.

Debt reduction is a noble objective, but if the surplus money is in Washington, trust us: Congress and the White House will spend it. Instead, Congress should use across-the-board tax cuts to return the money. Only cockeyed logic supports the notion that the government should collect more from citizens than it needs to operate. The worst thing we could do is fuel government growth.

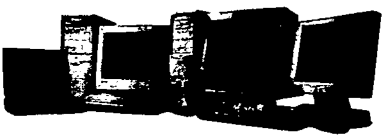
The nub of the problem is this: When we had a deficit, it restrained Congress' natural inclination to spend. But the emerging budget surplus threatens to fuel a further expansion of the size and scope of government.

This point was not lost on our Founding Fathers. Believing that surpluses would spur the federal government to grow beyond its limited constitutional powers, America's early political leaders lashed out against the corrupting nature of budget surpluses.

"To secure the republic," writes budget historian James Savage, "both federal deficits and surpluses were to be avoided, for only a truly balanced budget could prevent corruption."

James Carter is an economist with the U.S. Senate. James Miller, a budget director under President Reagan, is the Olin Fellow at Citizens for a Sound Economy Foundation.

It's our annual "spend-your-budget-before-it's-gone" sale.



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Statement of James Gwartney
Chief Economist, Joint Economic Committee, U.S. Congress
JEC Hearing on Tax Cuts and the Budget Surplus
September 13, 1999

Congress has passed a $792 billion reduction in taxes spread over the next ten years. The bill would reduce marginal tax rates by 1 percentage point, cut the capital gains tax rates from 20% and 10% to 18% and 8%, widen both the standard deduction and tax brackets in order to reduce the marriage penalty, and provide additional incentives for savings, investment, and research. The President has called the legislation "reckless and risky," and promises to veto it. I would like to make four points with regard to this debate.

Point 1: There is a negative relationship between size of government and economic growth.

The debate over the tax bill is primarily about spending rather than taxes. The President wants to use the projected on-budget surpluses to increase spending. Congress wants them returned to taxpayers. Given the nature of the debate, it is important to consider the relationship between size of government and economic growth. Small differences in growth when sustained over a lengthy time period can make a big difference in living standards.

Governments play a key role in establishing an economic environment conducive for individuals to use their skills and knowledge productively and where markets can operate smoothly. The key elements of that environment are: (a) a sound legal structure that enforces contracts and provides for secure property rights, (b) competitive markets, (c) price stability, (d) freedom of international trade, and (e) small government expenditures. The recent policies of the U.S.—particularly those in the areas of monetary and trade policy—have been fairly consistent with long-term growth.

Given the size of government in high-income industrial countries, the level of government spending is inversely related to economic growth. Countries with large government spending as a share of the economy and more rapid growth of government experience lower levels of economic growth. Figures 1 and 2 illustrate this point.[1]

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[1] See James Gwartney, Robert Lawson, and Randall Holcombe, *The Size and Functions of Government and Economic Growth*, (Washington: Joint Economic Committee of the U.S. Congress, 1998); Edgar Peden, "Productivity in the United States and Its Relationship to Government Activity: An Analysis of 57 Years, 1929-1986." *Public Choice* 69 (1991): 153-173; and Gerald Scully, *What Is the Optimal Size of Government in the United States?* Dallas, TX: National Center for Policy Analysis, 1994. While the methodology employed by each of these

Exhibit 1 looks at the relationship between the size of government and the growth of OECD countries during each of the last four decades. Size of government at the beginning of a decade is measured on the x-axis and growth of real GDP *during that decade* is measured on the y-axis. The graph contains four dots for each of the 21 OECD members on which data were available. Thus, the total number of dots is 84. Each dot represents a country's total government spending *at the beginning of the decade* and its accompanying growth of real GDP *during that decade*. As the plot illustrates, there is a clearly observable negative relationship—larger government expenditures are associated with slower growth. The accompanying regression equation also includes dummy variables for the data points in the 1960s and 1970s in order to adjust for the fact that the overall growth rate during these decades was significantly different than during other decades. The size of government variable is highly significant (at the 99 percent level) and it indicates that a 10 percentage point increase in size of government as a share of GDP reduces the long-term annual growth rate of real GDP by seven-tenths of a percent. The R^2 indicates that size of government and the decade dummy variables "explain" 62 percent of the variation in growth across these high-income nations.

During the last four decades, the size of government has expanded in every OECD country. At the same time, the growth rates of these countries—with the exception of Ireland—have fallen. However, there has been considerable variation in the magnitude of government expansion. If big government retards long-term growth, as Figure 1 implies, then there should be a relationship between *increases* in the size of government and *reductions* in economic growth. The countries with the largest *increases* in government should experience the sharpest reductions in growth.

Since 1960, the size of government as a share of GDP has increased 20 percentage points or more in six OECD countries—Denmark, Finland, Greece, Portugal, Spain, and Sweden. On the other hand, the growth of government has been 10 percent or less in four OECD countries—Iceland, Ireland, United Kingdom, and United States. Figure 2 presents data on the growth rates of these two groups, along with the average for OECD countries (bottom line of the table). Among the "rapid expansion in government" group, the growth rate of real GDP fell from 6.4 percent in 1960-1965 to 1.9 percent in the 1990s, a reduction of 4.5 percentage points. In contrast, the average growth rate of the countries with less expansion in the size of government fell from 4.1 percent during 1960-1965 to 3.5 percent in the 1990s, a drop of only 0.6 percent. In every case, the reduction in growth of those countries in the "rapid expansion in government" group was greater than for any of those in the "slower expansion in government" group.

It is interesting to note that in 1960, government expenditures as a share of GDP for every country in the top part of Figure 2 exceeded the OECD average (bottom line of table) of 27.3 percent. At the same time, their average GDP growth rate of 4.1 percent was below the OECD average of 5.6 percent during the 1960s. The situation was exactly the opposite *for this same set of*

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studies was different, each found that the growth maximizing size of government was considerably smaller than the level present in OECD countries.

countries in the 1990s. After their ratios of government expenditures to GDP dropped below the OECD average, their GDP growth rate rose above the average.

Just the reverse happened to the nations in the bottom part of Figure 2. In 1960 their government expenditures as a share of GDP were below the OECD average, and their GDP growth rates were higher than the OECD average. By 1998 their mean size of government had risen above the OECD average and their growth rates had fallen below it. Because these figures are for the same countries (and country groupings), they are particularly revealing.

Point 2: The $792 billion tax cut spread over ten years is small.

The tax cut bill passed by Congress is small compared to the size of the economy, total federal revenues, the surpluses that will remain after the tax cut, or any other sensible measure. Only $156 billion is scheduled to take affect during the first five years. The remaining $636 billion will not be phased in until after 2004. As Figure 3 shows, it is approximately .7 of a percent of GDP—0.4% during the first 5 years and 1.0% during the last five. The tax cut amounts to only 3.5 percent of the projected federal revenue during the ten-year period.

Even with the tax cut, huge surpluses will be present during the next ten years (see Figure 4). To a large degree, these projected surpluses are a reflection of favorable demographics—the large share of the U.S. population currently in their prime-earning years of life. If the tax cut is instituted, the surpluses are projected to average approximately $200 billion per year during the next five years and more than $300 billion per year during the years 2005-2009. This is a highly restrictive fiscal policy. Sizeable tax cuts are needed to smooth the transition of financial markets to large budget surpluses of the next decade.

Both Congress and the Administration are on record as favoring use of the $1.9 billion projected Social Security surplus to retire outstanding debt during the next ten years. Figure 5 shows the path of the net privately-held debt if (a) the Social Security surplus is used for this purpose and (b) the Fed holdings of debt increase at the same rate as during the last decade. If this is the case, the net privately-held debt will fall from the current $3.3 trillion to only $826 billion in 2009. ***This will push it to less than 10 percent of GDP, the lowest level since prior to World War I.***

Point 3: The CBO projections grossly underestimate the size of the future surpluses.

The CBO's methodological assumptions understate federal revenues by at least $1.35 trillion dollars over the next ten years. There are two reasons for this underestimation:

1. The CBO assumes that federal tax revenues will increase less rapidly than nominal income. According to their projections, a 53.1% increase in nominal GDP between 2000 and 2009 will lead to only a 49.6% increase in federal revenue. Thus, their implied tax revenue-income elasticity is 0.94. This is substantially too low. We have a progressive tax structure. While the tax brackets are indexed for inflation, a larger and larger share of income

will be taxed at higher rates as real income grows. In addition, the current system is not fully indexed for inflation. Most notably, as inflation increases nominal capital gains, the rate of taxation on the gains will rise. Clearly, the tax revenue-income elasticity is greater than 1.0.

During the last four years (1995-1998), there have been only minor changes in the tax law. The 1994 revenues would reflect the implementation of the 1993 Clinton tax increase. Even though the tax system was basically unchanged, federal tax revenue rose 8.1% annually during 1995-1998 compared to a 5.2 % annual growth rate of nominal GDP. This would imply a tax revenue-income elasticity of 1.56. Most public finance economists would place the long-term tax revenue-income elasticity of the U.S. tax structure between 1.1 and 1.3. Thus, we re-calculated the CBO revenue projections for the next ten years using these more realistic elasticity figures. As Figure 6 shows, this adjustment indicates that the CBO's projections understate tax revenues and therefore the size of the budget surplus by between $257 billion and $528 billion during the next five years. During the five years after that (2005-2009), the CBO understatement of the tax revenue elasticity results in an understatement of revenue between $709 billion and $1,621 billion. Clearly, these understatements of tax revenues are far greater than the Congressional tax cut.

2. In addition, the CBO assumes a 2.5 percent growth rate during the next decade. During the last ten years, the annual real growth rate was 2.6%; it was 2.7% during the 1980s and 3.2% during the 1970s. During the last five years, real GDP grew at an annual rate of 3.4%. During the last 15 years, real GDP growth has averaged 3.1% annually. During the last 44 years for which it is possible to construct a 10-year moving average with the current GDP series, the 10-year average annual growth rate fell to 2.5% or lower on only 4 occasions. Given the highly favorable demographics—a high percentage of the work force in prime earning years—the 2.5% projected growth rate of the CBO is too low. As Figure 7 shows, even if real GDP growth is only 2.8%, just three-tenths higher than the CBO projection, $89 billion will be added to federal revenues during the next five years and an additional $296 billion would be added during years 2005-2009. A still more realistic annual growth rate of 3.0 percent during the next decade will increase federal revenues by $150 billion during the next five years and $495 billion during 2005-2009.

The tax cut looks puny when compared with the CBO's underestimation of revenue during the next ten years.

Point 4: If we do not reduce government spending as a share of GDP during the next decade, we will become Euro-ized when the baby-boomers retire.

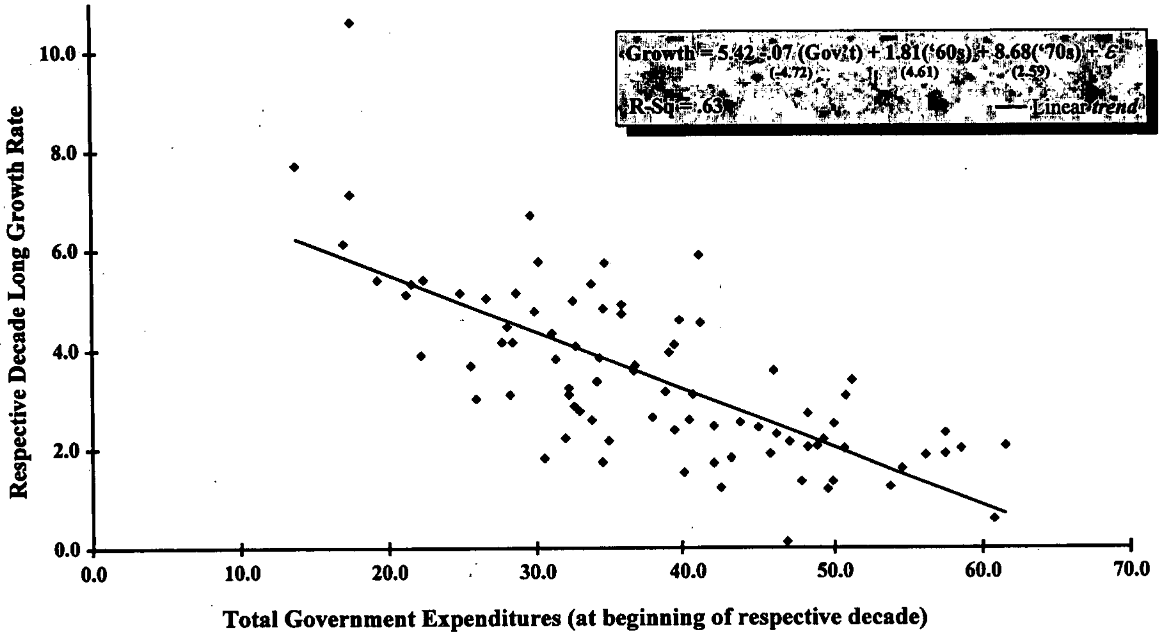
Persons age 65 and over currently account for approximately 12 percent of the U.S. population. Expenditures on health care, social security and other entitlements targeted toward the elderly account for about 12 percent of the total federal budget. When the baby boomers retire between 2010 and 2025, the elderly population will increase to 18 percent of the total. Under current law, this will push federal spending up by 6 to 8 percentage points as a share of GDP during this period. If new programs are added and government spending is maintained at approximately the current share of GDP during the next decade, the retirement of the baby boomers during the following decade (2010-2020) will push total government spending (including federal, state, and local) up to 40 percent of GDP. No country has been able to sustain real growth above 2 percent with government spending of this magnitude. If we go this route, we can expect European-type growth—one percent to 1.5 percent—when the baby boomers begin to retire.

Conclusion

We are at a crossroads. As a healthy economy provides substantial revenue, it will be tempting to expand spending in the years ahead. This tax legislation will be the first of several conflicts between those who want rapid growth versus those who want more spending, which will retard growth. The tax cut debate is about spending, not taxes. As Figure 8 shows, the President wants to use the on-budget surpluses to increase spending. The funds will be there to do so during the next decade. But such spending will plant the seeds of destruction for the following decade. Clearly, the American people are not under-taxed. As Figure 9 shows, federal taxes as a percent of national income are currently at an all-time high. Furthermore, they are projected to remain at or near this high level during the next decade. Even with the Congressional tax cut, there are only a few prior years with higher taxes as a share of national income than will be the case during the next decade. This suggests that, far from being "reckless," the tax cut is—if anything—too modest. Nonetheless, it is a step in the right direction.

Let me close with this question. Suppose that the non-social security budget was balanced and that Social Security was projected to generate a $1.9 trillion surplus during the next ten years. **Would you vote for a $792 billion tax increase?** If your answer is no, you should support the tax bill. If the bill is vetoed, this will in fact be the result. Under very cautious growth assumptions—ones that are well below what is likely to be achieved—the non-social security portion of the budget will not only be balanced, it will run a surplus. The government does not need more revenue. These funds belong to American taxpayers and they should be returned to them. This is precisely what the tax bill will do.

Figure 1: Economic Growth and Size of Government by Decade: 1960 - 1998



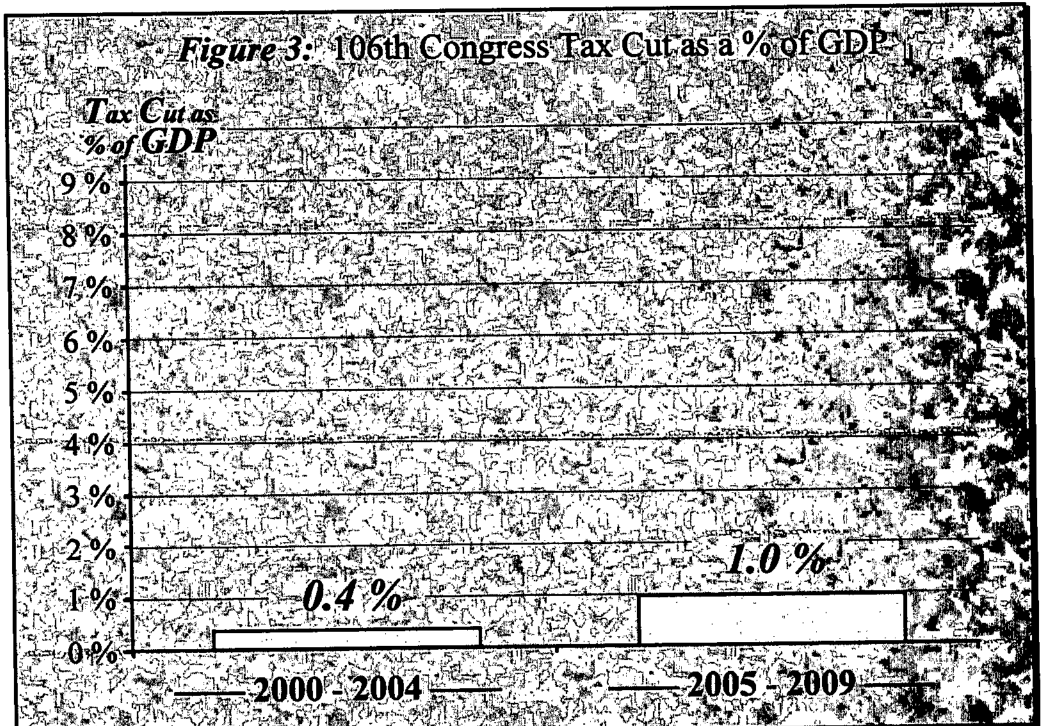
Source: *OECD Historical Statistics: 1960-1994* and *OECD Economic Outlook: June 1999* ** 21 OECD Countries: OECD omitting Switzerland and Luxembourg*

Figure 2: The Growth Rate of Real GDP in the 1990s Compared to 1960-1965:
OECD Countries with the Least and Most Expansion in the Size of Government

	Gov't as a % of GDP			Growth Rate of Real GDP		
OECD Countries with Least (< 10%) Expansion in the Size of Gov't as a Share of GDP	1960 (1)	1998 (2)	Change (3)	1960-1965 (4)	1990-1998 (5)	Change (6)
Iceland	28.2	36.2	*8.0*	4.5	2.3	*-2.2*
Ireland	28.0	33.1	*5.1*	4.1	7.1	*3.0*
United Kingdom	32.2	40.2	*8.0*	3.5	1.9	*-1.6*
United States	28.4	32.8	*4.4*	4.4	2.5	*-1.9*
Average	***29.2***	***35.6***	***6.4***	***4.1***	***3.5***	***-0.6***
OECD Countries with Most (> 20%) Expansion in the Size of Gov't as a Share of GDP						
Denmark	24.8	55.1	*30.3*	5.9	2.5	*-3.4*
Finland	26.6	49.1	*22.5*	5.6	1.3	*-4.3*
Greece	17.4	41.8	*24.4*	7.2	1.7	*-5.5*
Portugal	17.0	43.6	*26.6*	6.5	2.7	*-3.8*
Spain	13.7	41.8	*28.1*	8.5	2.2	*-6.3*
Sweden	31.0	60.8	*29.8*	4.9	1.1	*-3.8*
Average	***21.8***	***48.7***	***27.0***	***6.4***	***1.9***	***-4.5***
21 OECD Countries						
Average	***27.3***	***44.3***	***17.0***	***5.6***	***2.4***	***-3.2***

Source: Derived from *OECD Historical Statistics* and *OECD Economic Outlook* (various issues). All Countries for which data were available in the sample period were included.

21 OECD Countries: U.S., Japan, Germany, France, Italy, U.K., Canada, Australia, Austria, Belgium, Denmark, Finland, Greece, Iceland, Ireland, Netherlands, New Zealand, Norway, Portugal, Spain, and Sweden



Source: *Congressional Budget Office, Joint Committee on Taxation, and Joint Economic Committee.*

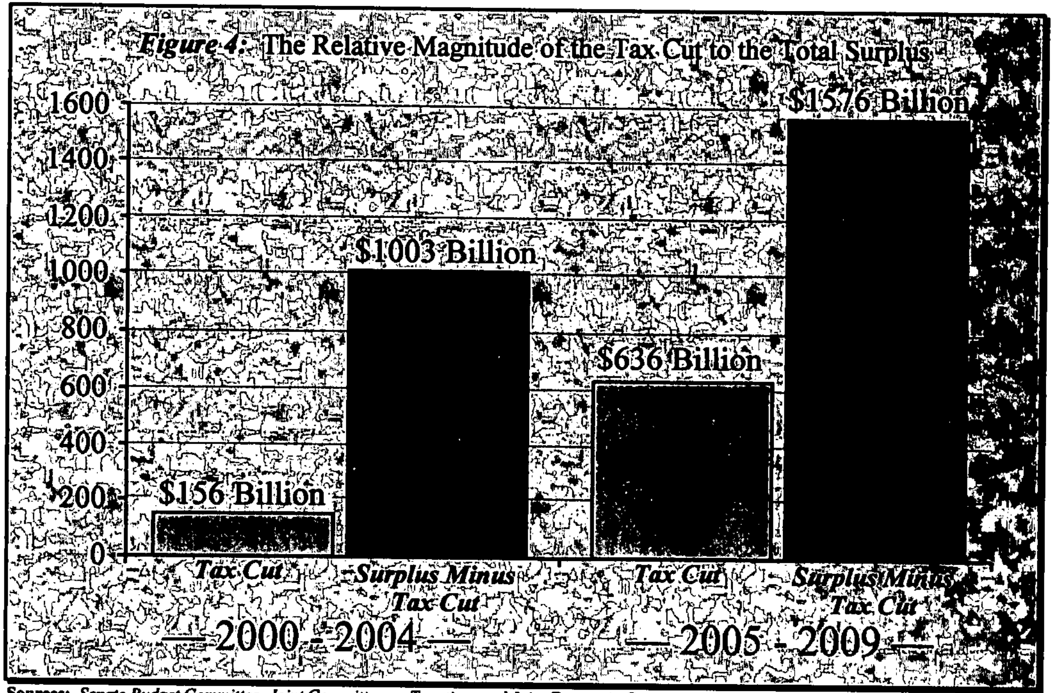


Figure 4: The Relative Magnitude of the Tax Cut to the Total Surplus

Sources: *Senate Budget Committee, Joint Committee on Taxation, and Joint Economic Committee.*

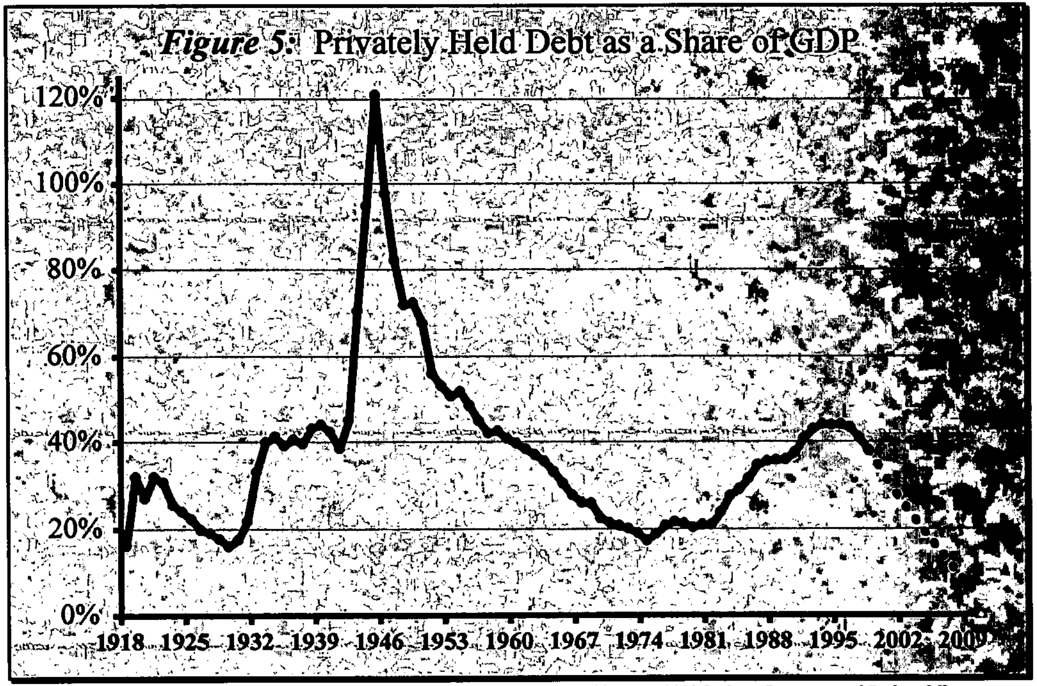


Figure 5: Privately Held Debt as a Share of GDP

Source: *Statistical History of the United States from Colonial Time, Historical Tables, F.Y. 2000 Budget; Congressional Budget Office.*

Note*: *The data that precedes 1946 is based upon a proxy set of variables that approximate closely the data from 1946 to 1998. The data that spans from 1999 to 2009 is projected using the assumptions that (a) the Fed will continue to increase its holdings of debt at the same rate that it has for the past decade (we use a 6 % measure as a conservative estimate of the actual % 6.4), and (b) that all (and only) the surpluses from within the Social Security "Lock-box" are used to retire Federal Debt (based on CBO projections of such surpluses).*

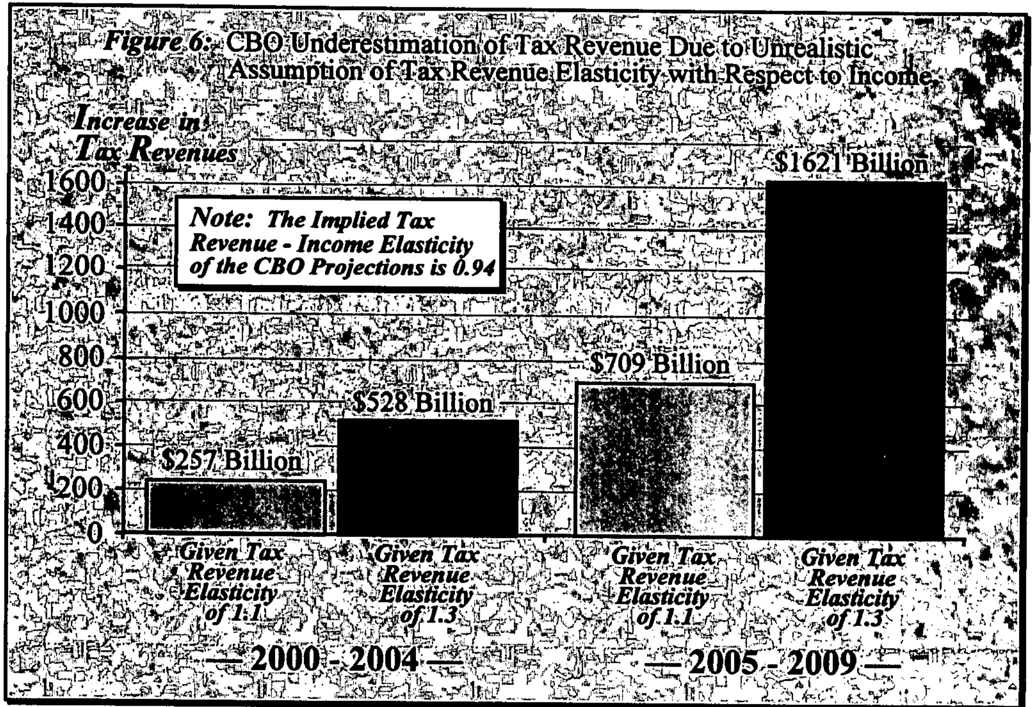
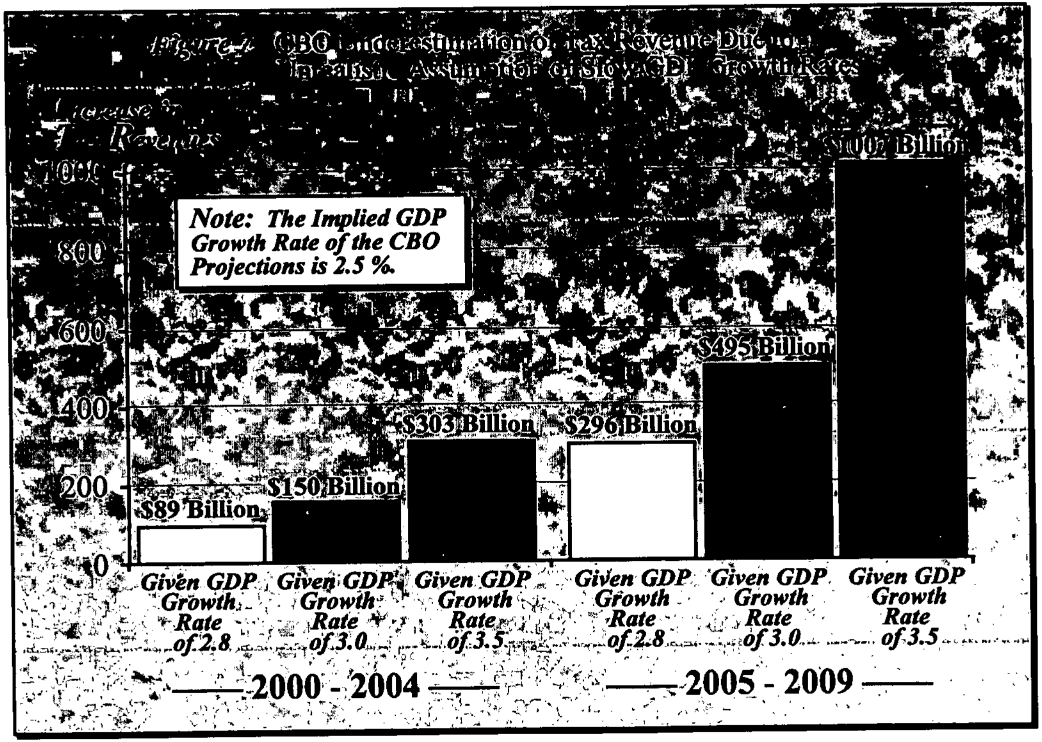
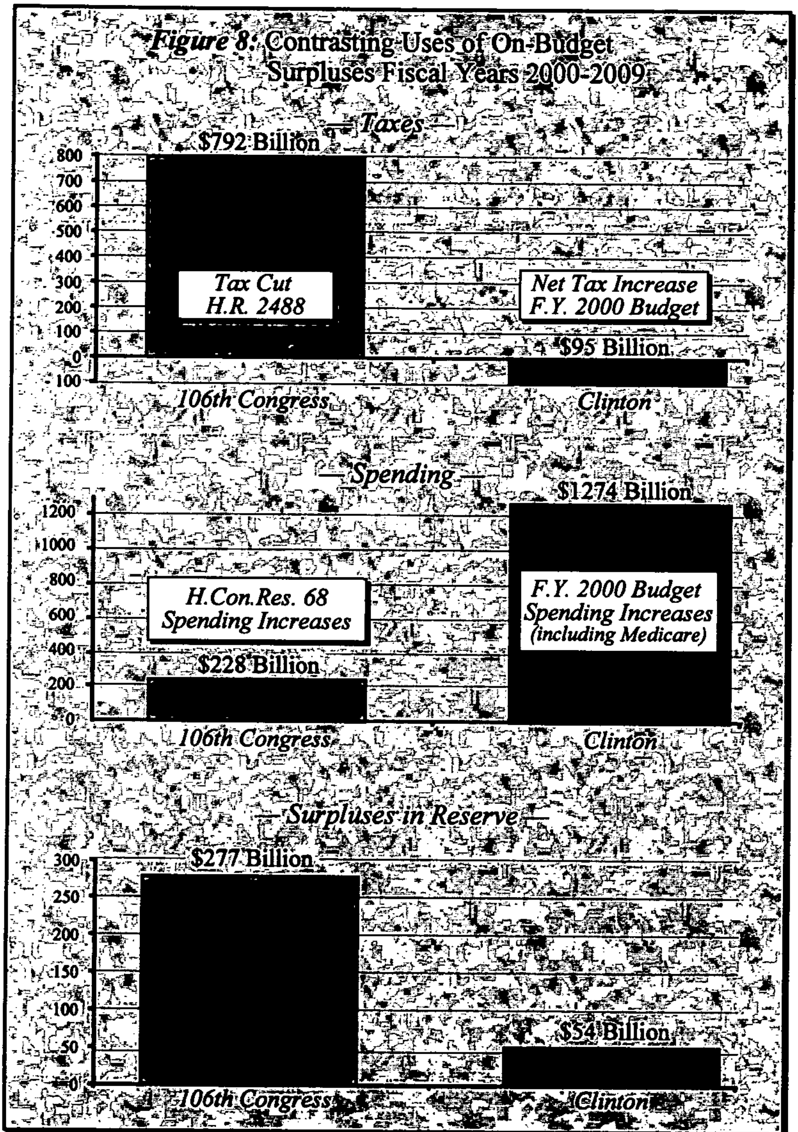


Figure 6: CBO Underestimation of Tax Revenue Due to Unrealistic Assumption of Tax Revenue Elasticity with Respect to Income.

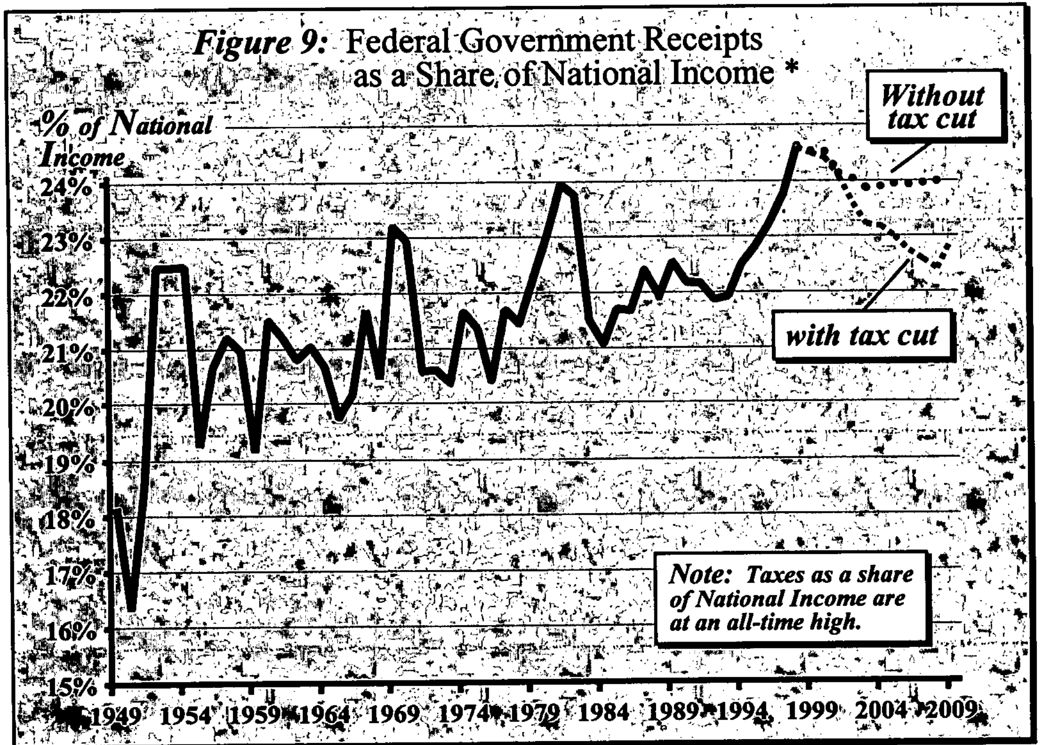
Source: *See Addendum to Fig. 6.*



Source: *See Addendum to Fig. 7.*



Sources: *Congressional Budget Office, Joint Committee on Taxation, and Senate Budget Committee.*



Source: *Haver Analytics, Joint Tax Committee, Congressional Budget Office.*

Note*: *The data beyond 1998 are projected using CBO annual GDP growth estimates for 1999-2009.*

Addendum 6.1

Projected Federal Tax Revenues: CBO Forecasts Corrected For Unrealistic Tax Revenue-Income Elasticity

(By Fiscal Year and In Billions of Dollars)

		0	1	2	3	4	5	6	7	8	9	10			
		1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009			
CBO Projected % Change in Nominal GDP[1]			4.6%	4.2%	4.2%	4.2%	4.2%	4.3%	4.4%	4.5%	4.5%	4.4%			
Multiplier	1.1		5.06%	4.62%	4.62%	4.62%	4.62%	4.73%	4.84%	4.95%	4.95%	4.84%			
Multiplier	1.3		5.98%	5.46%	5.46%	5.46%	5.46%	5.59%	5.72%	5.85%	5.85%	5.72%			
CBO Projected Federal Tax Revenues[1]		*1,821*	*1,905*	*1,970*	*2,045*	*2,116*	*2,198*	*2,296*	*2,396*	*2,501*	*2,609*	*2,725*	Mean		
Annual Percentage Increase			4.61%	3.41%	3.81%	3.47%	3.88%	4.46%	4.36%	4.38%	4.32%	4.45%	4.11%		
Projected Federal Tax Revenues															
Multiplier	1.1		*1,913*	*2,002*	*2,094*	*2,191*	*2,292*	*2,400*	*2,517*	*2,641*	*2,772*	*2,906*	Years 1-5	Years 6-10	Years 1-10
													2000-4	2005-9	2000-9
Increase From CBO Forecast			*8*	*32*	*49*	*75*	*94*	*104*	*121*	*140*	*163*	*181*	*257*	*709*	*966*
Multiplier	1.3		*1,930*	*2,035*	*2,146*	*2,264*	*2,387*	*2,521*	*2,665*	*2,821*	*2,986*	*3,156*			
Increase From CBO Forecast			*25*	*65*	*101*	*148*	*189*	*225*	*269*	*320*	*377*	*431*	*528*	*1,621*	*2,150*

[1] July 1999 CBO projections

Addendum 6.2: Calculated Tax Revenue-Income Elasticity for the CBO Projections

Year	Percent change in *CBO Forecasted* Nominal GDP *(fiscal year)*	Percent change in *CBO Forecasted* Federal Receipts (fiscal year)	*Calculated* Tax Revenue - Income Elasticity
2000	4.61%	4.61%	1.001
2001	4.24%	3.41%	0.804
2002	4.18%	3.81%	0.912
2003	4.19%	3.47%	0.829
2004	4.17%	3.88%	0.929
2005	4.33%	4.46%	1.031
2006	4.41%	4.36%	0.988
2007	4.47%	4.38%	0.981
2008	4.46%	4.32%	0.968
2009	4.43%	4.45%	1.003
2000-2009	53.06%	49.64%	0.936

Source: *CBO, & Joint Economic Committee.*

Addendum 7

Projected Federal Tax Revenues: CBO Forecasts Corrected For Expected Higher GDP Growth Rates

(By Fiscal Year and In Billions of Dollars)

		0 1999	1 2000	2 2001	3 2002	4 2003	5 2004	6 2005	7 2006	8 2007	9 2008	10 2009	Years 1-5 2000-4	Years 6-10 2005-9	Years 1-10 2000-9
CBO Projected Nominal GDP[1]		8,851	9,259	9,652	10,055	10,476	10,913	11,385	11,887	12,418	12,972	13,547			
CBO Projected % Change in Nominal GDP[1]			4.6%	4.2%	4.2%	4.2%	4.2%	4.3%	4.4%	4.5%	4.5%	4.4%			
Additional growth in GDP	0.3%		4.9%	4.5%	4.5%	4.5%	4.5%	4.6%	4.7%	4.8%	4.8%	4.7%			
Resulting Nominal GDP			9,285	9,703	10,139	10,595	11,072	11,581	12,126	12,708	13,318	13,944			
Additional growth in GDP	0.5%		5.1%	4.7%	4.7%	4.7%	4.7%	4.8%	4.9%	5.0%	5.0%	4.9%			
Resulting Nominal GDP			9,302	9,740	10,197	10,677	11,178	11,715	12,289	12,904	13,549	14,213			
Additional growth in GDP	1.0%		5.6%	5.2%	5.2%	5.2%	5.2%	5.3%	5.4%	5.5%	5.5%	5.4%			
Resulting Nominal GDP			9,347	9,833	10,344	10,882	11,448	12,054	12,705	13,404	14,141	14,905			
CBO Projected Federal Tax Revenues[1]		*1,821*	*1,905*	*1,970*	*2,045*	*2,116*	*2,198*	*2,296*	*2,396*	*2,501*	*2,609*	*2,725*			
CBO Projected Federal Tax Revenues as a % of GDP[1]			20.6%	20.4%	20.3%	20.2%	20.1%	20.2%	20.2%	20.1%	20.1%	20.1%			
Projected Federal Tax Revenues															
Additional growth in GDP	0.3%		*1,910*	*1,980*	*2,062*	*2,140*	*2,230*	*2,336*	*2,444*	*2,559*	*2,679*	*2,805*			
Increase From CBO Forecast			*5*	*10*	*17*	*24*	*32*	*40*	*48*	*58*	*70*	*80*	*89*	*296*	*384*
Additional growth in GDP	0.5%		*1,914*	*1,988*	*2,074*	*2,157*	*2,251*	*2,363*	*2,477*	*2,599*	*2,725*	*2,859*			
Increase From CBO Forecast			*9*	*18*	*29*	*41*	*53*	*67*	*81*	*98*	*116*	*134*	*150*	*495*	*645*
Additional growth in GDP	1.0%		*1,923*	*2,007*	*2,104*	*2,198*	*2,306*	*2,431*	*2,561*	*2,700*	*2,844*	*2,998*			
Increase From CBO Forecast			*18*	*37*	*59*	*82*	*108*	*135*	*165*	*199*	*235*	*273*	*303*	*1,007*	*1,310*

[1] July 1999 CBO projections

CENTER ON BUDGET
AND POLICY PRIORITIES

August 20, 1999

TAX BILL CONTAINS ONLY MODEST BENEFITS FOR MIDDLE CLASS DESPITE ITS HIGH COST

by Iris J. Lav and Robert Greenstein

The tax bill Congress approved in early August is decidedly not a broad-based middle-class tax cut plan; it is only modestly less favorable to high-income taxpayers than the earlier version of the tax bill the House of Representatives passed. Although the tax plan does provide some tax reduction for those in the middle of the income spectrum, an overwhelming and disproportionate share of the tax cuts in the bill would go to those at higher income levels.

A Treasury Department analysis issued August 5 finds that the 10 percent of households with the highest incomes would receive 59 percent of the bill's tax cuts when the tax cuts are in full effect. The top fifth of households would receive 78.5 percent of the tax cuts — more than three-quarters of the total. By contrast, the bottom 60 percent of the population *combined* would receive just 7.5 percent of the tax cuts, only about one-third as much as the top one percent would get by itself.

The Treasury analysis estimates that the wealthiest one percent of households would each receive an average tax cut of nearly $32,000 a year. The bottom 60 percent of the population would receive a $166 average tax cut.

An analysis conducted by Citizens for Tax Justice similarly finds the bill to be heavily skewed toward high-income households. The CTJ analysis estimates that 81 percent of the tax cuts would go to the top fifth of households, while the bottom 60 percent of households would share just 9 percent of the tax cuts.

The provisions in the package that would do the most for middle-class taxpayers are the proposed increase in the standard deduction for married couples and the proposed reduction of the 15 percent tax rate to 14 percent.

- The increase in the standard deduction for married couples and the reduction in the 15 percent tax rate account for less than one-fifth of the annual tax-cut benefits the bill

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provides. In 2008, when most provisions are largely phased in and before the artificial "sunset" of a number of provisions in the bill, these two provisions would account for only $32 billion of the $168 billion that the Joint Committee on Taxation estimates the package as a whole will cost. (Note that even this reduction in the 15 percent rate would provide a larger dollar tax cut to those at higher-income levels than to much of the middle class. The full benefit of this tax rate reduction would be available only to individuals and families whose incomes place them *above* the 15 percent bracket. Middle-class families in the 15 percent bracket would get only a partial benefit from the rate reduction.)

COST OF VARIOUS PROVISIONS IN 2008
(in billions of dollars)

Provisions Providing Bulk of Their Benefits to Middle-class or Lower-Income Filers	
Reduce 15 percent rate to 14 percent	$26.4
Increase standard deduction for couples	6.0
EITC marriage penalty relief	1.3
Expand dependent care tax credit	1.1
Subtotal	**$34.8**
Provisions Disproportionately Beneficial to Higher-Income Families	
Cut 28, 31, 36, and 39.6 percent rates	$31.0
Repeal individual AMT	30.8
Raise income limit for 14 percent bracket	22.0
Cut capital gains taxes	7.6
Repeal estate and gift taxes	10.9
Raise IRA and pension income and contribution limits	8.2
Corporate and business tax breaks	9.2
Subtotal	**$119.7**
Total cost in 2008	**$167.9**

Source: Joint Committee on Taxation

- There are some other, smaller provisions in the package that would benefit moderate- and middle-income families, such as the increase in the dependent care and adoption credits and marriage penalty reduction for married-couple families that receive the Earned Income Tax Credit. But in total, the provisions that grant a substantial share of their benefits to middle- or low-income taxpayers account for less than one-quarter of the bill's cost when the provisions are fully in effect.

- Most of the remaining tax cuts in the bill would accord a disproportionate share of their benefits to the 20 percent of taxpayers with the highest incomes.

Should the Distribution of Tax Cuts Mirror the Distribution of Tax Burdens?

Some proponents of the tax bill dismiss data showing that the bulk of the bill's tax cuts would go to more affluent households by observing that these households pay the bulk of the taxes and should therefore get the bulk of the tax cut benefits. The tax cuts in the bill are, however, disproportionate to taxes paid. The highest-income 20 percent of the population pays about 59 percent of federal taxes but would get 79 percent of the tax cuts in the legislation.

Moreover, the notion that tax cuts should be apportioned in accordance with the share of taxes that various income groups pay is itself highly problematic. Use of such a standard implies that the more that income disparities widen in the United States and high-income individuals receive the lion's share of the income gains (and thus pay more of the taxes), the more that tax cuts should be directed to the wealthy, making the disparities still greater.

Use of such a standard also overlooks the fact that the wages and living standards of much of the population, with the notable exception of upper-income households, are not much better than they were a decade or two ago. In fact, the hourly wage of the typical (or median) worker is slightly lower today than it was at the end of the 1970s, after adjusting for inflation. By contrast, both executive compensation and capital gains income have risen smartly for those on the upper rungs of the economic ladder.

These developments have multiple causes, including international competition, technological advances, the decline in unionization, other economic factors, and policy changes. Given these trends toward widening wage and income disparities, tax policy ought to compensate at least modestly. At a minimum, tax policy should not magnify these trends.

This is a matter of some importance, since the trend toward increasing income disparities has been quite marked. Congressional Budget Office data show that from 1977 to 1995 (the first and last years for which such data are now available), the average before-tax income of the top one percent of the population jumped 77 percent after adjustment for inflation. The average income of the top fifth of the population also rose substantially, climbing 29 percent. But the average income of the middle fifth barely changed during this period, rising only two percent, and the average income of the bottom two fifths of the population declined. A policy of distributing the lion's share of tax cuts to those on the top rungs of the economic ladder, on the grounds that tax cuts should be conferred in proportion to taxes paid, would exacerbate rather than ameliorate these trends. It would increase further the growing disparities of income and wealth between the most affluent individuals and the rest of society.

Finally, there is the issue of priorities. There is not an economic need for tax cuts geared to the high end of the income spectrum — the economy is running at full tilt with the current tax rates, the stock market is booming at the current capital gains rates, high-income households are already much better off than in the past, and Federal Reserve chairman Alan Greenspan has cautioned that tax cuts in general may be ill-advised at this point. Thus, the question arises as to whether tax cuts of this nature should take precedence over other needs. Should tax cuts that provide the lion's share of their benefits to the most affluent members of society be accorded priority over greater debt reduction, strengthening the long-term financial security of Medicare and Social Security, public investments that hold promise for improving long-term productivity growth (such as investments in education and training, infrastructure, research, and early intervention programs for children), measures to lower the child poverty rate (which remains well above the child poverty rate in Canada and most of western Europe), and tax cuts in which a greater share of the tax reductions go to the middle class and the working poor?

These provisions include the elimination of the estate tax, the capital gains tax cuts, the elimination of the alternative income tax, provisions raising income and contribution limits for Individual Retirement Accounts and employer-sponsored pension plans, the reduction in the tax rates above the 15 percent rate, and the increase in the income level at which the 15 percent tax rate ends for married filers and the 28 percent rate starts.

Rate Reductions

The income tax rate reductions in the bill might seem as though they would provide significant benefits to middle-income taxpayers. In fact, the rate reductions provide only a modest benefit to most moderate- and middle-income families. The bulk of the benefits of the rate cut would go to those at much higher income levels.

The bill gradually reduces each tax rate by one percentage point. Like the Senate bill, the conference agreement gradually lowers the 15 percent rate to 14 percent. But it also lowers each of the other, higher marginal income tax rates, bringing down the 28 percent rate to 27 percent, the 31 percent rate to 30 percent, and so on. Bringing down all of the rates skews the benefits much more in favor of high-income taxpayers than the Senate proposal did.

Even under the Senate bill, the full benefit of reducing the lowest rate from 15 percent to 14 percent would have been secured only by families with income at least as high as the level at which the 15 percent bracket ends and the 28 percent bracket begins. For a family of four, income would have to exceed $61,000 to receive the full benefit — equal to about $450 — from reducing the 15 percent rate to 14 percent. (See box on page 6.) Families below this level would receive a smaller tax cut from this provision.

Three-quarters of taxpayers either are in the 15-percent bracket or owe no income tax. Only the top quarter of taxpayers are in the higher brackets, and only they would receive the full benefit of reducing the 15 percent rate. No one outside the top quarter of taxpayers would benefit even to a small degree from reducing the rates in the higher brackets.

Families with gross incomes at more modest levels would gain little from the rate-cut provisions. Consider a family of four with income of $25,000. Although such a family owes little income tax, it pays sizeable payroll taxes and other federal taxes. This family would receive a tax cut of just $20 from the rate reduction. For a family of four with income of $35,000, the tax from the rate reduction would be $168. By contrast, a family with gross income of $200,000 could receive a $1,500 break from the rate reduction.

The cost of lowering the 15 percent rate to 14 percent while leaving the higher rates unchanged, as the Senate bill would have done, would have been $26 billion in 2008. Adding in the reductions in the higher tax rates more than doubles the cost; the cost of the rate reduction in the conference agreement is $57 billion in 2008. The additional $31 billion in tax cuts would accrue solely to the 25 percent of taxpayers with the highest incomes.

Marriage Penalty Relief

The conference agreement provides three types of marriage penalty relief: an increase in the standard deduction for married couples, a modification of the earned income credit for married couples, and an increase in the income level at which the 15 percent tax rate ends for married couples and the 28 percent rate begins.

The increase in the standard deduction is well-targeted on middle-income families; most higher-income families have sufficient expenses to itemize their deductions and do not use the standard deduction. The bill would set the standard deduction for married couples at a level twice the deduction for single taxpayers. If this provision were effective in 1999, the standard deduction would increase by $1,400 this year. This would generate a tax cut of $210 for most couples in the 15 percent tax bracket. (Applying a 15 percent tax rate to $1,400 less in income yields a tax cut of $210.)

The second type of marriage penalty relief in the tax bill — a modest increase in the amount of earned income credit received by married couples with incomes between $12,000 and $32,000 — also is well-targeted. The standard deduction increase and other marriage penalty relief provisions in the conference agreement will not help most of these low- and moderate-income working families because they have no income tax liability and hence cannot make use of larger income tax deductions. Yet many of these families do face marriage penalties that arise from the structure of the Earned Income Tax Credit. EITC marriage penalties occur when two people with earnings marry and their combined, higher income places them at a point in the EITC "phase-out range" at which they receive either a smaller EITC than one or both of them would have received if still single or no EITC at all.[1]

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[1] Consider a man and woman that each work full time at the minimum wage. If unmarried, the man would file as a single taxpayer, while the woman would file as a head of household and claim an EITC for her two children. Before they are married, the man pays $550 in income tax while the woman qualifies for a $3,816 refund, the maximum EITC for a family with two children in 1999. Their combined refund thus is $3,270. If they marry, the couple's combined income puts them in the phase-out range of (continued...)

Who Is in the 15 Percent Tax Bracket?

The income level at which the 15-percent bracket ends has been widely misreported as being $43,050 for married filers. The $43,050 figure, however, is the level of *taxable income* at which the 15 percent bracket ends for married filers; it is not the level of *adjusted gross income* at which filers move from the 15 percent to the 28 percent bracket. The lowest level of gross income at which the 15 percent bracket ends for a married family of four is $61,250. (This is the level of adjusted gross income at which the standard deduction and the four personal exemptions the family would claim would reduce the family's *taxable income* to $43,050, the break point between the 15 percent and 28 percent brackets.) Married families of four that itemize their deductions can have incomes somewhat higher than $61,250 and remain in the 15 percent bracket.

Three quarters of all individuals and families are in the 15 percent bracket or owe no income tax. Only the top quarter are in higher brackets.

The tax bill would reduce EITC marriage penalties. (The bill would do so by raising by $2,000 both the income level at which the EITC for married families begins to phase down and the income level at which married families cease to qualify for any EITC benefits.) For a husband and wife that each work full time at the minimum wage, this provision would alleviate about one-third of their marriage tax penalty.

In contrast to the standard deduction increase and the EITC provision, the provision in the bill that would raise the income level at which the 15 percent bracket ends and the 28 percent bracket starts for married couples would benefit only those couples with incomes exceeding the level at which the 15 percent bracket currently ends. A couple with two children would need to have income surpassing $61,250 to benefit from this provision. (Couples *without* children would need to have income exceeding $55,750 to benefit.)

The cost of increasing the standard deduction for married couples to an amount that equals twice the standard deduction for single taxpayers would be $6 billion in 2008, while the cost of the EITC marriage penalty relief would be $1.3 billion. By contrast, the provision raising the income level at which the 15 percent bracket ends would cost $22 billion in 2008, three times as much as the other two provisions combined. All of the $22 billion in cost resulting from increasing the income level at

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[1] (...continued)
the EITC and reduces their EITC substantially. Their combined refund is reduced to $1,930, yielding a marriage penalty of $1,340.

which the 15 percent bracket ends for married couples reflects tax cuts that would be limited to taxpayers in the top quarter of the income distribution.

Alternative Minimum Tax for Individuals

The bill would scale back the individual Alternative Minimum Tax beginning in 2005 and repeal it fully in 2008. This would allow some very high-income taxpayers to pay taxes at rates well below those that middle-income families pay — or to avoid paying personal income taxes altogether.

The individual AMT was enacted in its current form in the Tax Reform Act of 1986 as a way to prevent high-income taxpayers from using a combination of tax exemptions, deductions, and credits in such a way that they largely or entirely eliminate their income tax liability. The Joint Committee on Taxation projects that 937,000 taxpayers will pay the AMT in tax year 2000 and that approximately three-quarters of these taxpayers will have incomes exceeding $100,000.

In its current form, the AMT is projected to begin imposing additional taxes on some middle-income families in future years, a development that policymakers never intended.[2] The Joint Committee on Taxation projects that by 2008, some 6.9 million taxpayers will pay the AMT under current law, and 44 percent of them would have incomes below $100,000. By that time, a sizeable number of middle-income taxpayers would have various tax credits — such as the child credit, dependent care credit, or education credits — effectively reduced or eliminated as a result of the AMT. It is widely acknowledged that some modification to the AMT must be made to prevent this from occurring.

There are a number of ways the AMT could be modified to exempt most middle-income taxpayers from it while assuring that its original purpose — to prevent tax

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[2] This will occur because the AMT utilizes a single deduction of $45,000 (for married couples) in lieu of the exemptions, deductions, and credits allowed for the normal tax calculation. The rate applied to the taxable income computed in this alternative manner is either 26 percent or 28 percent, depending on income. For taxpayers in the 28 percent tax bracket or a higher tax bracket, the alternative minimum tax generally is higher than the tax owed under the regular tax computation only if a taxpayer is using a very large amount of deductions and credits disallowed under the AMT. Unlike the personal exemptions and standard deductions used for the normal tax calculation, however, the single $45,000 deduction allowed under the AMT is not indexed for inflation. As a result, a growing number of middle-income taxpayers in the 15 percent tax bracket will begin to be subject to the AMT unless changes in the AMT are made. But there is no need to repeal the AMT to prevent it from affecting the tax burdens of the middle class.

avoidance by high-income taxpayers — continues in effect. The tax bill that emerged from conference, however, repeals the AMT entirely, which would result in windfalls for some very high-income taxpayers. If the AMT is repealed, some high-income individuals would again be able to escape all federal income tax or to reduce their tax payments very substantially.

The Treasury Department estimates that repeal of the AMT in 2008 would result in 25,000 taxpayers with incomes surpassing $200,000 escaping federal income tax in 2009. The Treasury also estimates that several hundred taxpayers with incomes of *more than $1 million* would avoid paying any income tax.

Estate Tax Repeal

The tax bill would gradually reduce the estate tax and fully repeal it beginning in 2009. The benefits of estate tax repeal would accrue solely to the estates of the nation's wealthiest decedents. Joint Tax Committee estimates show that under current law, only two percent of all deaths result in estate tax liability. Specifically, the Committee's estimates show that only 1.96 percent of decedents in 1999 will have estates large enough to require payment of any estate tax.[3]

Moreover, the bulk of the estate tax is paid by rather large estates. An IRS analysis of the 32,000 taxable estates filing in 1995 showed that the one-sixth of taxable estates with gross value exceeding $2.5 million paid nearly 70 percent of total estate taxes.[4]

Estate tax repeal thus would benefit only the estates of those high on the wealth scale. Claims that family farms and small businesses would be among the principal beneficiaries of this tax cut are inaccurate. Farms and small, family-owned businesses make up only a tiny proportion of taxable estates. The IRS analysis of estates that filed in 1995 found that all farm property, regardless of size, accounted for *less than one-half of one percent* of all assets included in taxable estates. Family-owned business assets, such as closely-held stocks, limited partnerships, and non-corporate businesses, accounted for *less than four percent* of the value of all taxable estates of less than $5 million.

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[3] Joint Committee on Taxation, *Present Law and Background on Federal Tax Provisions Relating to Retirement Savings Incentives, Health and Long-Term Care, and Estate and Gift Taxes* (JCX-29-99), June 15, 1999.

[4] Internal Revenue Service, *SOI Bulletin*, Winter 1996-97.

Cost of Tax Bill Would Reach $2.6 Trillion In Second Ten Years

The tax bill has an official cost of $792 billion over the 10-year period from 2000 through 2009. But its actual cost would likely exceed $792 billion in the first 10 years and reach approximately $2.6 trillion in the second 10 years, from 2010 through 2019.

The bill's official cost is held to $792 billion in the first 10 years through use of a gimmick. The bill "sunsets" many of its principal provisions after 2008 — including the reductions in tax rates, the marriage penalty relief, the capital gains rate cut and capital gains indexing, the increase in IRA contribution limits, and the repeal of the alternative minimum tax. The official cost estimate assumes these provisions will not be in effect in 2009. All remaining provisions of the bill then sunset after 2009.

In fact, canceling some of these provisions would be virtually impossible as a practical matter, while sunsetting others — while technically possible — would be extremely difficult politically. If these provisions really ceased to be effective after 2008, the result would be a $54 billion income tax increase in 2009 — larger than the tax increase that occurred in 1991 following the 1990 deficit reduction deal that President George Bush negotiated with Congress. (These comparisons adjust costs from different years for inflation.)

Furthermore, full sunset of the bill after 2009 would result in an unprecedented — and politically unthinkable — single-year tax income of $180 billion, which would be nearly three times larger than the tax increase that took effect in 1994 following enactment of the 1993 deficit-reduction legislation.

Without the highly unrealistic sunset provisions, the bill's cost — which mushrooms from $62 billion in 2004 to $117 billion by 2006 to $168 billion by 2008 — would rise to $180 billion in 2009. The official estimate, by contrast, shows the cost plummeting from $168 billion in 2008 to $126 billion in 2009.

After the initial 10-year period, the cost of the tax cuts in the bill would explode. Using conservative estimates likely to understate the bill's long-term cost, we find that if the tax bill became law and was in effect after 2009, it would cost approximately $2.6 trillion in the second 10 years, from 2010 through 2019. This is more than triple the $792 billion cost officially shown for the first 10 years. These massive costs in the second 10 years would occur during the same period in which the baby boom generation begins to retire, Social Security and Medicare costs mount, and surpluses both in the Social Security budget and the non-Social Security budget are expected to stop growing each year and begin shrinking.

Additional information concerning the devices the bill uses to mask its long-term costs and the likely cost of the bill in the second 10 years may be found in the Center analysis, *Conference Agreement Tax Cut Would Cost $2.6 Trillion in Second 10 Years,* by Iris J. Lav and Robert Greenstein.

Capital Gains

The legislation contains substantial reductions in capital gains taxes, which are paid on profits from the sale of stocks, bonds, and similar assets. The preferential tax treatment of capital gains income that current law provides would be expanded in two ways — through a rate reduction and an indexing provision.

Under current law, most assets held for more than one year are taxed at a maximum rate of 20 percent. Consider an asset that is purchased for $100,000, grows in value at 7.5 percent per year, and is sold after four years for $133,550. Under current law, the tax would be 20 percent of $33,550, or $6,709.

Current law already provides a major tax break on capital gains income. The affluent individuals who receive the vast bulk of the capital gains income have incomes sufficiently high as to pay income taxes at rates above the 28 percent rate. If capital gains were taxed at the same rate as other types of income, such as salaries, interest, dividends, and self-employment income — as they largely were for a number of years following passage of the 1986 Tax Reform Act — a taxpayer in the 31 percent bracket who secured the $33,550 profit in the example cited above would owe $10,400 in tax on the profit. Instead, because capital gains income is taxed at a preferential rate of 20 percent, this taxpayer owes $6,709, about one-third less.

Preferential capital gains tax rates are worth the most to the wealthiest individuals. The capital gains tax that a very high-income individual in the 39.6 percent tax bracket pays is only half what this individual would pay if capital gains income were taxed like other income.

The tax bill that Congress passed in early August would substantially enlarge the already-generous capital gains tax breaks in current law. First, the rate at which most capital gains income is taxed would be lowered from 20 percent to 18 percent.

Under the 1997 tax law, the tax rate on profits from the sale of assets held more than five years is already scheduled to decrease to 18 percent in 2006. The new tax bill would accelerate the effective date of this rate reduction to January 1999, making it retroactive.

Capital Gains Tax Cut Example

Initial investment	$100,000
Value after four years*	133,547
Profit	33,547
Tax on profit under current law	6,709
Tax at 18 percent with indexing	4,170
Total tax cut	-2,540
Percentage tax cut	-38%
Effective tax rate on profit	12.4%

*Assumes 7.5 percent annual growth in the value of the asset (2.5 percent for inflation and five percent real growth).

More important, the bill would eliminate the requirement that assets be held five years to qualify for the lower rate. The 18 percent rate would apply to gains on all assets held more than one year. In the example discussed above, this rate cut would reduce the tax on the $33,550 profit from $6,709 to $6,038, a further reduction of 10 percent in capital gains taxes.

The bill also adds a major additional capital gains tax break not included in either the House or Senate bill — a provision allowing investors to index profits for inflation when figuring their capital gains tax. Under current law, when the capital gains tax is applied to the profit from the sale of an asset, the profit is calculated as the difference between the price for which the asset was sold and the price at which the asset originally was purchased.

Under indexing, a calculation is made that can substantially reduce the amount of profit subject to tax. Assume in the example above that inflation averaged 2.5 percent per year during the four the years investor held the asset. Under the bill, a taxpayer figuring his or her capital gains tax would adjust the $100,000 he or she paid to purchase the asset upward to approximately $110,400 to account for four years of inflation; the capital gain to which the capital gains tax would apply would be considered to be $23,150 rather than $33,550 — $133,550 minus $110,400, rather than $133,550 minus $100,000. With an 18 percent capital gains rate, the tax due on the gain would be reduced to $4,170 as a result of indexing, an additional capital gains tax cut of 28 percent.

When the rate cut and indexing are considered together, the total capital gains tax cut in this example would be $2,540 — a 38 percent reduction in the capital gains tax. Moreover, this tax cut would come on top of the large reduction in capital gains taxes included in Taxpayer Relief Act of 1997. If those tax cuts are enacted, taxes on capital gains would be slashed *more than 50 percent* as a result of the two tax bills.

In the example used here of an asset purchased for $100,000 and sold four years later for $133,550, the effective tax rate on the profit would be reduced to 12.4 percent (that is, the capital gains tax paid would equal 12.4 percent of the profit the investor secured). This illustrates the fact that under the bill, many wealthy investors would pay a lower effective rate of tax on profits from the sale of stocks than moderate- and middle-income families would pay on their wages and on interest they receive on modest savings accounts.

The principal beneficiaries of both of the types of capital gains tax breaks the legislation contains would be wealthy investors. Two-thirds of all capital gains are received by the one percent of taxpayers with incomes exceeding $260,000. These high-

Capital Gains Tax Cuts Would Foster Economic Inefficiency and Tax Sheltering

One effect of the combination of the bill's capital gains rate cut and its indexing provision would be to increase substantially the difference between the top income tax rate on most forms of income and the effective tax rate on capital gains income. The current top rate on ordinary income — including salaries and interest and dividend income — is 39.6 percent. The combination of the proposed 18 percent maximum tax rate on capital gains income and the indexing provision would reduce the effective tax rate on capital gains in many circumstances to approximately 13 percent, or about one-third the rate that very high-income individuals pay on ordinary income.

This differential would create a huge incentive to "convert" ordinary income into capital gains. The large differential could lead investors to avoid investments that yield interest income, forcing some businesses to create equity instruments rather than to borrow needed capital even when borrowing makes more business sense. It also could lead executives to demand compensation in the form of stocks or stock options rather than salary.

More important, it could give new life to the tax shelter industry, which specializes in creating complex, multi-layered transactions that change the character of income for tax purposes. These types of income shifts and tax sheltering are the antithesis of economic efficiency; they skew investment decisions by causing many such decisions to be made on the basis of where the tax advantages are greatest rather than where the economic gain itself is the greatest in the absence of the distorting effect of the tax preferences. It was for precisely this reason — to enhance economic efficiency — that the Tax Reform Act of 1986 equalized the tax rates on ordinary income and capital gains income.

income individuals thus would receive approximately two-thirds of the benefits from the bill's capital gains tax reductions.

Moreover, fully one-third of all capital gains income goes to taxpayers whose annual capital gains income *exceeds $1 million*. These extremely high-income investors would gain the most from these capital gains tax cuts. Most of them would receive average annual capital gains tax cuts greater than the entire income of the typical American family.

Individual Retirement Accounts

The bill includes several types of Individual Retirement Account expansions. It would increase the income limits on the use of Roth IRA tax preferences by individuals with employer-sponsored retirement plans; this would benefit only highly paid individuals with incomes above the limits that current tax law sets. The bill also would more than double the amount a taxpayer and spouse can contribute annually to either a conventional IRA or a Roth IRA.[5] This, too, would primarily benefit those on the higher rungs of the income scale, since few middle-income families could afford to put this much of their income aside and place it in an IRA each year.

The primary effect of these changes would be to give the 20 percent of taxpayers with the highest incomes substantial new tax breaks. Many of these taxpayers would secure these generous tax breaks by shifting savings from one account to another, rather than by saving more.

- Under current law, a taxpayer covered by an employer-sponsored pension plan may make deposits in a Roth IRA or a conventional IRA if the taxpayer's income is below specified levels. For married filers, the income limit is $160,000 for Roth IRAs. For conventional IRAs, the income limit for married filers will increase under current law to $100,000 by 2007.[6] Taxpayers of *any* income level who are not covered by an employer-sponsored plan may make tax-advantaged deposits to either Roth IRAs or conventional IRAs.

- The bill would raise the income limit on Roth IRAs for married filers to $210,000. This would allow substantial numbers of additional taxpayers with incomes that exceed the current limits to use Roth IRAs regardless of whether they also participate in a tax-favored employer-sponsored plan.

- The current limits exclude only a modest proportion of taxpayers from IRA tax preferences. The Joint Committee on Taxation reports that more than 80 percent of married taxpayers with earnings and more than 85 percent of single taxpayers with earnings are eligible to make deductible contributions to conventional IRAs in 1999. These percentages will rise

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[5] Under conventional IRAs, qualified taxpayers and spouses may deduct from their taxable income each year up to $2,000 apiece in contributions to their accounts. Once the contributions are made, earnings of the deposits accumulate free of tax. Income taxes on the principal and interest are deferred until the funds are withdrawn. In contrast, contributions made to Roth IRAs are not deductible from taxable income. But all earnings on Roth IRA deposits are forever free of tax. All qualified withdrawals from Roth IRAs are free of tax because the principal already has been taxed and the earnings are not taxable.

[6] Under current law, married taxpayers who participate in an employer-sponsored pension plan may deduct contributions to a conventional IRA if they have income below $61,000 in 1999; the income limits rise to $100,000 by 2007. Married taxpayers participating in an employer-sponsored plan may contribute to a Roth IRA if they have income below $160,000. (For single individuals participating in an employer-sponsored plan, the income limit for deductible contributions to a *conventional* IRA is $41,000 in 1999, rising to $60,000 in 2005. The income limit for making a contribution to a *Roth* IRA is $110,000 for single taxpayers participating in an employer-sponsored plan.)

under current law, as the income limits for conventional IRAs increase in stages through 2007. Furthermore, the income limits for Roth IRAs are much higher than those that apply to conventional IRAs; the proportion of taxpayers eligible to make Roth IRA contributions under current law consequently is considerably higher than 80 percent to 85 percent.

- Since current law limits the ability of only the 20 percent of taxpayers with the highest incomes to use conventional IRAs — and the ability of a still-smaller percentage of high-income taxpayers to use Roth IRAs — lifting the income limits for Roth IRAs would almost exclusively benefit upper-income taxpayers.

- The bill also would increase the amount that can be contributed each year to either conventional or Roth IRAs. Under current law, a taxpayer and spouse may each contribute $2,000; the bill would raise the maximum contribution to $5,000 each. Thus, the total amount a couple could contribute would rise from $4,000 to $10,000. This, too, would favor higher-income taxpayers. Most of those able to contribute more than $2,000 to an IRA annually would be people who have relatively high incomes or already have substantial assets.

- Many higher-income individuals would be able to shift savings they already possess from taxable investments to tax-advantaged IRAs, thus securing a larger tax break without increasing their savings. On average, people who save through IRAs hold more than three times as much in financial assets as people who do not use IRAs, giving them ample opportunity to transfer assets from other types of savings to IRA accounts.

- While benefiting high-income households, an increase in the IRA contribution limits to $5,000 could work to the detriment of some low- and middle-income workers. It could lead some small businesses not to offer an employer-sponsored pension plan.

  Currently, a small business owner can contribute $2,000 to his or her own IRA and another $2,000 to his or her spouse's IRA, for a total of $4,000. To place more funds in a tax-advantaged retirement account, the business owner would have to establish an employer-sponsored plan that covers the business' employees as well as the owner.

  Under the bill, however, the small business owner and his or her spouse could deposit a total of $10,000 into their IRAs rather than $4,000. With these higher limits, the small business owner may not see a need to provide a company pension plan and may drop such a plan or fail to institute a plan in the first place. As Donald Lubick, Assistant Secretary of the Treasury for Tax Policy, noted earlier this year in Congressional testimony on this matter, "Currently, a small business owner who wants to save $5,000 or more for retirement on a tax-favored basis generally would choose to adopt an employer plan. However, if the IRA limit were raised to $5,000, the owner could save that amount — or jointly with the owner's spouse, $10,000 — on a tax-preferred basis without adopting a plan for employees. Therefore, higher IRA limits could reduce interest in employer retirement plans, particularly among owners of small businesses. If this happens, higher IRA limits would work at cross purposes with other proposals that attempt to increase coverage among employees of small businesses."[7]

The bill also includes one other upper-income IRA tax break. Under current law, all taxpayers with incomes below $100,000 may choose to convert conventional IRAs they hold to Roth IRAs. The bill would allow joint filers with incomes up to $200,000 to make such conversions. Couples with gross incomes between $100,000 and $200,000 would be able to convert conventional IRAs into Roth IRAs.

Shifting funds from conventional IRAs to Roth IRAs could be highly advantageous to many affluent individuals in this income range. Once they have shifted funds from a conventional IRA to a Roth IRA, all amounts earned on the funds would be forever free of income tax. In addition, Roth IRAs can allow wealthy individuals to bequeath large amounts of funds to their heirs free of any income tax. Conventional IRAs require taxpayers to begin taking distributions of funds from their IRA accounts no later than at age 70½, but no such requirements apply to Roth IRAs. Well-to-do holders of Roth IRAs can leave all of the funds in the accounts, which then can be bequeathed. Furthermore, an heir may be able to keep the bulk of the funds from an inherited Roth IRA on deposit, with the earnings continuing to compound free of tax. (Heirs generally are required to take distributions from the inherited accounts only gradually, spread over the course of their own life expectancies.)

Health Insurance Deductions

Finally, the tax bill includes a new tax deduction for the purchase of health insurance by taxpayers who pay at least 50 percent of the cost of the premium. As first glance, this may seem an attractive idea. Closer examination indicates, however, that

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[7] Statement of Donald C. Lubick, Assistant Secretary of the Treasury for Tax Policy, before the Subcommittee on Oversight, House Committee on Ways and Means, March 23, 1999.

the proposed deduction would provide little help to most of those lacking insurance and would not significantly reduce the ranks of the uninsured.

At least 93 percent of uninsured individuals either pay no income tax or are in the 15 percent income tax bracket. For them, this deduction would do little or nothing to make insurance more affordable, because it would reduce the cost of insurance by no more than 15 percent. As a result, those who would benefit most from such a tax deduction are, by and large, individuals in higher tax brackets who already purchase individual insurance.

- Some 18 million uninsured individuals — 43 percent of all of the non-elderly uninsured — owe no income tax; their earnings are too low for them to incur an income tax liability.[8] These uninsured individuals would receive no benefit from a tax deduction; a deduction would do nothing to make health insurance more affordable for them.

- Another 20 million uninsured individuals — 50 percent of the non-elderly people without health insurance — pay income tax at a 15 percent marginal tax rate. A deduction would provide these taxpayers with a subsidy equal to 15 percent of the cost of insurance not covered by an employer. For low- and moderate-income families and individuals without employer-sponsored coverage, a 15 percent subsidy that leaves them with the other 85 percent of the premium cost is much too small a subsidy to make insurance affordable.

  For a family earning $35,000 whose employer does not offer insurance, the proposed deduction would reduce the out-of-pocket cost of a typical family health insurance policy that carries a $1,000 deductible from $6,700 to $5,860 — or from 19 percent of income to 17 percent of income.[9] An Urban Institute study shows that more than three-quarters of low- and moderate-income uninsured individuals will not purchase insurance that

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[8] General Accounting Office, Letter to The Honorable Daniel Patrick Moynihan, June 10, 1998, GAO/HEHS-98-190R, Enclosure II. The analysis is based on the 1996 Current Population Survey.

[9] A General Accounting Office study found that in 1996, the middle of the range of premium costs was $5,700 for a family-coverage policy that included a $1,000 deductible. The proposed tax deduction would provide a subsidy of $840 for the purchase of a policy with a $5,700 premium ($840 equals 15 percent of $5,700). This means the family would have to pay the remaining $4,860, or 14 percent of its income, to purchase the health insurance policy. Since this premium is for a policy with a $1,000 deductible, another three percent of income would have to be expended before any benefits would be available. The family's net expenditure for health coverage — the premium plus the deductible — would total $5,860, or 17 percent of the family's income. Without the proposed tax deduction, the full cost of the policy plus the deductible is equal to 19 percent of the family's income.

consumes more than *five* percent of their income.[10] Few families that have forgone health coverage because they cannot afford to spend 19 percent of income on it would find coverage affordable because a deduction had lowered its cost to 17 percent of income. (By contrast, the child health block grant established in 1997 set a limit on the premiums and co-payments that can be charged under programs that receive block grant funds, with the limit being *five* percent of income for families above 150 percent of the poverty line and lesser amounts for poorer families.)

- This provision might be of modest help to some moderate-income families whose employer pays half or nearly half of the premium costs since the deduction would be in addition to the employer subsidy. But even families whose employers pay 50 percent of the premium would receive only very modest help from the deduction. The deduction would reduce the proportion of the premium that these families have to pay only from 50 percent of the premium to 42.5 percent.

  While that might help some families afford insurance, the number of such families likely would be small. Moreover, the deduction could induce some employers currently paying more than 50 percent of premium costs to scale back their contribution to 50 percent (or possibly less)

- The group that would appear to benefit most from this deduction would be higher-income taxpayers. A health insurance deduction is worth more than twice as much to affluent individuals in the 31 percent, 36 percent, and 39.6 percent brackets than to moderate- and middle-income families in the 15 percent bracket. Although few higher-income individuals and families are uninsured, a significant number do buy insurance on the individual market. Under this provision, these higher-income taxpayers could deduct the cost of the premiums they pay for health insurance coverage they already have.

[10] Leighton Ku, Teresa Coughlin, *The Use of Sliding Scale Premiums in Subsidized Insurance Programs*, Urban Institute, March 1997.

CENTER ON BUDGET AND POLICY PRIORITIES

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Much of the Projected Non-Social Security Surplus Is a Mirage:

Vast Majority of Surplus Rests on Assumptions of Deep Cuts in Domestic Programs that Are Unlikely to Occur

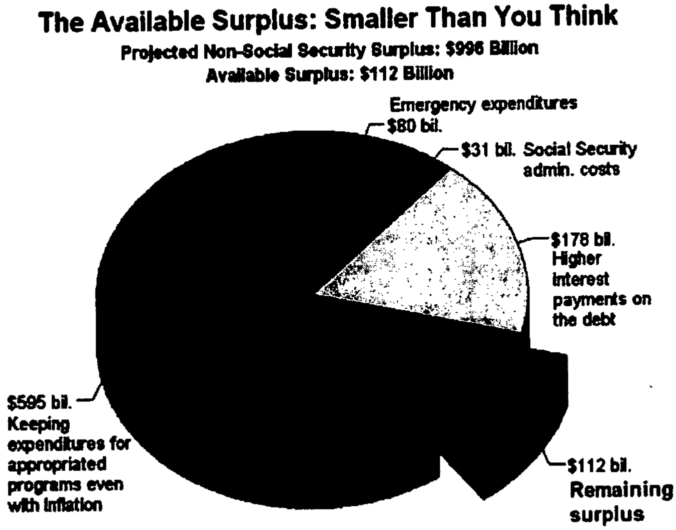
by Sam Elkin and Robert Greenstein

Estimate of Available Surplus Lower than in Earlier Center Analyses

Based on Congressional Budget Office data, this analysis shows that when realistic assumptions are used, the non-Social Security surpluses total only about $112 billion over the next 10 years. Earlier Center versions of this analysis showed modestly larger available surpluses. The revisions in this analysis stem from two factors. First, on July 12, the Congressional Budget Office issued a table that raised CBO's estimate of the portion of the CBO surplus projection that results from the assumption that discretionary spending will be cut. CBO had earlier estimated that $584 billion of the projected surplus was attributable to assuming that non-emergency discretionary spending would be reduced below the FY 1999 level of non-emergency discretionary expenditures, adjusted for inflation. CBO now estimates that $595 billion of the surplus projection is due to this assumption. Second, an earlier Center analysis did not address the assumption in the CBO projections that there would be no emergency expenditures for the next 10 years. This revised Center analysis does address this matter.

Congressional Budget Office figures released July 1 indicate that the large majority of the budget surplus projected outside Social Security is essentially artificial because it depends on unrealistic assumptions that large, unspecified cuts will be made over the next 10 years in appropriated programs and that there will be no emergency expenditures over this period. When the more realistic assumption is made that total non-emergency expenditures for appropriated programs will neither be cut nor increased and will simply stay even with inflation — and that emergency expenditures will continue at their 1991-1998 average level — nearly 90 percent of the projected non-Social Security surplus disappears.(1)

The new CBO projections show that under current law, the federal government will begin running surpluses in the non-Social Security budget in fiscal year 2000 and run cumulative non-Social Security surpluses of $996 billion over the next 10 years. But these projections, like those OMB issued several days earlier, assume that total expenditures for appropriated programs — which include the vast bulk of defense expenditures — will remain within the austere and politically unrealistic "caps" the 1997 budget law set on appropriated programs.(2)



- To remain within the FY 2000 caps will entail cutting appropriated (i.e., discretionary) programs billions of dollars below the FY 1999 level. No one expects this to occur. Leaders of both parties have acknowledged that a number of appropriations bills cannot pass unless the amount of funding provided for the bills is at significantly higher levels than the current caps allow.

- The caps for FY 2001 and 2002 are more unrealistic than the FY 2000 cap; the caps for those years are significantly lower than the FY 2000 cap when inflation is taken into account. Moreover, the CBO and OMB projections assume that for years after 2002, total expenditures for appropriated programs will remain at the level of the severe cap for FY 2002, adjusted only for inflation in years after FY 2002. This means that the surplus projections assume levels of expenditures for appropriated programs for fiscal years 2001 through 2009 that are *lower, when inflation is taken into account, than the highly unrealistic FY 2000 cap that almost certainly will not be met.*

- Also of note, both parties have proposed significant increases in defense spending in coming years. Defense spending constitutes about half of overall expenditures for appropriated programs. In addition, legislation enacted last year requires increases in highway spending in coming years. These factors are further reasons why the caps are unlikely to be sustained.

CBO must base its budget projections on current law. The spending caps on appropriated programs are current law. CBO has acted properly in developing its projections. But policymakers who act as though the $1 trillion in non-Social Security surpluses projected over the next 10 years all represent new funds that can go for tax cuts or program expansions appear to misunderstand the meaning of the projections.

- Because the CBO projections rest on the assumption that expenditures for appropriated programs will be held to the levels of the caps, these projections assume that over the next 10 years, these expenditures will be reduced $595 billion below current (i.e., FY 1999) levels of non-emergency discretionary spending, adjusted for inflation. (The $595 billion figure is found in a CBO table on this matter issued July 12.)

- Since defense spending is widely expected to rise, all of these $595 billion in cuts would have to come from non-defense programs, primarily domestic programs. This would entail reducing overall expenditures for non-defense appropriated programs by 15 percent to 20 percent over the next 10 years, after adjusting for inflation. Since some areas of non-defense spending such as highways are slated to increase, other areas would need to be cut deeper than 15 percent to 20 percent. Achieving cuts of this magnitude in non-defense appropriated programs would be unprecedented.

- Cutting federal expenditures results in lower levels of debt. CBO projects that the $595 billion in reductions in appropriated programs assumed in its baseline would generate $154 billion in additional savings over the next 10 years through lower interest payments on the debt. Consequently, the reductions in appropriated programs that the CBO projections assume result in total savings of $749 billion over the next 10 years.

CBO's Surplus Forecast
How Much Is Really Available for Tax Cuts and Program Expansions?
(in billions of dollars)

CBO projection of non-Social Security surplus over 10 years	**$996**
Amount needed to keep non-emergency spending for appropriated programs even with inflation	-595
Likely emergency expenditures (based on average annual emergency expenditures, FY 1991-1998)	-80
Social Security administrative costs (CBO counts as a Social Security expenditure, but Congress counts as a non-Social Security expenditure)	-31
Higher interest payments on debt due to higher levels of spending for appropriated programs than the CBO projections assume	-178
Remaining surplus available for other uses (if some of this is used for tax cuts or program expansions, interest payments will rise further above the CBO projection, requiring some of the $112 billion to be used for interest costs)	**112**

These $749 billion in assumed savings account for 75 percent — or three-fourths — of the non-Social Security surplus projected over the next 10 years. Since most or all of these cuts are unlikely to materialize, a large majority of the surplus projected in the non-Social Security budget is essentially a mirage.

Emergency Spending

Nor does this represent the full extent to which the CBO projections rest on assumptions that lead to an overstatement of the likely non-Social Security surplus. The CBO projections assume no emergency spending for the next 10 years. There will, of course, be emergencies over the next 10 years that result in government expenditures. There have been emergency expenditures outside the spending caps every year since the Budget Enforcement Act of 1990 established the caps. Hurricanes, tornados, floods, and international emergencies will not magically disappear.

Over the 1990's, emergency funding has averaged $8 billion a year, excluding both emergency expenditures for Desert Storm in the early 1990s and the higher level of emergency spending in fiscal year 1999.[(3)] The most prudent assumption to make is that emergency expenditures will continue to average about $8 billion a year.

This means an additional $80 billion of the projected surplus over the next 10 years is not likely to materialize since it will be used for emergency expenditures. This $80 billion in expenditures will cause interest payments on the debt to be $24 billion higher than the levels the CBO projections assume.

Congressional and Clinton Budgetary Treatment of Spending for Appropriated Programs

The Congressional budget resolution approved earlier this year assumes a very large tax cut of $778 billion over 10 years. The resolution can accommodate a tax cut of this magnitude because it assumes that *none* of the surplus will go to placing spending for appropriated programs at a more realistic level. Moreover, the budget resolution assumes that *additional* cuts in appropriated programs of nearly $200 billion over 10 years will be instituted, *on top of* the already unrealistic reductions assumed in CBO's projections. (These additional reductions would come in years after 2002.) Under the budget resolution, overall expenditures for non-defense appropriated programs would be cut 29 percent between FY 1999 and FY 2009, after adjusting for inflation.

The Clinton budget would add back somewhere in the vicinity of $500 billion over 10 years for appropriated programs, or most of the $595 billion needed to keep non-emergency spending for appropriated programs even with inflation. The Clinton budget only uses $328 billion of the surplus, however, for this purpose. The remaining funds would be raised through a series of offsetting cuts in entitlement programs and tax increases, such as a cigarette tax increase. Many, if not most, of these offsets are given little chance of passage on Capitol Hill. If these offsets are not approved and no funds from the surplus are provided for appropriated programs beyond the $328 billion the Administration has proposed, appropriated programs would have to be cut approximately $270 billion over 10 years below current levels, adjusted for inflation. (To compute the exact amount appropriated programs would have to be reduced under this scenario requires data not yet available on the Administration's new budget plans.) In addition, the Administration's budget does not appear to reserve a portion of the surplus for the emergency expenditures that inevitably will occur.

Another $31 billion also must be subtracted from the projected non-Social Security surplus; it is needed for the administrative costs of operating Social Security. As the Congressional Budget Office explains on page 6 of its new report, CBO counts these $31 billion in costs as a Social Security expenditure, but Congress treats them as part of the non-Social Security budget and counts them against the spending caps on discretionary programs. (The Congressional budget resolutions passed each year include these expenditures as non-Social Security expenditures that affect the size of the non-Social Security surplus. It is the budget resolution, not the CBO projections, that Congressional budget rules enforce.) Counting these costs as part of the non-Social Security budget reduces the non-Social Security surplus.

When this $135 billion — $80 billion for emergency expenditures, $24 billion for related interest payments on the debt, and $31 billion for Social Security administrative costs — is added to the $749 billion described above in expenditures for appropriated programs and related interest payments on the debt, a total of $884 billion — 89 percent of the projected non-Social Security surplus — dries up. Only $112 billion remains. (See table on page 3.) In addition, non-Social Security surpluses of any size do not appear until 2006; the non-Social Security budget either continues to show deficits or is in balance (but without significant surpluses) until that time.

One other caution regarding the surplus projections should be noted. The economic and technical assumptions underlying the forecast could prove too rosy (or not rosy enough). CBO has repeatedly warned that a high degree of uncertainty attaches to budget projections made several years in advance. In a report issued earlier this year, CBO noted that if its projections for fiscal year 2004 prove to miss the mark by the average percentage amount that CBO projections made five years in advance have proved to be off over the past decade, its surplus forecast for 2004 will be off by $250 billion.[4] If economic growth is modestly slower than forecast or health care costs rise substantially faster than is currently projected, budget surpluses could be substantially lower than those reflected in the CBO estimates.

Trends in Discretionary Spending

Expenditures for appropriated (i.e., discretionary) programs are already low in historical terms as a percentage of GDP. There is serious question about how much further they can be expected to decline.

- CBO projects that total discretionary spending will equal 6.5 percent of GDP in fiscal year 1999, the lowest level since at least 1962. (Published data on discretionary spending as a share of GDP only go back to 1962.)

- Much of the decline in discretionary spending as a share of GDP has come in defense spending, which fell following the end of the Cold War. But non-defense discretionary spending also has contracted as a share of GDP. At 3.4 percent of GDP this year and last, non-defense discretionary spending is at as low or lower a share of GDP as in any year since 1962.(5)

- Under the new budget projections, discretionary spending would fall much further as a percentage of GDP. The new CBO projections assume discretionary spending will fall from 6.5 percent of GDP today to 5.0 percent in 2009, a much lower level than in any year in decades.

Discretionary spending may be approaching its limits in terms of how much more it can fall as a share of GDP. That may be one of the lessons both of last year's highway bill and of last October's omnibus appropriations bill, which exceeded the budget limits for discretionary spending and designated the overage as emergency spending.

While non-defense discretionary spending has fallen over the past several decades as a share of GDP, it has not declined in inflation-adjusted terms (although it has declined since 1980 if an adjustment reflecting the increase in the size of the U.S. population is made as well). If we have emerged from a period of deficits without expenditures for non-defense discretionary programs having declined in inflation-adjusted terms, there is little reason to believe the political system will exact deep cuts in this part of the budget when the outlook is sunny, surpluses have emerged, and pent-up demands for various types of discretionary spending are coming to the fore (witness the aviation bill the House recently approved). This underscores the unrealistic nature of the assumptions of substantial reductions in discretionary program expenditures that underlie the projections of $1 trillion non-Social Security surpluses.

How Much of the Surplus Is Available for Tax Cuts, Medicare, and Social Security if More Realistic Assumptions Are Used?

In summary, if more realistic assumptions are used — namely, that total non-emergency expenditures for discretionary programs will remain at the fiscal year 1999 level, adjusted for inflation, and emergency spending will remain at its average level for the recent past — a very different picture emerges of how much in surplus funds is available for tax cuts, shoring up Medicare and Social Security, and other initiatives. Under this more plausible scenario, only about $112 billion remains available, and hardly any of it is available in the next five years.(6)

It may be noted that to assume, as we do here, that total non-emergency expenditures for appropriated programs will be no higher in future years than non-emergency expenditures for such programs in fiscal year 1999, adjusted for inflation, is to use a conservative assumption. It is a foregone conclusion that defense spending will rise faster than inflation. Hence, for *overall* non-emergency expenditures for appropriated programs to remain even with inflation, non-defense programs must be cut in real (i.e., inflation-adjusted) dollars. Yet spending for some non-defense program areas such as highways is already slated to rise. The House recently passed legislation to boost aviation spending as well. Thus, the assumption used here for expenditures for appropriated programs may be too low.

These findings have major implications for policymakers. For there to be sufficient surplus funds to finance the large tax cuts some policymakers advocate, Congress would have to make cuts of unprecedented depth in appropriated programs over the next 10 years — cuts substantially deeper than those policymakers are balking at passing this year.

End Notes:

1. We use the average level of emergency spending in fiscal years 1991 through 1998, other than expenditures for Desert Storm. This also excludes the high level of emergency spending in fiscal year 1999. The term "appropriated programs," as used here, means discretionary programs.

2. Technically, OMB assumes expenditures for discretionary programs that exceed the caps, but it also assumes offsetting reductions in mandatory programs and tax increases.

3. The $8 billion figure represents average funding for emergencies other than Desert Storm for fiscal years 1991 through 1998, as expressed in 1999 dollars.

4. In computing the average percentage amount by which CBO projections made five years in advance have proven to be off, CBO excluded the effects of legislation on deficits or surpluses. The $250 billion figure is based on the average percentage amount by which the budget projections missed the mark due solely to economic and technical factors. See CBO, *The Economic and Budget Outlook: Fiscal Years 2000-2009*, January 1999, p. xxiii.

5. This level also stood at 3.4 percent of GDP in 1962 and 1989. There is no year since 1962 when it was lower than 3.4 percent of GDP.

6. There would be a small non-Social Security surplus in fiscal year 2002.

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TESTIMONY BEFORE THE JOINT ECONOMIC COMMITTEE

By

Wayne D. Angell

September 13, 1999

Mr. Chairman, members of the committee, thank you for the opportunity to testify today on the subject of tax cuts. It is a very welcome opportunity to discuss some of the important economic analytical principles that, I believe, should be used to cast light on the current debate about tax reduction in the context of the Republican plan to cut taxes by $792 billion over the next 10 years. Let me say at the outset that while the plan is far from perfect, it represents a first step toward addressing our most critical problem—the inadequacy of national saving in financing the burgeoning growth of capital spending on which our new era economy depends. Before turning to the critical risk posed by our undersaving problem, I believe it is important to review the performance of the U.S. economy and the favorable economic outlook.

U.S. economic performance and outlook

U.S. economic growth is very strong, core inflation rates are at their lowest levels in over three decades, job creation is robust, unemployment is at a three-decade low, real wages are rising, and the stock market hits new records with remarkable frequency. The current economic expansion is in its 103rd month and is the longest peacetime expansion in the history of the United States. However, the expansion shows no signs of old age. Over the last three-and-a-half years, annualized real GDP growth has averaged 3.9% as measured by the Commerce Department, and there are good reasons to believe that this growth rate is understated. Inflation, however, has fallen on balance over this period to levels that policymakers thought unlikely to occur. Indeed, during the first seven months of 1999—a period during which inflation anxieties have risen in some quarters—the core rate of CPI inflation has been only 1.7%, which is the lowest rate of core inflation over such a period since 1965. The unemployment rate has fallen to a 29-year low of 4.2%. All socioeconomic groups have increasingly felt the fruits of the expansion, although much progress yet needs to be made. This is why I favor policies that will produce the fastest sustainable rate of economic growth.

I believe that this remarkable economic performance is consistent with the view the U.S. economy has entered a New Era. The font of New-Era economic performance is the focus on shareholder value by U.S. companies that has in turn produced a sharp increase in the growth rate of labor productivity. The Federal Reserve and Congress have made important policy choices that have helped bring about this economic transformation of U.S. companies. First and foremost has been the Fed's pursuit of gradual disinflation that appears to have removed from CEOs the notion that they have any pricing power. Second, the administration and congress have, for the most part, been supporters of free trade policies, including the passage of NAFTA. Third, budgetary discipline has freed real resources for private employment and has permitted the emergence of federal government fiscal surpluses, which, up to now, may have contributed to lower borrowing costs. Fourth, the reduction in capital gains tax rates combined with the lower effective tax rate on capital that is a product of the decline in inflation has offset the partial reversal of the 1980s' tax rate reductions by the Bush and Clinton administrations and thereby our economic performance has remained on track.

Perhaps the most important contribution that has been made is the restoration of confidence in the dollar that enabled an emergence of a highly competitive entrepreneurial high-tech economy. The emerging digital economy, so well described in a recent Commerce Department study, has provided CEOs, CFOs, COOs, line managers, and workers with the tools to enhance productivity growth, cut costs, and better address the needs of customers. Over the last three-and-a-half years, nonfinancial corporate productivity growth has averaged 2.9% per year, and, over the last year has run at an even higher rate of 3.8%. This compares very favorably to the 1.5% average growth rate of productivity recorded between the mid-1980s and the mid-1990s. This rapid growth of labor productivity has been made possible by a sharp rise in investment as a share of the overall economy. In real dollar terms, the share of nonresidential fixed investment in GDP has risen to a record-high 13.3% in the second quarter of 1999 from a low of 8.8% at the beginning of the current expansion. Spending on computers has grown rapidly, averaging an annualized growth rate of 50% since the end of 1995.

Our undersaving problem

This remarkable economic performance, however, cannot be taken for granted. We face a persistent and growing mismatch between national saving and gross private domestic investment. Quite simply, our after tax rate of return on savings does not provide sufficient motivation to save annually the $1.5 trillion dollars needed for investment in labor productivity enhancing capital goods. Currently, domestic savings of government, business and households of nearly $1.2 trillion falls about $0.25 trillion short of our demand for capital goods necessitating a foreign inflow of money capital. That means that over the next 10 years we are at risk that our net external obligations of net debt and net external equity obligations nearly double as a percent of $GDP from the current 17% to 30% in 2009 as our net external obligations rise from $1.5 to perhaps $4.3 trillion. In contrast, it is likely that the U. S. debt held by the public to $GDP ratio will decline from the 41% current level to 17% in 2009. And that includes an assumption that the Congress will decrease tax rates sufficiently to hold general government revenues in balance with general government expenditures over the next 10 years.

Social Security trust fund receipts are likely to exceed outlays by about $1.9 trillion over the next ten years. If we were to balance the general government budget on average over the next ten years then U. S. government debt available to be held by the public would be cut in half from $3.8 trillion to $1.9 trillion. That would mean that the debt held by the public to $GDP ratio would have declined from 50% in 1995 to the current 41% and continue to decline to 17% in 2009.

Foreign central bank current holdings of $0.6 trillion and other foreign holdings of U. S. Treasury securities of $0.7 trillion surely would need to rise by at least 50% over the ten year period if we are going to attract capital inflows. And assuming that the Federal Reserve grows its balance sheet of Treasuries at the same 5% growth rate assumed for $GDP there would be no Treasury securities for the private sector. No Treasuries bills, notes and bonds for holding by state and local governments, including pension plans. Likewise there would not be any U. S. savings bonds or Treasuries available for holding by U. S. citizen including all of our private pension plans.

From this perspective it would seem irresponsible to continue to overtax our citizens to pay down the national debt. As the public debt to GDP ratio falls the corporate plus household debt to $GDP ratio will increase, unless we enter a period of credit contraction, and we can expect to continue to see the spread between Treasury securities and corporate securities widen. In principle, there is some level of debt to GDP that is optimal given the preferences of society. Given the high priority use of Treasury securities for the Federal Reserve and for other central banks there is ample reasons to suggest that that optimum ratio should not fall below 25 percent. In addition to central bank functions government debt is demanded by investors and public pension plans managers who require a very safe and highly liquid asset—indeed the concept of a risk-free asset is central to numerous theories of the efficient functioning of financial markets.

Consider, for example, the dollar's central role as the reserve asset of the world. Clearly, such a role has imparted tremendous benefits on the U.S., not the least of which is the seniorage gain from the $487 billion of U.S. currency that circulates, with perhaps at least two-thirds of these greenbacks circulating overseas. In addition, overseas monetary authorities as the major asset in their foreign currency reserves hold $603 billion of U.S. government securities. It is unlikely, in my judgment that foreign monetary authorities would hold anywhere near the amount of dollars that they currently do if there were no safe, liquid asset for them to hold. And as the Federal Reserve succeeds in making the dollar synonymous with price stability and the economy of the United States creates high rates of returns on capital, more countries are likely to consider dollarization, currency boards, or to maintain even higher dollar reserves in floating currency systems.

The Federal Reserve also needs a safe, liquid asset in order to conduct their open market operations. The Fed alters the level of overnight interest rates by buying or selling U.S. Treasury securities. The Fed would face considerable operating difficulties if there were not a liquid Treasury market. Think of the credit assessment signal that could occur if the FOMC were forced to substitute corporate debt for Treasury bills and notes in doing open market operations. Corporate securities in Federal Reserve banks portfolios would necessitate an FOMC credit rating and credit approval. Imagine the banking community and Wall Street ramification of word that X Corporation securities have been removed from the FOMC approval list. Clearly risk free Treasury securities have a decided advantage. Furthermore, the Treasury securities in the Fed's portfolio provide the asset that is used to back the U.S. currency. The Federal Reserve currently owns $486 billion of U.S. Treasury debt. Immediately we see, therefore, that the Federal Reserve and other central banks hold $1.1 trillion of federal debt.

The private sector also has a need for the safety and liquidity of U.S. Treasuries. Private pension companies, state and local pension plans, and insurance companies hold $683 billion of U.S. Treasuries, despite the fact that higher yielding assets, such as corporate bonds and mortgages, are available. It is because of the demand for the perceived safety of Treasuries that the government is able to borrow at lower rates than the private sector. If the private sector views holding some Treasury debt in its portfolio as desirable, it is likely that optimal debt-to-GDP ratio is somewhere between 25% and 40%.

On the other hand, the appetite for government debt is not unlimited. One of the major causes of financial instability and consequent inflation in other parts of the world and at other times has been an unsustainable large government debt, which has ultimately ended in some form of monetization of the debt. In recent experience, the examples of Russia at the present time and Brazil earlier in the decade should serve to illustrate the point. It is possible that Japan is heading in that direction since the debt-to-GDP ratio in Japan moved above 100% at the end of last year.

By international standards, the U.S. debt to GDP ratio is relatively low. The ratio of federal debt held by the public has fallen to 41.1% in the second quarter, which is down sharply from a ratio of 50.1% in 1995. With the federal government projected to run significant surpluses, this ratio is likely to fall sharply over the next decade. Note that at present levels of growth (I assume 5% nominal GDP growth) and federal debt, the debt will decline as a share of GDP as long as the deficit is below 2% of GDP. Note also that if the federal budget is just kept in balance, the debt to GDP ratio will fall to 17% by the end of the next decade, which is lower than the debt to GDP ratio has reached in the post was period. If, in addition to a $1.9 trillion buy down by the social security trust funds, a general government surplus were to run at 1% of GDP, federal debt would fall to less than 10% of GDP by the end of the next decade.

Compare this level of debt to European debt levels. In Germany, the debt to GDP ratio was about 63% last year. In France, the ratio was about 59%. In Italy, about 119%. And in the UK, the ratio was about 53%. By G-7 standards, therefore, US debt is low in relation to GDP. Why should we postpone reducing taxes to push the federal debt to levels that we have seen in the post war period or across other G-7 countries?

Tax policy and the saving rate

Some prefer to keep marginal tax rates high in order to pay down the national debt in order to foster a low interest rate environment. Surely, it is not hard to understand that with a continued shortfall in national saving as compared to our investment demand it is likely that interest rates will remain high enough to continue to attract money capital inflows from abroad. Consequently, there is little likelihood that interest rates can come down and some risk that rates will increase. Until we alter our tax disincentives to saving, interest rates will necessarily be high enough to offset the tax rate or to attract additional money capital from abroad.

The only way to get our economy back onto a path to lower interest rates is to alter the after tax rate of returns on savings. That is why I have supported a radical switch from an income tax to a consumer spending tax. But, that is not the choice that we have today. Our choice today is to take the first step toward a reduction in marginal tax rates that will improve expectations for lower taxes on saving in the future.

The proposed $792 billion tax cut over 10 years amounts to less than $80 billion per year. Assuming 5% nominal GDP growth, the average annual level of GDP over the next decade would be almost $12 trillion per year. The GOP tax cut proposal represents, therefore, a very modest two-thirds of a percent of GDP.

From one perspective it may seem too low to make much difference. Yet, we should know that failure to take this small step would likely lead us to a legislative atmosphere of spending the money and thereby losing momentum for economic growth. In order to continue the surge in non-residential capital spending which is essential in order to continue to increase labor productivity, we have to be very Spartan in our use of our labor and capital to produce public services. And this tax cut proposal that includes marginal tax rate reductions, a reduction in the capital gains tax rate, and reductions in death taxes does go several small steps in the direction of increasing our saving rate.

Once again, I want to reiterate that our fabulous new era economy is essentially driven by the surge in non-residential capital spending from 9% of real GDP in 1990 to 13.3% in the second quarter of 1999. High technology capital spending is the source of the growth of non-financial corporate productivity to 2.9%. Yet national saving lags far behind and is growing at the same rate as $GDP—just over 5%. Meanwhile capital investment is growing at a 9% annual rate. The shortfall in saving is large as a percent of $GDP and getting larger. That means that the annual deficit in our external sector is getting larger and that our net external obligations as a percent of $GDP are likely to rise from the current ratio of 17% to 30% in 2009 or in dollars from $1.5 to $4.3 trillion. At some point we run the risk that foreign investors and central banks will want higher interest rates to compensate them for the risk of dollar devaluation.

Up to now in its conduct of monetary policy the Federal Reserve has been free to focus almost exclusively on price stability conditions in our domestic economy. If we fail to make savings more attractive by reducing the tax disincentive to saving then Federal Reserve monetary policy considerations may increasingly be at risk as to the willingness of foreign investors and central banks to hold dollars in either Treasury or corporate securities. Think of the ramifications of a downturn in bond prices and a downturn in equity prices generated by a declining dollar or vice versa. Our economy is not immune from changes in foreign assessment if we continue a tax system that damages our incentive to save. It is time to begin. Let's not risk waiting until we have a crisis.

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TRANSFORMING IRAQ'S ECONOMY

HEARING

before the

JOINT ECONOMIC COMMITTEE
CONGRESS OF THE UNITED STATES

ONE HUNDRED EIGHTH CONGRESS

FIRST SESSION

June 11, 2003

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SUBMISSIONS FOR THE RECORD

Transforming Iraq's Economy

Wednesday, June 11, 2003

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

The Committee met, pursuant to notice, at 9:30 p.m., in Room 628, Dirksen Senate Office Building, the Honorable Robert F. Bennett, Chairman of the Committee, presiding.

Present: Senators Bennett, Sununu; Representatives Stark, Saxton, Maloney, English, Paul, Hill.

Staff Present: Donald Marron, Ike Brannon, Jeff Wrase, Chris Frenze, Robert Keleher, Brian Higginbotham, Kurt Schuler, Colleen Healy, Melissa Barnson, Gary Blank, Wendell Primus, Chad Stone, Rachel Klastorin, Nan Gibson.

OPENING STATEMENT OF SENATOR ROBERT F. BENNETT, CHAIRMAN

Senator Bennett. The Committee will come to order.

I have a prepared opening statement which has been distributed, and I don't back away from it. But I am going to deviate from it a little in the actual remarks that I make to kick off the hearing, because I think the best demonstration of the atmosphere in which this hearing is being held comes from this morning's papers.

Here is *The Washington Post* and its cover picture. And it says:

"In Holy City, Things Are Going Right. U.S. Forces and Iraqis Work Together In Shiite Stronghold of Karbala."

The New York Times, however, says: "G.I.s In Iraqi City Are Stalked By Faceless Enemies At Night."

And the lead says: "Since the American command quadrupled in military presence here last week, not a day has gone by without troops weathering an ambush, a rocket-propelled grenade attack, an assault with automatic weapons, or a mine blast."

Reminiscent of the war, when we won it on Fox, but lost it on CNN.

(Laughter.)

There is a constant sense of instant conclusion that goes on in the media. We must know, pre-season, who is going to win the World Series. We must know, pre-season, which two teams are going to go to the Super Bowl and which one is going to win.

We have national rankings of college basketball teams before the first dribble is ever bounced on a hardwood floor.

And we carry that same sense of determination to announce outcomes immediately over into politics.

So everything is going well in one newspaper, everything is a disaster in another newspaper. We're going to triumph. There is no hope.

Pick your paper. Pick your conclusion.

The purpose of this hearing today is to get above that kind of babble of voices one way or the other and recognize that we will not know whether we have succeeded in establishing a democratic, stable regime in Iraq for a year, two, or even longer.

The implications of that quest, the desire to replace a brutal tyranny and harsh dictatorship with a functioning, stable government ready to join the world and participate as a true partner in the world economic structure, has enormous implications for the United States. It has enormous implications for our economy. But it has even bigger implications for the world at large.

The establishment of a peaceful, stable, and economically-viable Iraq will transform the Middle East if it is successful. If it is not, we will pay a price that is almost incalculable at this point.

So I want to say to everyone who is listening -- I don't think I need to say it to our witnesses who are testifying -- that if you have come here to try to get the latest answer for are we making progress in getting the water turned on? Will the electricity be available by next Friday? Where are we in finding the latest artistic treasure? This is not the hearing for you. This is a hearing to be discussing very long-term prospects and very long-term strategies, to help the Congress and we hope through the Congress, the American people.

And yes, if I may be so bold, to help the Administration to understand some of the strategies that might work, some of the strategies that should be avoided, and overall, the opportunity and challenge that we are presented with.

There's never been a time in history where more is riding on a successful post-war engagement.

Now I say that looking back, that's probably not true if you look at the accomplishments that followed the Second World War. But the Second World War kicked off an entirely different international situation. As we followed the Second World War, we went into the Cold War, where there was a polarization of forces, with the United States and the other countries of the West on one side, the Soviet Union and its satellites on the other. And the successes that were achieved in Japan and South Korea in taking what had not been a democratic society and turning it into a viable, modern state occurred within the framework of the Cold War challenge.

Now we are in a world where there is only one super-power, but there are a multitude of nonstate powers that would seek to destabilize the world through acts of terror. And how things come out in Iraq can have an incredible impact on whether or not we get on top of that new kind of world.

So that's the background against which we meet this morning. Those are the issues that we intend to explore. And we have assembled, I believe, an outstanding panel of experts to help us do that.

Now, with that, we're joined by Mr. Stark, the Ranking Member, and I will yield to him for an opening statement. And I would ask consent of the Committee -- our normal pattern is that we have opening statements only from the Chairman, the Ranking Member, and the Vice Chairman. But I would ask that Ms. Maloney be recognized for a brief opening statement because she has to leave us and wants to be part of this, to the degree that she can.

So if there is no objection, following Mr. Stark, we'll hear from Mr. Saxton and then Ms. Maloney.

[The prepared statement of Senator Bennett appears in the Submissions for the Record on page 43.]

OPENING STATEMENT OF REPRESENTATIVE PETE STARK, RANKING MINORITY MEMBER

Representative Stark. Thank you, Mr. Chairman.

I want to commend you and pay homage to your creativity in holding this hearing at this time. It's an important topic. And it's an important responsibility that the President has put on the shoulders of the American taxpayers -- or should I say, debt-holders, since this Administration doesn't believe in taxes.

As I was pondering my thesis for my doctorate in theology at Bob Jones University, I'm a humanist and therefore, the here-after doesn't mean much to me. I keep looking for heaven on earth.

One of the problems of doing that is that I could never find a place for right-wing Democrats or Republicans, either.

And it came to me as I was reading Hendrik Hertzberg's _New Yorker_ article, which I'd like, Mr. Chairman, to put in the record --

Senator Bennett. Without objection.

Representative Stark. -- that describes Iraq. Why it's a supply-sider's dream.

There are no taxes. There are no environmental regulations to get in the way of you free-enterprises. Why, religion is the government. There's no separation of church and state.

I have never seen a place where a free-market economy is running amuck.

Charlton Heston would love to go there. Everybody's got a gun. He could organize the NRA and be there. Why, the Club for Growth ought to build their national headquarters there.

(Laughter.)

I just think, Mr. Chairman, that this is the nirvana for the supply-siders and the right-wing Republicans.

Now I'm afraid that's not what we're going to hear from our witnesses today. The facts are that Iraq's economy and their civilian society is a mess, and I suspect we have a long and expensive reconstruction ahead of us.

I don't think we should be surprised if the Administration put as much time into preparing for the inevitable problems with the reconstruction process, instead of preparing their public relations campaign to get us to invade and preparing the prime-time movie about Private Jessica Lynch.

Why, maybe we'd have had some ideas. But that's not what happened and we have to pick up the pieces.

So we'll hear some creative ideas from our panel. But I hope they won't lull us into thinking that this is going to be easy. I think it's going to be expensive and long-term, and I hope you'll be very honest with us so that we can be honest with the American public for a change, and tell them what the consequences are, because I'm afraid if we don't change our domestic policy soon, that our next hearing will be on restructuring the American economy.

Thank you, Mr. Chairman, and I look forward to the testimony of our witnesses.

[The prepared statement of Representative Stark appears in the Submissions for the Record on page 45. *New Yorker* article entitled Building Nations, Hendrik Hertzberg submitted by Representative Stark appears in Submissions for the Record on page 46.]

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

Senator Bennett. I was going to Mr. Saxton.

Representative Saxton. She can go if she wants. That's okay.

Senator Bennett. All right. Mr. Saxton yields to you. So go ahead.

OPENING STATEMENT OF REPRESENTATIVE CAROLYN B. MALONEY

Representative Maloney. Thank you so much, Mr. Chairman, and Mr. Saxton.

At this point, I'm supposed to be at Financial Services Committee hearing in which I'm Ranking Member, but I feel that this is a tremendously important hearing and I ask permission to revise and extend my remarks and just briefly say that in this hearing, we will hear several approaches for setting the groundwork for reconstruction.

One issue that I believe should be a significant part of the discussion is debt relief.

As we have seen in post-war Germany, debt relief can be an essential tool in rebuilding a nation destroyed by war and humiliated by its leadership.

We have also seen in recent years that debt relief is an effective development tool that releases funds within a nation that can be used to address poverty and meet essential human needs.

The case for some debt cancellation is even more compelling in Iraq, given that much of the debt can be characterized as odious.

Odious debt is internationally recognized as debt that is taken on by a country for the personal benefit of corrupt leaders or for the oppression of a people.

Clearly, much of the Iraqi debt falls in this category.

To address the issue, this week I will introduce legislation in the House calling for debt relief from Iraq's international debts, including funds it owes the World Bank and IMF.

Who should pay debt that Sadaam owes? How can we ask the people of Iraq who lived in fear of Hussein's secret police to pay back the loans that supported these armed assassins?

You don't have to travel far outside of Baghdad to see a sprawling slum called Sadaam City that houses 2 million Shiite Muslims. The slum is overrun with garbage and children climb the mountain of refuse to look for scraps of food or things that could be traded for food or clothes.

In the face of this poverty, the Iraqi regime spent billions of loaned dollars on palaces and other luxuries. What better way to enhance our efforts at reconstruction and empower the people of Iraq than debt relief?

If Iraq is ever truly to be a peaceful and prosperous democracy, its citizens must be allowed to start anew. 50 years ago, 20 nations led by the U.S., England and France agreed to forgive half of Germany's pre- and post-war debt. The so-called London Agreement proved to be the right course. Debt cancellation for Germany was a very important part of the Marshall Plan, which helped the country become a strong and prosperous democracy post-World War II.

This approach can aid Iraq as well.

In addition to odious and other debt that Iraq owes public and private world creditors, the IMF and World Bank are priority Iraqi creditors. When nations service their external debt, they will pay the IMF and World Bank first.

While estimates of Iraq's debt range from $100 billion to several hundred billion, the combined debt owed the IMF and World Bank is just over $150 million. These institutions have resources to relieve the debt, setting an important precedent for the rest of the world.

For this reason, I will be introducing the Iraqi Freedom From Debt Act, legislation to require the U.S. to negotiate in the IMF, World Bank, and other appropriate multi-lateral development institutions for the IMF and World Bank to relieve the debts owed by Iraq to these institutions.

Furthermore, this legislation includes a "Sense of Congress" that the President should urge France and Russia and all other public and private creditors to relieve the debts owed to them by Iraq.

By taking the lead on debt relief, we have an opportunity to do the right thing for Iraq's economy and to prove to the world that the major reason for war was to benefit the Iraqi people.

And I yield back the balance of my time and I thank you for this consideration and I would hope that you would consider looking at this legislation for the Senate.

[The prepared statement of Representative Maloney appears in the Submissions for the Record on page 49.]

Senator Bennett. Thank you very much. We appreciate your contribution and we will take a look at the legislation when it comes over.

Mr. Saxton?

OPENING STATEMENT OF REPRESENTATIVE JIM SAXTON, VICE CHAIRMAN

Representative Saxton. Thank you. It's a pleasure to join in welcoming the witnesses.

Before Ms. Maloney departs the room, I think her position and mine are fairly close on Iraqi debt. In fact, last week I introduced a bill which is H.R. 2338, which sounds very close to what you have just outlined and I'm going to speak a little bit more about that.

So I look forward to working with you.

Representative Maloney. I wish I could stay, but I must go.

Representative Saxton. That's okay. Mr. Chairman, during your opening statement, you referenced the development of a long-range strategy to promote Iraq's economy, which has been sinking for years under the rule of Sadaam Hussein.

I'd like to talk about at least one important piece of what could become that long-term strategy.

The economy in Iraq has for years been doing very poorly. Extensive ownership control and influence of business by the government, its officials, and political cronies undermined economic growth. Iraq's invasion of Kuwait resulted in economic sanctions and the Oil-For-Food Program.

And although the recent war has resulted in some economic damage, Iraq's economic situation today is quite similar in my opinion to the Eastern European countries after the collapse of the Soviet Union.

New institutions are needed that are compatible with a market economy and improved prospects for economic growth. The prospects for Iraq's economic recovery are clouded by an unsustainable debt burden that Ms. Maloney was just referring to.

One of the major challenges to improve the potential of the Iraqi economy is the heavy burden of foreign debt accumulated under the regime of Sadaam Hussein. The hated regime is gone, but the financial legacy should not continue to oppress the Iraqi people, undermining their economic potential.

Forgiving much of Iraq's foreign debt is the right thing to do. But foreign creditors may be hesitant if they anticipate an opportunity for a bail-out indirectly through the IMF or the World Bank.

A write-down of at least part of Iraq's debt would greatly improve Iraq's economic outlook.

Under legislation that I have recently introduced, Iraq's creditors would be encouraged to forgive much of Iraq's outstanding foreign debt rather than to wait for a potential bail-out from the IMF or the World Bank.

This legislation, of which this is a copy, would mandate that safeguards be in place to ensure that lending by these institutions could not be used to repay Iraq's creditors, thus encouraging a more timely write-down of some of Iraq's debt and protecting taxpayer money.

As I have pointed out many times before, the IMF should not be used as a bail-out agency, as this practice creates a potential for mis-use of IMF funds.

Taxpayer money should not be used to bail-out investors of high-risk ventures. There is a role for the IMF and the World Bank in Iraq, but it should be carefully defined to ensure that past mistakes are not repeated.

With adoption of appropriate institutional reforms and market-oriented economic policy, Iraq's people could look forward to a better future.

The IMF and the World Bank can be useful in this regard, but not if the money is to be just funneled through to Iraq's creditors.

Thank you, Mr. Chairman.

[The prepared statement, including H.R. 2338, of Representative Saxton appears in the Submissions for the Record on page 51.]

Senator Bennett. Thank you very much. We'll now go to our panel of witnesses, and I'm quite excited about the witnesses that have agreed to appear today.

I know you would all like to give us something of a seminar, and we would undoubtedly benefit therefrom. But if each witness takes 15 or 20 minutes, we'll be in some trouble time-wise. And we would hope to have some interaction with the witnesses.

Now our normal pattern is five minutes. Some of you may have a little more to say than that, and I'll be a little generous. But if you start tending towards ten minutes, why, I'll begin to tap the gavel and ask you to summarize if you can, so that we can get the kind of interaction that we would hope for from this panel.

Our panelists today are Mr. Basil Al-Rahim, who is of Iraqi heritage. I believe he was born in Iraq. He's an investment banker, founder of the Iraq Foundation.

Mr. Hernando de Soto of the Institute for Liberty and Democracy, a best-selling author and advisor to a wide range of governments.

Dr. David Ellerman. He is an economist, recently retired from the World Bank.

And Dr. Rachel Bronson, who is director of Middle East Studies from the Council on Foreign Relations.

So I think this gives us a wide spectrum of background and understanding and we look forward to hearing from you all.

Mr. Al-Rahim, we will begin with you.

OPENING STATEMENT OF MR. BASIL AL-RAHIM, FOUNDER AND BOARD MEMBER OF THE IRAQ FOUNDATION, MANAGING DIRECTOR OF MERCHANTBRIDGE

Mr. Al-Rahim. Mr. Chairman, thank you very much.

You asked me to speak on transforming the Iraqi economy. It's a huge subject. I'll try to summarize some salient points in five minutes or so.

I apologize that I will miss a lot of the details, obviously.

First, let me say that there are four points to my presentation.

One is that we need a full economic program and it cannot be a haphazard transformation of the economy. The program has to be well thought out, comprehensive, transparent, and elaborated to the public, both here and in Iraq.

I have called this program the Phoenix Plan because rehabilitating Iraq will be like rehabilitating an Olympic athlete that can compete, not rehabilitating a cripple that can, at best, just walk.

The second point is that oil alone is definitely not a panacea. While Iraq has huge reserves, these are underground and don't do the man on the street much good.

The third point is that the solution to transforming the Iraqi economy is empowering the private sector. There is no escaping this.

The fourth point is that the plan must be implemented by an independent commission of technocrats with the ability to fast-track the regulatory approvals necessary to underpin this plan.

Let us remember that Iraq has four very important resources. First is oil, which we all know about. Second, Iraq has water, two major rivers in an otherwise arid part of the world. Iraq has very fertile land and has achieved self-sufficiency in food production in the past, and can do so again.

Fourth, and most important, Iraq has a large technical professional labor force made up of engineers, doctors, lawyers, teachers, et cetera, and it has experienced a very severe brain drain which needs to be reversed.

The economic blueprint that I'm calling the Phoenix Plan is an economic model for Iraq, the region and the future. It will counter the regression that Iraq has gone into back into the 19th century and bring it back into the 21st.

By empowering the private sector and using oil revenue as a catalyst, I believe that this plan can be implemented.

It should have three phases -- an immediate phase, removing bottlenecks in the economy, a medium-term plan, five years, where we detail planned targets, such as production, industry, banking, health, education, with a target GDP per capita of $10,000. And it should have a long-term ten-year objective of a GDP per capita of $20,000, which is where Iraq should be had it grown normally during the last 20 or 30 years of the Baath regime.

The state should act as a facilitator and enabler. Monetary and fiscal policy have to be pro-active to support the plan.

Debt resolution is very important, as Mr. Saxton has mentioned. Debt has to be recognized in three categories -- bona-fide commercial debt, government debt, and war reparations.

Each one needs to be treated entirely separately and absolutely much of it must be forgiven.

The components of the plan fall into a number of sectors. Of course, the oil sectors is the major one. Big oil expertise and capital are definitely needed. However, the Iraqi private sector must be a partner in this exercise.

Though negotiations are difficult, they are between unequal partners. We must get the state out of the oil sector as the experience of the state in oil has been a bane to nations and never a boon.

There is the issue of whether Iraq should stay in OPEC or not, and that has to be thought through very carefully. Iraq has no interest to create price wars in order to obtain market share. But it cannot be tied to rigid allocations that no longer apply.

The downstream sector is also very important. But that also will require additional capital. The downstream sector is valuable not only in job creation, but also in improving the revenue-added value of exports.

The whole issue of privatization has to be explored. There are dangers and advantages to privatization. But this is the way to get what amounts to the majority of the productive assets of the country back into private hands.

There are many challenges, as to how do you value assets fairly at this time? How do you attract foreign investors? How do you achieve broad distribution? How do you avoid the problems that befell eastern Europe when people started out with a voucher and ended up with a bottle of vodka, and that was the extent of their participation in the economy.

Debt forgiveness and rescheduling, as I said, is critical. We see the three categories.

Commercial debt has to be renegotiated. Government debt has to be forgiven because it was extended to the old regime -- as Mrs. Maloney called it, the odious debt. And war reparations have to be recognized because somebody did actually suffer at the end of this adventurism by Sadaam Hussein.

The plan proposes trading some of this debt for a point system that can be then used for concessions, licenses, contracts.

The point system itself would start having a market value and be traded between people who want to buy those points for use in Iraq on their own. Therefore, you don't eliminate the value of those points, but you shift them to the free market.

Attracting foreign direct investment, an aspect of the plan, is critical. And there are very many issues on this. One of the important issues is to avoid economic pillage of the country by foreign investment, which will definitely happen if we are not careful.

Restitution of private property has to be a part of that plan. And that has resulted from the 1963 nationalization and just continued through various waves of government.

Currency stabilization is critical. A new Iraqi dinar pegged to the dollar and the Euro has to be introduced.

The banking sector is very rudimentary. The banking sector is made up of two banks, two government-owned large banks and 18 small private banks.

This must be modernized, upgraded. Joint venture banks have to be attracted to help rebuild the banking sector, which is a critical part of any economy.

Finally, the component of the plan that we can look at is the capital markets themselves. There is something called the Baghdad Stock Exchange. It's been around for many decades. That has to be expanded, deepened and broadened. And that can be done by linking privatization with ESOPs, with IPOs, and with other forms of participation in the public market.

There are three other critical issues and I apologize if I am running over on the time.

First and foremost, critical to this plan is the employment and empowerment of the private sector. The private sector has been reduced to poverty subsistence over the past 20 years. The transition to a free market economy and full membership in WTO, which should be the objective of Iraq, cannot happen overnight because we need to protect the population to make sure not to disenfranchise them from the wealth of the nation.

Vocational training centers have to be set up so that 400,000 soldiers decommissioned from the army can be brought back in a productive manner into the labor force.

We have to avoid the problem of oligarches and cronyism that we've seen in other parts of the world. And these are already beginning to cluster around Iraq.

Vulture regional and international investors are looking very closely at Iraq and these have to be prevented.

Finally, while the WTO has to be the objective, the plan has to recognize how we move to that objective, step by step.

There has been much talk in the press about something called the Iraq Development Fund. We don't know what the mandate of that fund is. We don't know what the governance and oversight of that fund are. And I would suggest that the mandate should be synergistic with the overall plan.

The governance and oversight has to be transitioned to full local authority once a legitimate government is in place.

There are models that we can look at. The Alaska Fund has been mentioned as one model and some aspects of that fund are attractive, not all are relevant.

The Oil For Food Program has been a resounding failure, in my opinion, in the last number of years and should not be followed. But there's also something called the Iraqi Development Board which was set up in the 1950s, which has some very clear attractions because it was able to take part of the oil revenues away from the government budgets completely and use them only for development work. And that's a program that needs to be clearly examined.

We need to deregulate infrastructure, some parts of it fast, and get the states out of there. The fast parts can be transportation, telecom and media. Over the medium-term, the government should get out and deregulate power and water. And it should partially deregulate but stay partially involved in health care and education.

In closing, I would like to say, what is the role of the United States and other players in the transformation of the Iraqi economy?

It is critical that the United States does not abandon its leadership role in Iraq. Iraq needs a strong open-markets patron and partner with a shared vision for its transformation. It cannot become a beacon for the region without U.S. help.

G-8 countries do have a role and should be brought in because they can bring diverse values that can help rebuild the country.

The gulf cooperation countries, Iraq's neighbors, should be encouraged to supplement the limited financial and industrial absorption capacity of their own economies by participating in the Iraqi market.

And finally, in conclusion, I would like to say that the Phoenix Plan requires an independent technocratic commission with the ability to fast-track implementation and regulations.

A healthy economy in Iraq is a prerequisite for a stable democracy and both are mutually reinforcing. The domino effect can happen and we have to be careful which way it tips.

Empowering the private sector is the only solution. Albeit, important, oil is only one part of the equation.

The price of losing the peace is not limited to Iraq or even the region, and time is of the essence.

Thank you very much.

Senator Bennett. Thank you, sir. We appreciate that. Mr. de Soto?

[The prepared statement of Mr. Al-Rahim appears in the Submissions for the Record on page 54.]

OPENING STATEMENT OF MR. HERNANDO DE SOTO, PRESIDENT, INSTITUTE FOR LIBERTY AND DEMOCRACY

Mr. de Soto. Thank you very much, Mr. Chairman, first of all, I would like to tell you how much I appreciate your comments on the fact that so much is at stake in Iraq. All the eyes of the world are on Iraq. And, in effect, if there is not a successful transformation there, that will definitely bolster the arguments of all those people who are already marching on the streets against globalization, against the values of a free market society, and the possibility of creating capital.

And if you aren't able to do it in Iraq, the question then will be -- are all countries made for that kind of freedom? If they're not, obviously it can't even work, even if the foremost power of the world is involved.

So a lot is at stake.

And I think a very important comment was also made by Mr. Saxton, which is that the important thing here is not to repeat mistakes.

And that's why it's very useful to look at history and see where mistakes have been made.

One of the interesting things about listening to Mr. Al-Rahim, both in a conversation previous to this meeting and here, is that what he says about Iraq is well known and is absolutely true.

There is a large technical and professional class in Iraq, and there is an elite, like of course there was in Cuba and there was in my country and there was in Venezuela and there was in Egypt.

Now why did we get off the track 40 years ago, and I think that's important to remember?

We got off the track because the people who could actually participate in a capitalist society, were, nevertheless, an elite, a minority. And when there are minorities, when it's only 20 percent of the population, 30 percent or 15 or 5 percent of the population that is in an elite position to benefit from a capitalist society, it usually becomes what I call mercantilism -- it becomes something that is politically unsustainable.

So if all it is about is restitution, in general, one must be very careful because what it could mean is restituting an elite. And the other people, feeling themselves on the outside, will then go for one of these isms, whether it's called socialism or whatever it is, to go for redistribution because that's the reason that though capitalism has been around for such a long time, it has failed in our countries.

It hasn't redistributed opportunities fast enough.

And that's really the history of the world -- in the United States, Japan, Germany, Switzerland, and France, capitalism came, but with large legal efforts to make sure that everybody could come inside the game.

In countries where there were elites that did not distribute these possibilities, whether it be Russia or any country that was part of the former Soviet Union, the system collapsed, and they will continue to collapse because they're not politically sustainable.

Nobody on the outside, as Marx said, will feel that they're participating. They will feel alienated. And that's how revolutions start, whether there's a Kremlin to organize them, whether Beijing is around to organize them, or whether they're not there.

However, we can learn from not only the bad experiences of history, but also the good experiences of history.

One of them, for example, is your own history in Japan, when the United States won the war against Japan and occupied Japan in 1945. What it did there that was good is useful to remember.

People sometimes forget what state Japan was in during the '30s and the '40s. For us Peruvians, of course, it's relatively easy because we had a president of Japanese origin from the year 1990 to the year 2000, President Fujimori, who was a member of one of the 1-1/2 million Japanese families who migrated to South America in the '30s and the '40s, especially to Peru and Brazil, which were open to Asian migration.

The reason the Fujimoris migrated to Peru, and the reason why the de Sotos did not migrate to Japan, was because our GNP per capita was higher than Japan's -- 20 percent higher in the case of Peru, 40 percent higher in the case of Brazil.

Now that President Fujimori has returned to Japan, he has found a Japan which is now ten times richer than any other Latin American country.

What did Japan do between 1945 and today to become ten times richer than us Latin Americans, who used to receive their migrants because they were poor?

The reply is that they created a capitalist system, but where everybody could participate. That required a plan. And that plan was originally set up by Americans working since 1942 in Honolulu to make sure that the feudal class did not recuperate all its privileges and that property rights were widespread.

As a matter of fact, they were already widespread, but at an extra legal level.

But the legal reforms that took place in Japan between 1946 and 1950 made sure that capitalism was a popular enterprise, the way it is today in the United States, instead of being an oligarchic enterprise, the way it is in most developing countries, and therefore, falters.

The ideas and virtues of your economy and political system have been around for more than 200 years and we've tried to imitate them.

One of the first things I think that should be done is to get the facts. What do you have to do to popularize a capitalist economy to make it democratic?

As you know, some of the work that we're doing in different countries, our think tank which you have so generously supported in the U.S. Congress, includes countries like Egypt, where we've been contracted by the government and the government has made public the numbers I'm going to give, therefore, I'm not breaking anybody's confidence.

Though I know that Egypt is not Iraq, Egypt is not very different from the other Asian and Latin American countries that we've been working in. We have found that in places like Egypt, the extra legal enterprises, small and medium enterprises, run by what are generally poor people, actually represent a large amount of assets.

The problem is their owners don't hold them within the law, and as a result, of course, their assets cannot become fungible or liquid. They cannot become capital.

But what we did find out is that the poor in Egypt own about $245 billion worth of assets only in small enterprises and land and buildings.

How much is $245 billion?

Well, it is 55 times the size of all foreign direct investment. In other words, a lot of the resources that Egypt and Iraq may need to get ahead are already within those countries. Their value is much higher than that of foreign direct investment.

Another interesting fact -- the $245 billion is 50 times greater than all World Bank loans given to Egypt.

So, no matter how much aid you give, public or private, the poor may already be holding their more, albeit, illegally. They can't really get into the official market, the expanded market, and their assets cannot be traded in a way that they can be leveraged and actually create major wealth.

In the case of Mexico, for example -- and by the way, excuse me. One last point.

All the assets of the poor in Egypt are 30 times bigger than the Cairo Stock Exchange.

So it would be interesting to find out, in Iraq, in spite of all the turmoil and all the problems, already the poor have got a stake, and that stake, instead of being withdrawn, should be enhanced.

In the case of Mexico, which is another oil-producing country, it turns out that what the poor have, also outside the law, is about $315 billion worth of assets. And the interesting aspect of it is that, today, Mexico of course produces more oil than Iraq and has been doing so for over ten years.

These assets that belong to the poor are seven times higher than Mexico's known oil reserves.

So the mistake -- the important thing here that you said in your statement is that property rights are crucial. Who gets the property rights? How does the legal system recognize them or not?

Because, in the end, if people see that the law protects their rights and what they have today in assets, and allows them to leverage them, then, of course, the rule of law can come into place because I will understand the rule of law and the measure that protects whatever assets I have, whatever capital I have, no matter how incipient it is.

And the clue to all of that, of course, Mr. Chairman, is inclusion. There are exclusive capitalist systems, what Mr. Al-Rahim called oligarchies and cronyisms, and there are democratic and popular capitalism. And it's very important to ensure that now that the eyes of the world are on Iraq, that that's the kind of capitalism that you get.

[The prepared statement of Mr. de Soto appears in the Submissions for the Record on page 67.]

Senator Bennett. Thank you very much.

Dr. Ellerman?

OPENING STATEMENT OF DAVID P. ELLERMAN, PH.D., AUTHOR AND FORMER ECONOMIST AT THE WORLD BANK

Dr. Ellerman. Thank you, Mr. Chairman. I'm here to speak about some of the lessons learned from the transition economies of the former Soviet Union, in particular.

I think the short story is that the intervention of the international institutions of the World Bank, the Fund (IMF), western academics, the economic profession in the former Soviet Union and the nation-building effort there was a disaster. It was a debacle.

The recently appointed head of the Council of Economic Advisers, Greg Mankiw, from Harvard, just published a piece on this and was a bit agnostic about assigning the blame. But he said, if in fact this shock therapy and the voucher privatization was wrong, then it was a blunder of historic proportions -- one of the biggest blunders in world history.

But he was a little soft on assigning responsibility because it involved a lot of his Harvard colleagues.

So the question is, what do we learn from that? What are the lessons that we can take away from that experience?

One has to go back to the sort of mentality of the intervention. It was one where it was after a revolution; socialism had failed. The west came in with sort of a cold warrior self-righteousness of let's wipe the slate clean of everything from the past. Let's try to start over. Let's try to create a new society, a heaven on earth.

This is something that conservatives know doesn't work. You can't do this overnight. The Jacobins tried this in the French Revolution. The Bolsheviks in the original Russian Revolution. And yet, the United States backed the "market Bolsheviks" that tried to do the shock therapy and tried to do the voucher privatization and created basically a form of chaos in these countries.

What people knew how to do was not supported. They felt helpless. They were disempowered. And in this chaos, the oligarchs and the criminal elements flooded in.

So one of the major lessons in this is to look at it from the point of view of the population. Are the population empowered or are they all tarred with the same brush as if all were stained from the past?

Many of the -- in Eastern Europe, particularly -- the exiles that came back, tried to say that everybody in the country should be disqualified from office, that everybody is communist and so forth. And this aggravates the chaos, makes it much worse.

And so one point here is there needs to be a line drawn so that the people above that line are suspect, but the people below that line, the professional class, the technical class, scientific engineers and so forth, are people that often had to join the party, the communist party in the case of Russia and eastern Europe, the Baath party in Iraq, in order to get the jobs.

If they didn't, then the nomenclature would have gotten the jobs.

So it was something that was done pragmatically. They're not ideologues, and they should be treated as technical people, professional people, and not with prejudice.

So that is certainly one of the lessons.

Secondly, because this is a time-consuming effort to try to make this sort of a transformation, the immediate thing is to try to get some sort of working order restored, not to say, well, we have to restart things only under a new premise.

So this means something like going back to what's the last time things worked. What's the last time that the ministries worked, the last time the industries worked, and try to restore some sort of an order, even though it would not be perfect.

And the thing not to do is, as was recommended to us in Russia, don't try to jump over the chasm in one great leap, that it's better to try to build a bridge over the chasm from the old to the new, even though one foot of that bridge always has to be on the old, and which is maybe distasteful.

But the thing to avoid is to aggravate this feeling of being totally disenfranchised, totally disabled, nothing works any more. Things didn't work well before, but at least I could tinker around and I could get things to work in a haphazard way. But now things don't work at all.

And this will feed into much greater chaos and extremism.

So I want to urge a real pragmatism there and getting away from this sort of self-righteousness of a conquering army that's going to disempower everybody there and try to set up a new regime overnight.

Let's be very pragmatic.

And also, we can talk about privatization and some of the lessons learned there. But certainly, this attempt at voucher privatization, to just try to wipe away everything from the past and start anew with equal rights, sort of like a primitive communism almost, didn't work, and that should not be even contemplated in the future.

There should be a large emphasis on restarting the enterprises that people see in everyday life, which is the small and medium-sized businesses, the retail businesses, the things that affect people's ordinary lives so that they get some sense that they're returning back to a state of normalcy.

And the overall mentality here, we're often told by the Russians that you treat us as if we were a conquered people. And the Iraqi people are in that position.

So I think that we have to be doubly careful in the whole projection of the American intervention there that they are not treated as the objects of benevolence, the objects of charity.

In some sense, the way to put this is to say that we should not give them aid in the sense of trying to do things for them, that we should try to put the tools in their hands and then let them rebuild their own country as much on their own, than us to give out contracts and the like, which would, as it were, do it for them in a great show of American benevolence, which would only preserve them in this position of being powerless and humiliated.

And then one practical point I just wanted to raise which I think is very difficult to judge right now. But the Middle East is the only region of the world that doesn't have a regional development bank. There are development banks for all the other regions of the world.

For obvious political reasons, it's been hard to do that. But if in fact in the future we're looking for some means of extrication, then to have a regional bank that's a cooperative effort of the nations in the region, might as well be something to look at.

And finally, I want to just try to get you to look at the psychology of how this is viewed from the Iraqi people because I think they are in a very ambiguous position right now in their own psychology.

Do they want to make this occupation a success? Or do they not? They all want to rebuild their own country. But they're put in a position where if they cooperate with the occupying power, as in Germany and as in Japan, well, that was 55 years ago and we still have bases in Japan. We still have bases in Germany. And they didn't have oil.

So if you're an Iraqi looking at this situation and say, do I really want this to be a success and still 50 years from now have American bases in the country or not?

And so, the fundamental point has to be to somehow make that political switch so that they're not working to make the American occupation a success, they're working to rebuild their own country for themselves.

And that's very difficult. I can't emphasize enough that that's going to be fundamental to the success of this effort from the point of view of the Iraqi people.

Thank you.

[The prepared statement of Dr. David P. Ellerman appears in the Submissions for the Record on page 73.]

Senator Bennett. Thank you very much. Dr. Bronson?

OPENING STATEMENT OF RACHEL BRONSON, PH.D., OLIN SENIOR FELLOW AND DIRECTOR, MIDDLE EAST PROGRAMS, COUNCIL ON FOREIGN RELATIONS

Dr. Bronson. Mr. Chairman, Mr. Saxton, Mr. Stark, thank you very much for the invitation to speak with you today on transforming Iraq's economy.

I want to make four points. The transition in Iraq towards a successful economy and successful political situation will take time, it will be dangerous and will require our resolve, it will be expensive, but ultimately, it will be worth it.

I want to make sure that we don't leave this hearing thinking that the security situation that, Mr. Chairman, you highlighted by holding up the newspapers, is somehow distinct from the economic transformation of Iraq.

They are indeed linked. It is something that we have learned, case after case, particularly in the Balkans.

We need to focus on the security situation if we want all of our goals for the economic transformation of Iraq to succeed.

We must also remember that this is going to be very time consuming. Secretary of Defense Rumsfeld has pointed out that it took eight years for the United States to move from its period of revolution to a constitution.

In Germany, that experience took four years. And in Germany alone, it required $8 billion, in current dollars, between 1948 and 1952. Germany required a significant American and international security presence to help the Germans rebuild law and order in their society. And it took a lot of attention to the international context to help facilitate that outcome.

So we know from the experience in the United States, we know from the experience in Germany, we know from the experience of the '90s, this takes a long time. It requires international assistance. It requires serious attention to law and order.

I want to focus on law and order because it matters to this Committee, both because it will be very costly to the United States and the lack of attention has already set back Iraq's reconstruction.

Much of the looting and the chaos that we've seen in the streets has largely undone all of the good work military planners who carefully considered what to target and what not to target.

Areas that were originally kept off the target list, have largely been destroyed anyway by the looters and this will make everything more costly.

The lack of law and order also makes it harder for the Iraqis to go back to work. They are afraid to leave their homes because of what might happen to their families and their property.

We have to create a situation where they are more comfortable to go back to work.

Focusing on issues of law and order, goes to the heart of the difference between *The New York Times* and *The Washington Post* stories that the Chairman referred to.

The Washington Post stories are focusing on the slow building back of the basic law and order on the streets, very positive and the Administration can very much take credit for.

But the vacuum that was created in the weeks following the war has allowed Sadaam's security forces, loyalists, those in the Baath Party, to begin reconstituting. They are organized. They do not believe this war is over. And the Iraqi people will find it very difficult to work against them if they are not convinced that Sadaam and his sons are dead or that the security forces do not provide an organized opposition to the United States.

The average Iraqi is waiting to see who is going to win this, and right now for them, the jury is still out.

Law and order will be a very expensive proposition. Before the war, the Council on Foreign Relations, our task force, estimated that, at minimum, 75,000 troops would be needed to secure the peace and cost at least $15 billion a year.

We now know that figure is low. The Administration is on record as saying that 150,000 troops in Iraq are costing about $3 billion a month.

The longer chaos is allowed to reign, the more costly this will be and the more difficult this will be. That is why I want to be sure that we focus on the connection between law and order and economic reconstruction.

But even when we get to reconstruction, even if there had been a seamless transition from our authority back to the Iraqis, this still would have been expensive.

Iraq's reconstruction will not be self-financing. The oil industry is in dire straits.

Before the war, because of sanctions and poor political leadership in Iraq over the last decade plus, Iraq was losing about 100,000 barrels per day annually. We need to staunch the bleeding of Iraq's oil industry before we can even hope to get back to the levels that they were before 1990, 1991, or the heady predictions that were made before the war.

We must remember that before the war, Iraq was bringing in about $10 to $12 billion a year in oil. 70 percent of that was going to the humanitarian needs of the Iraqi people--food and medicine. $3 billion is required to go back into the oil industry just to keep it operating.

We estimated that the reconstruction of the oil facilities to get it back to the 3.2 million barrels per day that it was producing before the war could cost up to $5 billion.

To get its energy sector back up to where it was could cost as much as $20 billion. Iraq was a sophisticated society with a sophisticated infrastructure. It is not like repairing Afghanistan.

There are a number of other things that will be required and some of my fellow panelists, the witnesses here today, have made reference to them, and I will quickly go through them and then leave you.

First, there is a requirement to diversify Iraq's economy. Over 95 percent of its resources come from oil. This was not the case just a few decades ago. But relying on this sole commodity is bad for the Iraqi people and bad for the economy.

It also makes it very difficult to get to any sort of democratic future.

When the leadership owns the major resource, it doesn't depend on the people to participate. And so, we need to think about the transformation of its oil sector and its larger economy if we're trying to reach any different political outcome.

Restructuring Iraq's debt is going to be a massive undertaking and we need to show our own commitment to the process before those around the world are likely to forgive the debt.

And also, we have to support a stable, transparent political order. If we want investment to flow into Iraq or if we want to keep the Iraqi money at home, there has to be something to invest in.

This kind of political order will take time. If we move too quickly, the Balkans show us you get black markets, drug lords, and money-laundering.

The Administration was right to step away from the interim authority and trying to create one too early. But by bringing up the topic of an interim authority so soon after the fall of the Sadaam regime created unnecessary expectations.

The way forward is going to be very difficult in Iraq, but it is well worth doing. Iraq can be a model for the region. I receive calls from those around the region on a regular basis, from our dwindling number of supporters begging us to get this right.

Our supporters out there need a win that they can point to. And right now, their hopes are on Iraq. And I think we should make sure that their hopes are realized.

Thank you very much.

[The prepared statement of Dr. Rachel Bronson appears in the Submissions for the Record on page 78.]

Senator Bennett. Thank you. Thanks to all of you. I think you've given us the provocative insight that we had hoped for.

Now we have some members of the Committee who did not give opening statements. If you would like to stay and question, I will allow members of the Committee who did not give opening statements to question before the others do.

Do you want to take advantage of that?

Representative Hill. I'll take advantage of that.

Senator Bennett. Now, actually, having said that, Mr. Paul was here before you were. So I'd like to go in the order in which they arrived.

Mr. Paul, if you could do the first questioning. Or I'll let you two fight it out.

(Laughter.)

Representative Paul. I'll yield.

Representative Hill. Okay.

Senator Bennett. All right. Mr. Hill?

Representative Hill. Thank you, Mr. Chairman.

I don't know quite what to ask, to be honest with you. This problem -- and it is a problem -- of the state of the Iraqi people and what their future holds is obviously complicated.

I woke up this morning and went jogging with my friends. I knew where my meetings were going to be. I knew where the bathroom was. I knew that I had to go to my ATM machine and get some money.

None of that exists in Iraq.

First of all, when you talk about private property, how does that happen? How do people obtain this property? What mechanism is in place, what system is in place that can create private property rights for the people of Iraq?

Anybody?

Mr. de Soto. Well, I would say that one way of looking at it -- without knowing Iraq but knowing other developing countries and what happens -- is that, probably at this stage, after all the looting, the burning, the squatting that had taken place before the Baathist revolution, the adverse possession stakes, the creation of a large, small and medium enterprise situation, maybe a great popular part of Iraq, is similar to what California was like 150 years ago.

You had 800 mining jurisdictions that are being formed on the basis of squatting. Nobody really knew who owned what or where.

It took you 30 to 40 years to put that all together because most of the property was obtained in an extra legal fashion.

So regardless of what existed before, whatever legal system existed before, you have to think of creating a new legal system to accept all the new stake-holders within the system.

And that's why what I insisted upon before was how important it is to get an inventory of what has actually happened on the ground in Iraq over the last 30 years to find out where there are claims, where there are conflicting claims, to make sure whatever property system is redesigned and put into place, actually serves the majority of people's interests. Otherwise, you won't get the constituency to have a stable economy.

Very different than in the situation, for example, of Germany, because the property rights system or the legal system that defined property rights had already been defined in the 19th century.

So the occupation really didn't involve getting into the thick of that because there was a consensus on property.

In most developing countries, that consensus does not exist. What you will probably find are widespread markets and anarchy regarding the law and therefore, the need to re-adapt whatever law exists to reality.

Representative Hill. Well, I'll go back to something that Dr. Bronson had said, that the people are waiting to see who is going to emerge in leadership positions.

It seems to me that none of that can happen until there is some certainty in Iraq. Is that true or not true? And how long will that take?

What has to be done? What should we be doing?

Mr. de Soto. Well, the first thing that you did in Japan, which was very interesting, or rather, that the Japanese did under Gen. MacArthur's sponsorship, is have an inventory done of what the situation was all about.

It took about two years to put the inventory together.

In other words, underneath the feudal class of Japan there were people who held property, but they were not within the law, or their stakes were not recognized by the law.

It took two years to actually find out who owned what. It's the whole experience you had in all of the west of the United States. There were people that went around and tried to calculate how many trees were felled in Wyoming to create a cabin and then find out those that would be calculated improvements and create a property law that was adequate to it.

Your own Congress passed 32 pre-emption acts, the purpose of which was to violate an existing common law that no longer responded to the situation on the ground.

The first thing you did was an inventory, state by state, and then you put the law together.

Mr. Al-Rahim. Mr. Hill, if I can just jump in.

Iraq today is a lawless country. But this was a country that was well on its way to industrialization in the '50s.

There were extensive land records. There were extensive property-holdings, property rights. And we are not talking about complete breakdown of the system.

Mr. de Soto may be right that we need to take some inventory. But we're not talking about starting from scratch and a complete chaotic situation.

Yes, there has been looting. Yes, there has been squatting. But this comes only in the last couple of months.

The problem of restitution and property rights is really going a little bit further back in terms of what's happened since the nationalization and the waves of socialism that took over.

I don't think it's an insurmountable problem. It's one of the problems and there's a lot of problems that need to be resolved.

Representative Hill. Mr. Chairman, I see that my red light is on. But thank you for the opportunity to ask a few questions.

Senator Bennett. Mr. Paul?

Representative Paul. Thank you, Mr. Chairman.

In the Chairman's opening statement, he mentioned that we could be looking at Iraq either as being half full or half empty.

I tend to think that it probably is half empty, and I sort of identify a lot with Dr. Bronson's concerns about what's going on over there.

The other concern I have is it sounds like we're in the business of nation-building, which is something that a lot of us talked about in the past as not being a very good idea. And it's still very popular for me in my district in Texas to say that we shouldn't be in the business of nation-building, and that usually gets a pretty good response.

So I have a great deal of concern about the cost of this and how well it's going. And I appreciate the testimony of all of you because I think it gives us a lot of insight.

But I do see tremendous problems with this instilling property rights in this country. I think it's so much different than in Japan and Germany. These populations were so much more homogenous compared to what we have in Iraq.

So this tends to make me less pessimistic.

I'm just wondering if any of you have given any consideration to the restoration of private property rights on the original owners and the developers of the oil wells because, in Cuba, we're concerned about that all the time, even though it's been 40 or 50 years. There are still people who have claims about property ownership in Cuba.

And I'm just wondering -- I don't hear much talk about that and it seems like maybe we should give that some consideration.

Also, on the debt elimination, I think it's an academic question. They're not going to pay the debt. And it's always interested me that when we talk about debt repudiation, we always have to talk about an appropriation.

So if they owe us money and we can't pay it, why don't we just write it off the books? It makes me suspect that somebody is going to get paid off that probably really doesn't deserve it, or they should get in line.

So I'm always concerned about appropriating money for debt forgiveness.

But if we did have the restoration or the implementation of private property markets, I think the idea of capital is irrelevant. The money will go there. That's all there is to it. We don't need huge appropriations.

So it is more important that we have the right rules set up, of course, by those who are there.

But my question is a political question in many ways because it seems like it's going to be so difficult. To me it seems like we have three countries over there. Iraq was an artificial country. It was designed by Europeans. It was designed after World War I.

And is it conceivable that even with our occupation and our 150,000 troops, more troops now than we needed to liberate Baghdad. We need more troops and all these billions of dollars.

My question is, how long do you think we can do this? How long will the American people tolerate it? And is it achievable?

Maybe, in reality, if we knew right now it was unachievable because, already, we've had Rumsfeld say that, oh, well, we can't have an outright election because if it goes the wrong way -- and the majority would not vote what we want.

So it may well be that the only solution is going to be probably three different countries there. And maybe we're fighting a losing battle.

And I just wonder if you have some comments, especially how long do you think we can go without having success? I think Mr. de Soto said, we'd better have success and we need to have success.

So I'd like to hear your comments.

Dr. Bronson. Mr. Paul, thank you.

In terms of answering your constituency on nation-building, there's a counter-intuitive aspect to it that makes understandable why everyone is so confused.

The more committed and more present you are up front, the faster we can pull our men and women home. And the reason for that is Iraqis are looking to go back to work. They're looking to go on the streets. They need an authority there and a heavy American presence.

As long as chaos reigns, everything takes longer. Everything is more expensive.

The Administration's recognition that more military police, and more soldiers, were needed is actually a good sign. It bodes well that we may actually be able to pull out earlier because if you allow the sort of chaos because we don't have enough people and commitment there, it makes everything much harder.

Will Iraq break down into three distinct territories?

If we don't stay committed, there is the possibility of it. But I think if you look back to original meetings that the opposition was having in the early 1990s, there was a preference, for instance, in the Kurdish community, their first preference was to have their own independent state. They also recognized that that was unlikely to happen.

The second best alternative is participation in a full and free Iraq.

We need to keep them focused on that, that their first preference is unattainable, but their second preference is truly attainable. And that gets back to some of these economic and political issues we're talking about.

We need to think through how the oil from the north and the south goes back to the central government and then resources go back to the provinces.

As long as you can get that kind of system going where the money goes in and goes back out, you will keep Iraq whole.

But if there is no organization committed to that reality, people will start fighting over keeping that oil in the north and the south and that will be a problem for Iraq.

Representative Paul. You assume that it is crucial that it be kept whole.

Is that correct?

Dr. Bronson. That's right, I do. If it is not kept whole, all of the fears of the critics of this war will come to pass. And that is because if it starts fracturing, you will certainly see Turkey moving in because they will be worried about an independent Kurdistan on its border.

You will see the Iranians much more active than we are seeing now if there is going to be some sort of independent Shia state in the south.

It is crucial to the neighborhood and the United States that Iraq remains whole, but that's good news. There is a shared interest. And it's a second preference of the Iraqis themselves which gives us a good basis for moving forward.

We have to have a centralized authority with some independent autonomy in the provinces that allows them to benefit from that kind of vision.

Representative Paul. Thank you. Other comments?

Mr. de Soto. Yes. The only comment or reference to the issue of property claims, what has happened in many developing countries, practically in all developing countries, and many former Soviet Union countries, over the last 34 years, is that, in some cases, because of natural migrations, in other cases, because dictatorships, also need some kind of legitimacy and they go around redistributing land and redistributing property.

And they've done that and probably, Sadaam Hussein has had to do the whole thing to create legitimacy for his own regime. It is very surprising what you see once the dictator is out.

The first thing that you will have seen is that one person may have owned just one estate. Today, there are 15,000 people living on that estate.

And so, what do you do? Do you just restitute to where you were before? Do you give California back to 15 Mexican families or do you keep the 3 million people with big guns on them?

What do you do?

So what I'm saying that I think is important, and it gives you an idea of the time, is you have to make an inventory of what has happened.

I don't think that even Sadaam Hussein actually knows what was happening underneath his nose. It's a whole social process that's been going into place.

Take Egypt: The logical thing of course would seem restitution. There were rent controls. Property was redistributed at the time of the revolution.

The Egyptians want to welcome investment again. But they find out that it's impossible because the families that will be benefitted are a small minority and those that would be dislodged are the large majority that you need for the rule of law to come into place.

The plan for how you go about this cannot be designed until you have an inventory of who is where, who owns what, and what are the different claims within the land: Then you can start creating the kind of law that peacefully settles those conflicts and allows you to bring in stability.

And that's what you in the U.S. Congress did in your own country 32 times before you created the Homestead Act. There's always people who believe that the Homestead Act started the process whereby a large majority of Americans who had squatted now had a right to property.

It was actually the last of your acts. You had 32 going before, including when President Washington had a third of his farms invaded by what he called the Banditti.

But, first of all, you had to take stock of what had gone on. And in many cases in Iraq, I don't think that anybody really knows what's going on. And the process is going to take time.

Senator Bennett. Mr. English?

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

Starting with Mr. De Soto, given the natural potential of Iraq's mineral wealth, what options would you suggest to maximize the potential of the petroleum industry since we've brought it up, in order to spur investment and growth in the overall economy in Iraq?

And at the same time, how do you utilize that asset without leading to an imbalanced economy, such as you have in Venezuela, where petroleum had become pretty much the only driver in the economy.

Recognizing Mr. Al-Rahim's point that there has been an industrial base in Iraq, how do you use petroleum and at the same time, encourage a movement towards a strong mixed economy?

Mr. de Soto. Thank you for your question, but I'm afraid I know very little about the use of petroleum. I know about successful experiments, your own in the United States in Alaska bringing a wide amount of people to participate in the wealth.

I know what, for example, the Bolivians have done in terms of their gas industry and how they've made all citizens stake-holders. But I know very little about the headlines, sir.

Representative English. Mr. Al-Rahim, would you like to take a whack at that?

Mr. Al-Rahim. Mr. English, thank you.

Obviously, the oil sector is very important. But I see it as important only as a catalyst for the economy.

Just to put it in context, Iraq has 113 billion of proven reserves. The last count or assessment of those reserves is 20 years old.

Assume that if a new assessment is made, the reserves may be as high as three times that.

Putting reserves in the ground, proven reserves, 1-1/2 times those of Saudi Arabia and, in fact, the largest in the world.

However, reserves in the ground is something and oil revenues is something else.

As Dr. Bronson said, it takes about $5 billion to rehabilitate the industry and it will take probably another $30 billion to get up to six million barrels a day, which at that time will give about $35 billion of revenue a year.

You have to get the private sector to participate actively. The oil sector is not just about upstream production, of course. It's a whole world by itself as an industry. And it is a sector that will involve not just oil field services, midstream activities and downstream activities.

The way to do it is to invite foreign participation with special protection clauses because for a country the size of Iraq which today has a GDP of $25 to $35 billion, to negotiate with a company like Exxon-Mobil, which an annual turn-over five times that, this is not a level playing field by any stretch of the imagination.

But you need to attract the major players.

You also need to implement things that you will implement in the privatization program, which is local participation, employee share ownership programs, IPOs, so as to really get that broad wealth distribution out into the country.

But there are a number of methods that you can do this.

Representative English. Very good. Dr. Ellerman, I've been interested in the thrust of your remarks. And you have argued, as I understand it, for an incrementalist approach to building the Iraqi economy based on your experience in Eastern Europe.

Can you offer us what you think would be probably the best example of how that incrementalist approach has been successful in eastern and central Europe since the fall of the Berlin Wall?

Dr. Ellerman. Well, the general idea is to try to take what I would call the de facto property rights that people have -- their capabilities, their skills, what they know how to do, how they know to operate industry, how they know to make things, and so forth -- and try to then, as it were, shrinkwrap the ownership and control structure around that.

So the people who have to show up to work every day to make the thing work, they have to cooperate together, so they have the control in their hands to make it work.

It's very practical, don't try to set up great long chains of authority that has taken us decades and a century to work right.

Try to have something more like local ownership. And the ESOP, the employee stock ownership plan that's been mentioned, is an excellent way to do that.

Representative English. And which country in central and eastern Europe do you feel has most successfully undertaken that approach?

Dr. Ellerman. Well, all the countries use very mixed programs. You've got to almost go program by program.

But in Poland, for example, what they call privatization by liquidation program was a type of lease buy-out. And ESOP is like a lease buy-out, where the ownership goes to the management and the workers in it, but they have to pay it off over time.

So it's like a lease purchase arrangement where the company itself pays it off.

Something like that also happened in Hungary which was very successful. The country that I used to live in and worked in was Slovenia, and it was certainly very successful in Slovenia.

So something like that is a way of empowering people, a way of giving them a stake fairly quickly.

And for your question and for the previous question, this idea of us getting into nation-building, what I keep trying to say is we have to get the reconstruction effort conceptualized as their building their own nation, not as us doing nation-building to them.

And something like the ESOP, something like these programs where people can formalize their property rights and feel that they can then know what they can do, they're empowered to do it, and they can go further, that's the key thing to make it their effort and not ours.

Representative English. Thank you. And I need to head to the House floor, so I thank you, Mr. Chairman.

Senator Bennett. Thank you, sir.

Senator Sununu?

Senator Sununu. Thank you, Mr. Chairman.

Mr. Al-Rahim, you mentioned an organization established in the '50s or '60s you mentioned as a good model, a good structure for coordinating and maybe identifying prospective investment.

What is it about that model or that structure that works from an economic perspective or a cultural perspective?

Mr. Al-Rahim. Mr. Sununu, that was a development board set up in the '50s, independent of the government, staffed by technocrats, where, at the time, this was prior to the revolution, the government decided to allocate 70 percent of oil revenues to this board. And the board also had the benefit of a number of prominent international economists invited to it.

The attraction of that is that the revenues that came to this board were kept out of government budgets, so that people couldn't spill over and start using that money. And that money was really earmarked just purely for development work.

I just mentioned it as one example of something that could be interesting and could work.

Senator Sununu. Was the fact that it kept a large portion of the oil revenues out of the hands of government part of the reason for its success?

Mr. Al-Rahim. Yes, I would say that. You didn't have government overspending spilling onto its budgets because they were kept in completely separate boxes, as it were.

Senator Sununu. Mr. de Soto, you mentioned both Alaska and Bolivia. I'm familiar I think with the structure of the Alaskan trust.

What is the structure of the equity or revenue distribution of the Bolivian gas industry and to what degree has it been successful? And to what degree could it be a model for Iraq?

Mr. de Soto. I'm sorry, I wouldn't have a reply to that question.

Senator Sununu. I'm sorry. You did mention it, though, didn't you?

Mr. de Soto. I mentioned that I knew of the successful experiments, but I know no more than that.

Senator Sununu. Okay. Could you talk a little bit more about the experience with the inventory in Egypt? What's the scope of that effort? Is it nation-wide? Is it a pilot program?

How long has it been going on? When is it expected to be completed?

Mr. de Soto. It's a nation-wide exercise that the Egyptian government is carrying out and in which we are the technical support.

It began when there was a consciousness that may be a great part of their economy was an underground economy or an extra-legal economy. And we were brought in to quantify it, to try to find it to categorize it.

And the results were surprising. That's why I was saying that it would be interesting to also carry out that kind of an exercise in Iraq.

So far, we've reached the point in July that there is a plan now to carry out the reforms. There were two stages. One was the inventory, and then once you had the inventory --

Senator Sununu. The inventory is complete?

Mr. de Soto. The inventory is as complete as you can get it now.

And as I repeat, the interesting thing about the inventory that we found to be the extra-legal economy is actually the largest part of the economy. It is bigger than their oil reserves. It is bigger than all the other industries, as I said before. It's 30 times the size of their own stock exchange and it's about 70 times the size of all the bilateral aid they've received ever.

So these are also like oil resources. They're huge human capital and asset resources that are simply not put within the legal system and therefore, they cannot be mortgaged and therefore they cannot be leveraged and they cannot create the wealth that they can in the United States.

Senator Sununu. Has the package of reforms been proposed and adopted?

Mr. de Soto. The package of reforms is being proposed now. Discussions for adoption will start taking place beginning the month of September.

Senator Sununu. To what extent are you concerned that there may be political forces that work counter to the potential economic benefits here?

We'll leave Egypt out of the discussion. It may or may not fall into this category.

But one might argue that, in some societies, the governing forces have some interest in people holding their land or being allowed to use their land, or being allowed to operate their business to a certain extent at the pleasure of the government.

Property rights that are protected empower individuals, make them less dependent on the whims or the political dispositions of the leadership.

So, to a certain extent, might you be concerned, whether it's an Iraq or anywhere else where these kinds of land reforms are undertaken that the governing forces don't really have an interest in establishing clear, quantifiable and protected individual rights?

Mr. de Soto. Well, sir, in the case of the countries we've been called to, including Egypt, and where we have been paid to carry out these studies, various millions of dollars, I supposed that we've been called in because people have been interested in the reforms.

What always spurs along the reforms is, as I repeat, the inventory.

If as a result of the inventory, for example, in the case of Egypt, as we were talking about, one finds out that 88 percent of businesses function outside the law, and 92 –

Senator Sununu. Leaving Egypt out. In the other case histories that you've looked at, I guess, have you seen this phenomenon or is it just a concern that hasn't been seen in the case studies?

Have you seen the phenomenon where sort of political forces desire to have a system where ownership rights are vague or not easily enforced?

Mr. de Soto. I was coming to that, sir. The thing is that when you are aware, if you're a politician, that in fact you are not governing 88 percent of the people who work in the private sector because they work outside your system, that you really don't know who is living where in 90 percent of your land, you have every political interest for that to change.

I have not found resistance for change coming from somebody saying, well, it's all right. 90 percent can live outside the law. I don't really care if they have property rights or not, because the consequences of not having property rights are not only the fact that you don't get development because credit, investment, is all based on property rights. But it's also that you can't even police these places.

You don't know where Osama bin Laden is hiding because you don't have a system of addresses. You cannot participate in the global economy.

Where the danger comes from, sir, is the following one. It has a lot to do with ideology and with cultural myths.

So let me tell you a little bit just how we work there in two minutes and why we're optimistic about the fact that these changes will be adopted.

For example, Egypt has been trying to pass a mortgage law for many years now and has been unable to because the forces of resistance say, how are you going to have a system whereby people are able to use their homes or their chattel, their goods, their animals, their equipment, to guarantee to secure a credit?

Because credit only functions where people have something to lose. That's what basically creates the trusts and that's what allows you also to enforce noncompliance. And therefore, the idea is you can't impose this on poor people. Therefore, you will not be able to pass a mortgage system.

That has been stopping them for years and years now, if not decades.

What we do is try and look at the dark side of the economy because it actually provides the answers in an unideological form.

So we start asking, for example, how do people in this large extra-legal sector of Egypt, but we could also be talking about Mexico, survive on a day-to-day basis within their small enterprises? Do they get credit?

And the reply is they do.

And the question then is, how is it guaranteed? And it's guaranteed by an instrument which, as a matter of fact, the Arabic culture created 700 years ago, which is the check system. I think it even comes from an Arabic word.

There were Arab checks circulating all the way up to Shanghai 700 years ago.

So the way it would work, sir, is that if you asked me for $12,000, I will say that the guarantee will constitute a check written against your account for that amount.

Excuse me -- not for that amount, but it will be drawn blank.

If you do not pay, I can get you in a month or two in jail because in all these countries, there is debtors jail. And a great amount of the prisoners are people who haven't paid their debts.

So what we do are the statistics, which are the following one:

How many people today of Egyptians actually -- there's no mortgage law, mind you -- but how many people to pay off the debt and not to go to jail, have had to sell their houses?

One point five percent.

How many people have gone to jail and anyhow had to sell their houses?

Another 4.5 percent.

How many people have had to flee the region which they live because they've not been able to pay their debts?

20 percent, and therefore, have had to sell their houses as well.

And then we put it next to, for example, U.S. statistics, that say -- the Fannie Mae statistics that I've got, at least -- only 0.3 percent of Americans lose their homes as a result of the mortgage system.

So then the argument becomes the following one:

Not having a mortgage system violates human rights and property rights much more than having a mortgage system. But the examples that you bring are not the examples from how good this works in the United States because then you get a Samuel Huntington telling you that there's something in the Anglo-Saxon gene that makes it work in the states.

What you do is you compare it to the credit system that already exists for most Egyptians, and in this case, for most Iraqis, show how badly it works, how many more little old ladies actually lose their homes under the lack of the rule of law, and that's how you get your rule of law passed.

Senator Sununu. Thank you. Thank you, Mr. Chairman.

Senator Bennett. Thank you very much.

Let me try to summarize some of this, at least for me.

Mr. Al-Rahim, I'm interested to have you say that, along with oil, Iraq has water and fertile land, as well as a technological and professionally capable labor force.

From the papers, we hear about the oil and we hear about the labor force. But we don't hear that Iraq has fertile land and water.

It would seem to me that that would be an enormously valuable resource in the Middle East, to have fertile land and the water to cultivate it, and that Iraq could not only become self-sufficient in food production for its own population, but begin to export food, if not in the Middle East, down into Africa or other places where food is desperately needed.

What are the chances in your view of that becoming a viable economic opportunity for the Iraqis separate and apart from the oil?

Mr. Al-Rahim. Mr. Bennett, I think it's a very viable opportunity within the context of the plan because Iraq has been self-sufficient in the past.

It doesn't even have to go as far as Africa to export because a lot of the region, for example, the Gulf states, are net importers of food, anyway. So it can just export to its own neighbors.

There are two major rivers in Iraq, the Tigris and the Euphrates. They are large rivers, and provided they don't get subjected to severe damming in the north, in Turkey and Syria, and there's been threats of that, those rivers can support a very large agricultural industry in Iraq.

That industry has not had any modernization brought to it like any other industry for the past 20 years for the reasons we all know.

So I don't think it would be very difficult to reactivate it.

I put in my paper which is now in the record, at some point, we need to re-establish a system of collective co-ops just to have the economies of scale that you need in modern agricultural operations.

But I don't think that that is going to be, again, something that is impossible or every difficult to achieve. I think it's a very viable component of the overall plan.

Senator Bennett. And Mr. de Soto, that clearly would go to the question once again of property rights, of who owns the land that could then be turned into agricultural activity.

Maybe we don't want small farms. Maybe we want more of an agri-business kind of approach. But that means the people who are in the way of an agri-business acquisition of large tracts of land would have to be compensated for moving. They'd have to sell their land the way the small farmer in America sells his land to Archer-Daniels-Midland or whoever, and takes that money and goes off to the city and becomes an entrepreneur in some other kind of circumstance.

So it seems to me that there's a connection between that opportunity. And we should focus on that because we have become so pre-occupied with oil, we should recognize that there are many other opportunities.

I want to come back to you, Dr. Bronson, and a point which was your fourth one which I think has been lost in some of the specifics that we've gotten tied up with here.

When you say this is timely, dangerous, expensive and worth it. And I think we should focus on the worth it.

This is, after all, the Joint Economic Committee. We want to talk about the impact economically on the United States. And let me just philosophize for a minute and then get your reactions, any of you.

Dr. Ellerman, you're in this field as well.

Looking back at the examples that have been talked about here, Japan and Germany at the end of the Second World War, those were enormously expensive operations on the part of the United States of America.

Japan at least dealt with a very, very different culture. The Germans were used to a western style of entrepreneurial activity, the kind that would be compatible with their neighbors. The Japanese were a feudal empire.

Dr. Ellerman, MacArthur kept a bridge on the other side of the chasm. He did not eliminate the emperor. Indeed, when Japan was being bombed, they did not bomb the Imperial palace.

I remember as a businessman driving through the streets of Tokyo with my manager when I owned a business in Japan and looking at all of the buildings, some of which were modern skyscrapers and some of which looked much more traditional.

And I asked, how many of these buildings were built since the Second World War? And the answer was all of them, because every building in Tokyo, with the exception of the Imperial Palace and the Diechi Insurance Company was destroyed by the American bombs.

So MacArthur very wisely kept at least one toe on the old bridge by keeping the emperor in place, but eliminated the system of slavery.

We don't realize that the Japanese had slaves in the 20th century, in the feudal system that they had. The woman who managed my business in Japan was part of the team -- she was a translator for the American occupation forces and was part of the team that went into those areas and told these people, you're now going to have property rights. Told these people, you are no longer slaves.

How long did it take MacArthur to make that transition? Seven years? Five years? Something along that line.

How much did it cost us? I don't know. But it was huge. Dr. Bronson, it was obviously worth it.

Japan, even with its deflation and problems now, is still the second largest national economy in the world, a major trading partner. Most Americans love Japanese cars, if nothing else.

We have created an island of stability and prosperity in a part of the world that desperately needed it. And we have the opportunity to do the same thing here -- create an island of stability and prosperity, property rights, proper kinds of capitalism -- I remember the Russian ambassador saying to me when we were talking about some of their problems, we've had plenty of shock, but damn little therapy.

And you're right. We did not do the Russian thing right, and we need to learn from that and do the Iraqi thing properly.

Am I just a rosy-glasses idealist here who's looking at the best thing? Or is this in fact an enormously valuable opportunity, how difficult and dangerous and expensive and timely it may be?

Is Dr. Bronson really right, everybody, that this is overwhelmingly worth all of the challenge that we need to put into it, and the advantages -- being very selfish -- the advantages to America, to our children, in terms of what could happen out of this, could be as great as the advantages that came to us because our parents did what they did in Japan and Germany at the end of the Second World War?

That's a philosophical question, but I think that's what we really want to deal with in this hearing as a whole.

Responses? Mr. de Soto?

Mr. de Soto. Well, one reply to your question is, regardless of whether that's the way it should have taken place or not taken place, your occupation of Iraq, the fact is that it's done and you're there.

(Laughter.)

And now that you're there, it is an opportunity, not only because, Senator Bennett, it's an island of stability, but it's because these islands of stability are very contagious.

Senator Bennett. Yes.

Mr. de Soto. In the case of China, you didn't get it at the first throw with Chung Kai Chek. But by leaving behind the Brits two ports, with market economies and freedom, at least economic freedom, Singapore and Hong Kong, by allowing widespread property in all of these places, including Japan, what is today South Korea and what is today Taiwan, after 40 years, now the larger continent is also following.

It's very contagious. If it fails, that's also contagious as well. When, for example, you've done similar things in Latin America, but only for the purposes of just occupation, then withdrawing, that has not been contagious at all.

So I do believe, Senator Bennett, that what happens in Iraq since the eyes of the world are upon you, is going to very much determine the future of the whole Middle East, and will bolster the arguments that markets and freedom are something that transcends cultures or, on the contrary, will strengthen the hands of all of those people who say, we're not all built for those kinds of systems.

Senator Bennett. Dr. Bronson?

Dr. Bronson. For the record, let me say that I think that Dr. Bronson is right.

(Laughter.)

It is very important that we get Iraq right. Iraq is in the heart of the Middle East. With all the troubles and problems that we've had since certainly September 11th, with the region, but even before, getting Iraq right is going to be very important to the security of the United States.

We need to remember that, historically, Iraq has played a major role in Middle Eastern and inter-Arab politics. Economically, it has been an engine for the region. And culturally, we often forget this, the universities and the religious establishments of Iraq have shaped the thinking of hundreds of thousands in the region.

This is why many were nervous about us going into Iraq, but this is why it is so essential that we do get it right, because the eyes of the world are on us.

Think about the challenges we're facing in the Balkans, the black markets, the drug lords, all of the problems. Multiply that for Iraq in the region of the Middle East.

It will be catastrophic.

But getting it wrong, as I said in my statement, I have people calling me, begging for us to get this right. Our supporters need a win in this region and we are there -- one of my colleagues has made the point, we are occupiers. We might as well be good occupiers.

There is a lot to be done, but it is do-able and possible. We have to stay committed to it, though. If we don't, it all falls apart.

Senator Bennett. Yes. Getting it wrong -- go to Haiti and see what happens when we come in. It turned out we replaced a brutal dictator, much beloved of American conservatives, with a brutal dictator, much beloved of American liberals. And left. And the people of Haiti are worse off than they were before.

Mr. Al-Rahim, you had a comment.

Mr. Al-Rahim. Mr. Chairman, I have to tell you that I agree, not just fully with Dr. Bronson, but even more than she imagines because Iraq is so geo-politically important. And I'm not talking just about the benefits to the Iraqis.

This country made such a fuss about going into Iraq. The trumpet of changing the face of the region. There's a serious commitment to the world, not just Iraq, that was made about America's intentions, American abilities, and their visions of the future of this whole planet.

I think to get Iraq wrong, if nothing else, is egg on the face of this nation for the next 20, 30 years.

It's not like eastern Europe. When the wall fell down, everybody looked around and said, we won, turned their back and walked away. The western Europeans had to come in because they had to worry about primarily migration problems.

So they stepped in very quickly.

Today, if America does not get Iraq right and Iraq will start the domino effect. The domino effect will start from Iraq under all circumstances. The real question is which way is that domino going to tip?

And if it tips in the wrong way, don't forget Iraq's neighbors are Iran, Turkey, Saudi Arabia, Syria -- Israel is not very far down the road.

It's a volatile region. And if it tips the wrong way, everybody's going to feel it. We're not just talking about the Middle East any more.

And so, I think that's an added incentive of what you just very clearly and eloquently mentioned, that in Japan, you created an island of stability, of growth, of prosperity, as an example, because the tiger nations that eventually emerged in Southeast Asia really followed the example of Japan. That was closer to them.

And you can see that same thing happening again.

I can tell you, it's no secret -- much of the Middle East is still living in the 14th and 15th century, whether it's politically, whether it's systems of ownership, whether it's a feudal mentality, et cetera, et cetera. And that has to change.

The only question is, will that change happen violently and in the wrong direction, or can it happen peacefully by seeing the right example.

And that's one thing that we should all be concerned about.

Senator Bennett. I don't think there's any question but that we are in it for the long haul. We have to stay in it for the long haul. We have to do everything that we possibly can to get it right.

And at the risk of speaking out of school, but the Democrats have all gone --

(Laughter.)

I was at the White House yesterday. And at least based on the President's attitude and comments and general posture, this President is determined to stay however long it takes, spend whatever amount it costs, to see to it that we get it right.

And he is determined that we will not turn and leave, and we will not abandon that which we have begun. I think he understands, Mr. Al-Rahim, exactly what you're saying, that the domino can fall either way. And if it falls the wrong way, that will be a permanent stain on his presidency that George W. Bush is not willing to accept.

So, based on the conversations that we had at the White House yesterday, I think the President would agree with the consensus that has emerged from this panel.

Mr. Paul, do you have any final comments of your own? You've been very faithful all the way through here.

Representative Paul. I have a very brief question, if I may. I would once again like to direct it towards Dr. Bronson, since she's always right.

(Laughter.)

But we're talking about long and costly. Would you be willing to give us an estimate because we have to do some of the budgeting around here, how many troops will we have in Iraq in five years from now?

Dr. Bronson. I think the level of 150,000, where we are now, will be necessary not just for a matter of weeks, but months.

And then the numbers will start to drop after a year or so. But you're not down to this sort of golden number of 30,000 very quickly. It is going to take time and numbers.

To the extent to which we can work with our partners and allies who have constabulary forces and paramilitary forces, the exact kinds of forces that you need, our numbers can drop, because they will both supplement our numbers, but they also have the exact expertise that is needed.

And so, therefore, you can have fewer.

But to the extent to which we have to do this alone, we will be required to stay in there with those numbers because we don't really have that expertise. We have been resistant to nation-build and therefore, haven't built the kinds of forces and troops, security services, that you need.

I don't know the exact number, but I think the notion that we cannot go down below 75,000 probably for a few years. We don't get to that number of 30,000 three to five years, maybe even longer.

Representative Paul. Thank you.

Senator Bennett. Thank you all very much. This has been a most enlightening panel.

The Committee is adjourned.

(Whereupon, at 11:22 a.m., the hearing was adjourned.)

SUBMISSIONS FOR THE RECORD

PREPARED STATEMENT OF SENATOR ROBERT F. BENNETT, CHAIRMAN

Good morning and welcome to today's hearing. Amidst the cacophony of voices in this town talking about our actions in Iraq, let us humbly add our own. Our intent with today's hearing is to push the focus of the debate away from the short-term management of Baghdad and toward the implementation of policies that can ensure a long and prosperous free-market economy in the cradle of civilization.

To be sure, everyone in this room realizes that the current environment in Iraq is frustrating for many of its citizens and needs to be improved upon soon. However, there is little value in debating here how to get the Baghdad electric grid functioning or the resumption of garbage pickup in the country. Able men and women are dedicating themselves to this problem as we speak, under the careful scrutiny of other congressional committees and the ever-watchful gaze of the press.

However, we should not focus on the present to the exclusion of the future, which I submit we are in danger of doing.

Today we ask a fundamental question: what practices and reforms need to be underway in the next two years to ensure a prosperous Iraq in the future?

The only exception to this myopia has been the debate over how to develop and use Iraq's vast oil reserves, and thus far I am not encouraged by its tenor. Various pundits have suggested that the rebuilding of Iraq is as elementary as making a modest investment in oil industry infrastructure and using the proceeds to "pay" for the reconstruction of the economy. This overly-simplistic notion of "letting the oil wealth pay for it" borders on *naiveté*.

Oil wealth, economists tell us, has been more of a curse than a blessing for countries. I suggest with tongue only partly in cheek that the best thing that could happen for the Iraqi economy might be to suspend the production of oil for the next decade. Failing that, we need to think long and hard about how to ensure that natural resource wealth in Iraq is developed efficiently and invested prudently. I trust that our witnesses will address this issue in their testimonies today.

The plight of dealing with Iraq's oil wealth illustrates the essential conundrum of putting a decrepit economy on the path to prosperity. There is no one magical formula that we can employ nor one model we can point to in this task. The United States has a mixed record in the endeavor of rebuilding economies. While we succeeded admirably after World War II in transforming the Japanese and German economies into vibrant and productive markets, our efforts in assisting the former Soviet economies were less than successful. A half-hearted attempt to assist Haiti in the 1990s can be called little else other than an abject failure.

From the missteps in the 1990s economists have learned a number of lessons, the first of which being that it is not enough to mouth the words "free markets" upon entering a country and leave it at that. We now know that formal institutions need to be in place so that property rights are recognized. While a government's role in the market needs to be limited to ensure prosperity, a government must also guarantee the rule of law and efficiently collect the revenues necessary to provide the basic services expected of all governments, such as police protection and transportation infrastructure. It is also beneficial to have an entrepreneurial class in place with the knowledge of what it takes to compete in a free market.

The goal should be to reform Iraq as a beacon for market democracy in the Middle East. Every Arab country possesses some version of the corrosive, quasi-socialistic economies that have failed to materially improve living standards for nigh on two generations.

A prosperous Iraq would give lie to the dubious proposition that Western oppression, combined with geographic circumscriptions and cultural idiosyncrasies, make capitalism and its attendant prosperity untenable. History is not yet over in the Middle East; if we want market democracy to vie with radical theocracies for the hearts and minds of its denizens we need to present them with a model that works in their neighborhood.

I am pleased to have a panel of esteemed witnesses to discuss the nuts and bolts of transforming the Iraqi economy. Our panelists today are Mr. Basil al-Rahim, an investment banker and founder of the Iraq Foundation, Mr. Hernando de Soto of the Institute for Liberty and Democracy, Dr. David Ellerman, an economist recently retired from the World Bank, and Dr. Rachel Bronson, Director of Middle-East Studies from the Council on Foreign Relations. To our witnesses today we say welcome; we look forward to hearing your testimony.

Prepared Statement of Representative Pete Stark, Ranking Minority Member

Thank you, Chairman Bennett. I would like to commend you for holding this hearing on "Transforming Iraq's Economy." It's an important topic, and an important responsibility that President Bush has put on the shoulders of American taxpayers—or maybe I should say debt-holders, since this Administration doesn't believe in taxes. It is clear, instead, that the Bush Administration prefers the easy route of arguing that taxes are an unnecessary burden rather than accepting that taxes are a necessary means to meeting important responsibilities.

As I was thinking about this hearing, I was reminded of an interesting piece in the latest *New Yorker*. The author, Hendrik Hertzberg, observed that in many ways Iraq right now is a conservative's paradise, with limited government, limited regulation, limited gun control, and so forth. I would say, in addition, that if the theories underlying President Bush's economic policies are correct, Iraq should be poised for a robust economic recovery, since there is no meaningful government and no tax burden.

I suspect that this is not the testimony we will hear from our witnesses today. In fact, Iraq's economy and civil society are a mess. And we have a long and expensive reconstruction ahead of us. Should this outcome have been a surprise? Of course not. Should the Administration have put as much time and effort into preparing for the inevitable problems we would face in postwar Iraq as they did into developing an elaborate P.R. campaign to justify the war? Of course. But that is not what happened, and now we have to pick up the pieces.

I am sure we will hear some creative ideas from the economists at this hearing, but I hope they won't try to lull us into thinking that the transformation of Iraq's economy will be a cakewalk, and that all we need to do is set up the right conditions for the free market to flourish. The American public deserves honest answers about the task that lies before us so that we can make wise choices. The Bush Administration does not have a very good record of looking down the road and telling the public about the future consequences of its policies. If that doesn't change soon, we will be having a hearing on "Reconstructing the American Economy."

Thank you Mr. Chairman and I look forward to the testimony of our witnesses.

The New Yorker
June 9, 2003

SECTION: THE TALK OF THE TOWN; Comment; Pg. 39

LENGTH: 1180 words

HEADLINE: BUILDING NATIONS

BYLINE: Hendrik Hertzberg

BODY:
The other day, the *Times* quoted one of that ever-helpful breed, a "senior administration official," as expressing surprise at the horrendous condition of Iraq's "infrastructure," even before the destruction brought about by the war and its aftermath. "From the outside it looked like Baghdad was a city that works," the senior official said. "It isn't."

The quintessential city that works (or, at least, has a cleverly cultivated reputation for being the city that works) is, of course, Chicago. The ward heelers and aldermen of that city understand (or, at least, are celebrated in song and story for understanding) that political power flows not from the barrel of a gun, and not even, necessarily, from the ballot box (whose contents can change in the counting), but from the ability to fix potholes. Garbage that gets collected, buses and trains that take people places, cops that whack bad guys upside the head, taps that yield water when you turn them, lights that go on when you flip the switch, all lubricated by taxes and a bit of honest graft-these are what keep streets calm, voters pacified, and righteous "reformers" out of City Hall.

By Chicago standards, Baghdad, along with almost all the rest of Iraq, is a catastrophe. For that matter, conditions are disastrous even by the looser standards of places like Beirut, Bogota, and Bombay. Reports from the scene are in general agreement on the essentials. Iraq is well rid of the murderous regime of Saddam Hussein. But the blithe assumptions of the Iraq war's Pentagon architects-that a grateful Iraqi nation, with a little help from American know-how and Iraqi oil cash, would quickly pick itself up, dust itself off, and start all over again-are as shattered as the buildings that used to house Saddam's favorite restaurants. In Baghdad, and in many other Iraqi cities and towns, civic society has degenerated into a Hobbesian state of nature. Despite the heroic efforts of a scattered minority of midlevel Iraqi civil servants, the services that make urban life viable are functioning, at best, erratically. More often, they do not function at all. "In the most palpable of ways, the American promise of a new Iraq is floundering on the inability of the American occupiers to provide basic services," the *Times's* Neela Banerjee reported a few days ago. (Perhaps with an eye to educating her White House readers, she added that Baghdad is "about the size of metropolitan Houston.") Telephones are dead. Electricity and running water work, if at all, for only a few hours a day. Because the water pumps are hobbled by power outages, raw sewage is pouring into the Tigris River and is leaking into the fresh-water system, spreading disease and making the city stink. Hospitals that are secure enough to remain open overflow with patients, but they are short of food, medical supplies, and personnel. (Only a fifth of prewar health staffs are showing up for work.) Worst of all is the pervasive, well-founded fear of crime. Armed thugs rule the streets, especially in the pitch-black nights. "Amid such privations," Banerjee writes, "one of the few things that thrives now in Baghdad, at least, is a deepening distrust and anger toward the United States."

It's tempting to suggest that the Bush Administration is failing to provide Iraq with functioning, efficient, reliable public services because it doesn't *believe* in functioning, efficient, reliable public services-doesn't believe that they should exist, and doesn't really believe that they can exist. The reigning ideologues in Washington-not only in the White House but also in the Republican congressional leadership, in the faction that dominates the Supreme Court, and in the conservative press and think tanks-believe in free markets, individual initiative, and private schools and private charity as substitutes for public provision. They believe that the armed individual citizen is the ultimate guarantor of public safety. They do not, at bottom, believe that society, through the mechanisms of democratic government, has a moral obligation to provide care for the sick, food for the hungry, shelter for the homeless, and education for all; and to the extent that they tolerate such activities they do so grudgingly, out of political necessity. They believe that the private sector is sovereign, and that taxes are a species of theft. To paraphrase Proudhon, *les impots, c'est le vol.*

In a way, Iraq has become a theme park of conservative policy nostrums. There are no burdensome government regulations. Health and safety inspectors and environmental busybodies are nowhere to be seen. The Ministry of Finance, Iraq's equivalent of the Internal Revenue Service, is a scorched ruin. Museums and other cultural institutions, having been largely emptied of their contents, no longer have much use for public subsidies. Gun control is being kept within reasonable limits. (Although the occupying authorities are trying to discourage possession of heavy munitions, AK-47s and other assault weapons-guns of the type whose manufacture Tom DeLay and most of the House Republicans plan to re-legalize back home-have been given a pass.) And, in the absence of welfare programs and other free-lunch giveaways, faith-based initiatives are flourishing. The faith in question may be Iranian-style militant Shiism, but at least it's fundamentalist.

The Bush Administration no longer flaunts its contempt for nation-building abroad, but it remains resolutely hostile to nation-building at home. Its domestic policy consists almost solely of a never-ending campaign to reduce the taxes of the very rich. Not all of this largesse will be paid for by loading debt onto future generations. Some of it is being paid for right now, by cuts in public services-cuts that outweigh the spare-change breaks for less affluent families which the Administration, in selling its successive tax elixirs, has had to include in order to suppress the electorate's gag reflex. The pain is especially acute at the state level, where net federal help is in decline. States are cancelling school construction, truncating the academic year, increasing class sizes, and eliminating preschool and after-school programs. Health benefits are being slashed, and a million people will likely lose coverage altogether. In many states, even cops are getting laid off.

As it happens,these are the very kinds of public services that America's proconsuls are promising to bring to Iraq. Of course, being nice to Iraq does not necessarily require the United States to be nice to itself. Nor does denying medicine to kids in Texas require denying it to kids in Baghdad. The connection is more karmic than causal. But it's also political. Whatever one may think of the global democratic-imperial ambitions of the present Administration, they cannot long coexist with the combination of narrow greed and public neglect it thinks sufficient for what it is pleased to call the homeland. At some point-the sooner the better-a critical mass of Americans will notice.

LOAD-DATE: June 9, 2003

PREPARED STATEMENT OF REPRESENTATIVE CAROLYN B. MALONEY

I thank the Chairman and Ranking Member for calling this hearing on the post-war rebuilding of Iraq and its economy. In the aftermath of war, the immediate problems of restoring order and basic infrastructure for the people of Iraq have proven daunting. It seems that every morning the newspapers carry demoralizing stories of the latest attacks on American troops and of growing resentment of U.S. forces by the people. Given this atmosphere in the country it is particularly important for Congress to focus on ways that we can boost the Iraqi economy so the people can see that the U.S. action will have a substantial long-lasting positive impact on their daily lives.

In this hearing, we will hear several approaches for setting the groundwork for reconstruction of the country. One issue that I believe should be a significant part of the discussion is debt relief. As we saw in post-war Germany, debt relief can be an essential tool in rebuilding a nation destroyed by war and humiliated by its leadership. We have also seen in recent years that debt relief is an effective development tool that releases funds within a nation that can be used to address poverty and meet essential human needs.

The case for some debt cancellation is even more compelling in Iraq given that much of the debt can be characterized as odious. Odious debt is internationally recognized as debt that is taken on by a country for the personal benefit of corrupt leaders or for the oppression of a people. Clearly much of the Iraqi debt falls in this category. To address this issue, this week I will introduce legislation in the House calling for debt relief from Iraq's odious debt and relief from the debt Iraq owes the World Bank and IMF.

Who should pay debt that Saddam owes? The dictator who incurred the debts or those he oppressed and brutalized? How can we ask the people of Iraq who lived in fear of Hussein's secret police to pay back the loans that supported these armed assassins?

You don't have to travel far outside of Baghdad to see a sprawling slum called Saddam City that houses two million Shiite Muslims. The slum is over-run with garbage and children climb the mountains of refuse to look for scraps or things that can be traded for food or clothes. In the face of this poverty, the Iraqi regime spent billions of loaned dollars on palaces and other luxuries.

What better way to enhance our efforts at reconstruction and empower the people of Iraq than debt relief? If Iraq is ever truly to be a peaceful and prosperous democracy, its citizens must be allowed to start anew.

Fifty years ago, twenty nations, led by the U.S., England and France, agreed to forgive half of Germany's pre- and post-war debt and to renegotiate the remaining debt at favorable interest rates. The so-called "London Agreement" proved to be the right course, providing a much needed economic and spiritual boost to a country ravaged and humiliated by years of war and defeat. Debt cancellation for Germany was a significant part of the Marshall Plan which helped the country become a strong and prosperous democracy post-World War II. This approach can aid Iraq as well.

In addition to odious and other debt that Iraq owes public and private world creditors, the IMF and World Bank are priority Iraqi creditors. When nations service their external debt they will pay the IMF and the World Bank first- and at any cost. Thus it should be our priority to call on the IMF and the World Bank to relieve Iraq's debt, freeing the people of Iraq from the obligation to pay down debts that we accrued by dictatorial regimes.

While estimates of Iraq's debt range from one hundred billion to several hundred billion, the combined debt owed the IMF and World Bank is just over $150 million. These institutions have the resources to relieve this debt, setting an important precedent for the rest of the world.

For this reason, I am introducing the Iraqi Freedom from Debt Act. This bill will require the U.S. to negotiate in the IMF, World Bank and other appropriate multilateral development institutions for the IMF and World Bank to relieve the debts owed by Iraq to these institutions. Furthermore, this legislation includes a sense of Congress that the President should urge France and Russia and all other public and private creditors to relieve the debts owed to them by Iraq.

By taking the lead on debt relief we have an opportunity to do the right thing for the Iraqi economy and to prove to the world that the major reason for war was to benefit the Iraqi people.

I thank the Chairman and I yield back the balance of my time.

PREPARED STATEMENT OF REPRESENTATIVE JIM SAXTON, VICE CHAIRMAN

It is a pleasure to join in welcoming the witnesses before us today. The economic reconstruction of Iraq poses many policy questions that merit the attention of this Committee.

Iraq's economy had been shrinking for years under the rule of Saddam Hussein. Extensive ownership, control, and influence of business by the government, its officials, and political cronies undermined economic growth. Iraq's invasion of Kuwait resulted in economic sanctions and the oil-for food program. Although the recent war has resulted in some economic damage, Iraq's economic situation today is similar to that of the Eastern European countries after the collapse of the Soviet Union. New institutions are needed that are compatible with a market economy and improved prospects for economic growth.

The prospects for Iraq's economic recovery are clouded by an unsustainable debt burden. One of the major challenges to improving the potential of the Iraqi economy is the heavy burden of foreign debt accumulated under the regime of Saddam Hussein. The hated regime is gone, but its financial legacy should not continue to oppress the Iraqi people, undermining their economic potential.

Forgiving much of Iraq's foreign debt is the right thing to do, but foreign creditors may be hesitant if they anticipate an opportunity for a bailout indirectly through the International Monetary Fund (IMF) or World Bank. A write-down of at least part of Iraq's debt would greatly improve Iraq's economic outlook. Under legislation I have recently introduced, Iraq's creditors would be encouraged to forgive much of Iraq's outstanding foreign debt, rather than wait for a potential bailout from the International Monetary Fund (IMF) or World Bank. This legislation would mandate that safeguards be in place to ensure that lending by these institutions could not be used to repay Iraq's creditors, thus encouraging a more timely write-down of some of Iraq's debt and protecting taxpayer money.

As I have pointed out many times before, the IMF should not be used as a bailout agency, as this practice creates a potential for misuse of IMF funds. Taxpayer money should not be used to bail out investors in high-risk ventures. There is a role for the IMF and World Bank in Iraq, but it should be carefully defined to ensure that past mistakes are not repeated. With adoption of appropriate institutional reforms and market-oriented economic policies, Iraq's people could look forward to a better future.

108TH CONGRESS
1ST SESSION

H. R. 2338

To prevent loans for Iraq from the International Monetary Fund or the International Bank for Reconstruction and Development from being used to pay off Iraq's creditors.

IN THE HOUSE OF REPRESENTATIVES

JUNE 4, 2003

Mr. SAXTON introduced the following bill; which was referred to the Committee on Financial Services

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A BILL

To prevent loans for Iraq from the International Monetary Fund or the International Bank for Reconstruction and Development from being used to pay off Iraq's creditors.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. PREVENTION OF LOANS FROM IRAQ FROM THE INTERNATIONAL MONETARY FUND OR THE INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT FROM BEING USED TO PAY OFF IRAQ'S CREDITORS.

The Bretton Woods Agreements Act (22 U.S.C. 286–286oo) is amended by adding at the end the following:

"SEC. 64. PREVENTION OF INTERNATIONAL MONETARY FUND LOANS FOR IRAQ FROM BEING USED TO PAY OFF IRAQ'S CREDITORS.

"The Secretary of the Treasury shall instruct the United States Executive Director at the Fund and at the Bank to use the voice, vote, and influence of the United States to oppose the making of a loan by the Fund or the Bank, respectively, to the government of Iraq unless the Secretary of the Treasury determines that there are sufficient safeguards in place to prevent the loan proceeds from being used to reimburse persons or governments holding debt arising from credit extended to the government of Iraq, and outstanding as of the date of the enactment of this section, for any losses with respect to the debt.".

PREPARED STATEMENT OF MR. BASIL AL-RAHIM, FOUNDER AND BOARD MEMBER OF THE IRAQ FOUNDATION, MANAGING DIRECTOR OF MERCHANTBRIDGE

I. Intro

Good morning Senators, Congressmen, ladies and gentlemen. First let me thank you for inviting me to speak on this important topic. "Transforming the Iraqi Economy".

The subject is important not only because the fate of a nation and its people located in a supremely geo-strategic and volatile region is at stake, but also because the prestige of this country and its leaders (both administrative and legislative) will be judged in the present and for many years by the outcome and face of the new Iraq.

My career has been spent in commercial and investment banking in the Middle East, the United States and Europe. My sources are publicly available information, what little research that I could get my hands on, interaction with Iraqis both within the country and from the exile community and of course my personal experience and preferences. I have not tried to get the most precise numbers because I do not believe they are available from any definitive source at this time.

While I will attempt to cover a very broad area in my testimony I cannot possibly do it justice in the brief time available. The subject is too large simply because so many things need to be done, but that is also the advantage. We are starting from scratch with a nation anxious to get on with it and in possession of the means. If the program is successful it will be akin to the rehabilitation of an Olympic athlete who can compete again, not a cripple who at best will just walk.

To start with I would like to add two important provisos to this presentation. First, that Transforming the Iraqi Economy requires a pre-requisite of civil security; i.e. an efficient police force to maintain basic law and order, plus eventually an army potentially built on the Swiss model of an effective defence force. Second that the economic transformation will be far more achievable if it is led by an independent body, staffed by qualified technocrats combining certain functions of the ministries of Finance, Economy, Trade and Planning, with ability not just to develop and oversee the various programs but also and critically, the ability to fast-track approval of the regulatory framework necessary for the success of such programs.

II. <u>Resources</u>

There are four major resources available to the country that can be immediately recognized:

a. Oil: The last reliable estimate of proven reserves dates back over 20 years and put such reserves at113 billion barrels. This is from a limited number of fields and wells where exploration work has been carried out. More recent and informed guesstimates put the reserves at three times this number and this does not take into account gas reserves. If this is accurate Iraq's reserves are 1.5 times those of Saudi Arabia and represent a significant portion of world reserves. The other very important fact is that Iraqi oil is one of the cheapest in the world in terms of production costs at about the $1 per barrel.

b. Water: Iraq has two major rivers running through it. Assuming historic water rights are respected and these rivers are not subjected to extensive dams in the north this resource is critical in a generally arid part of the world.

c. Fertile Land: In combination with the water, the country can easily achieve self-sufficiency in agricultural products and livestock. Indeed Iraq can again become a net exporter of farm produce given the right circumstances.

d. People: Lastly and perhaps most important the country possesses a large professional and technically competent labour force (doctors, engineers, lawyers, etc.). While this body of people may have gotten rusted over the past 10 years and has certainly been subject to a severe 'brain drain' these factors can both be quickly rectified. It is worth noting that the country had already started its industrialization program as early as the 1950's but hit the progressive calamities of nationalization, Baathism, two decades of war and sanctions. The professional and mercantile classes within the country are eager to update their skills and many of those abroad, the majority of whom are successful in Western countries, are ready to return to help rebuild the country in the right environment.

One of the most critical issues is the ability to quickly address the problem of high unemployment rendered more severe since the de-commissioning of the army. This is an energetic and skilled young labour force that can become a main engine for growth.

III. Economic Blueprint: The Phoenix Plan

Over the past 23 years Iraq has slipped back into the 19th century while the rest of the world has moved on to the 21st. Examples of this economic regression abound, one needs to only look at per capita GDP, telephone penetration rates, internet access or any other plethora of indicators. It is imperative to develop a well thought out and comprehensive economic model for Iraq in which all the parts fit and work together in a synergistic manner.

We must immediately acknowledge two very important factors; first, that no economic rejuvenation and vitalization can happen without empowering the Iraqi private sector, therefore the role of the State has to be that of a facilitator and enabler to create the framework for a new economy. Second, that oil revenues alone are insufficient to lift the economy; the oil sector itself requiring significant investment, and therefore oil revenues are only a catalyst and not a panacea for the solution

The Plan will be implemented in three phases:

A short-term plan outlining immediate actions that can help to kick-start the economy, remove bottlenecks, clarify the regulatory environment, encourage the return of exile skills and attract foreign direct investment.

A medium-term five-year plan detailing expectations for each sector of the economy has to be clearly spelled out setting forth production levels, capacity, consumption and penetration rates as well as health coverage and education. Target GDP per capita should be about $10,000 (in 1979 it was about $7,140) enabling a phasing-in of open markets.

A long-term ten-year plan with per-capita GDP objectives of about $20,000 must be targeted, with a deregulated economy and full access to WTO.

Fiscal policy and monetary policy have to be designed to act in a supportive manner to achieve the desired objectives of the plan in a pro-active not a re-active manner.

Outstanding debt has to be broken down into its three categories, bona-fide commercial debt, government debt incurred by the Baath regime, and war reparations resulting from Saddam's adventurism. Each category has to be resolved in the corresponding manner.

IV. Components of the Phoenix Plan

A number of sectors have to be specifically addressed in the plan and are set out below. Due to the scope of this testimony only the most critical aspects of each are elaborated. Countless other details are important and their omission is not intended to downplay them but rather an admission of the complexity of each and the need for specialist experts. However, the following are the over-riding issues:

A. The Oil Sector:

The conventional wisdom holds that Iraq's rejuvenation program will be largely taken care of by the country's abundant reserves. While reserves may be plentiful, oil in the ground means nothing in the circumstances. Prior to the recent war Iraq produced 2.8 mbpd, with annual revenues of about $17 billion (about one or two month's turn-over for General Electric or Exxon-Mobil). It is estimated that up to $5 billion will be needed to restore this production capacity in the short term and up to $30 billion will be needed over the next five years to produce 6.0 mbpd. At that production level (in five or so years) and using the Shell Oil long-term projections for prices at $15 per barrel Iraq's revenues could be about $35 billion at the time. Given the overall needs and condition of the country and the size of the population it becomes very quickly clear that oil alone is not the solution.

Evidently Big Oil expertise and capital is necessary. Production Sharing Agreements may be appropriate but how those are structured and worded is critical. Experience has shown that oil in the hands of governments is a bane not a boon; however abdicating ownership to foreign interests under any circumstances is unthinkable. The Iraqi private sector itself must be encouraged to become a player and there are a number of methods of achieving this. Negotiating on a level playing field is not easy given the size of the respective negotiators (i.e. Iraq or Iraqi's vs. the oil majors). It is imperative that any agreements keep majority control in the hands of local ownership and fair and equitable exit clauses (put and call options) are available to keep both sides honest and working in the best long-term interest of the economy. While such clauses may not be standard and are novel in this context, they are not unusual in other transactions and can be easily adapted for the purpose.

The matter of whether Iraq should stay in OPEC or not has also been debated. It is obviously not in the country's interest to trigger a price war to achieve a pyrrhic victory. By the same token current quota allocations no longer have relevance in light of current needs and circumstances. A new formula has to be agreed that helps maintain market stability for consumers and viability for producers.

Finally Iraq should move quickly into the downstream sector, which in itself will require additional capital. This will not only benefit the economy directly through expansion and employment but also improve the added value of oil sales. In order to do this, agreements need to be put in place with end-user countries that receive some advantage for opening up their markets and removing trade barriers in advance of full WTO entry by Iraq.

B. Privatisation

It should be recognized that the Baath State, through inherited nationalisation and progressive expropriation, owned about 80% of the productive economic assets of the country. This, of course, must be brought back into the private sector. However, it is easier said than done since after all, this not only represents the wealth of the nation but arguably also the forfeited economic value of a population short-changed for the past three decades by the Baath State and reduced to living on rations. An economic programme must therefore be careful not to be accused of handing the economy over or selling assets too cheaply to a handful of oligarchs and foreign investors as the average Iraqi citizen does not have the means to participate in such programmes. The two problems, that of broad distribution of the wealth (assets) and 'fair' valuation must be solved simultaneously and quickly to get the economy firing on all cylinders and in a long-term socially and politically acceptable manner.

First, addressing fair valuation the problem is:

i) The current condition of the assets is seriously degraded, true both for machinery and equipment that is out of date or poorly maintained (i.e. for hard asset companies), as well as market share that has been lost or is weak (i.e. for service companies);

ii) Country risk as assessed by the major rating agencies will be near the bottom of the ratings;

iii) There is significant competition from a number of countries in the world all vying to attract privatisation money making it very much of a buyers market – witness the failure of both the Egyptian effort over the past six years and the more recent failure of the Saudi gas initiative.

Given the above factors fair valuation means that today 'auctions' will not do the job! Better to develop a programme that values assets progressively over the next few years using a set of pre-agreed benchmarks; e.g. EBITDA, Gross Sales or market share etc. This would give the buyer the assurance of the acquisition through an executed purchase and Sale Agreement, while giving the seller (the government) part of the cash price today and part at a later date when the full value of the asset is more properly measurable. Such Agreements can also incorporate Put and Call options between the parties that further ensure a "fairness" to both sides.

Second, as regards the broad distribution of the assets it is important to learn the lessons of Eastern Europe to avoid the economic disenfranchisement of the lower economic classes (essentially the overwhelming majority of the population in Iraq today) and prevent the emergence of a handful of oligarchs. This can be accomplished both through an extensive system of ESOPs and Trusts. For example, at every privatisation full vesting of any ESOP shares would be gradual, for example start paying dividend but delay conveying ownership (and thus the ability to sell) until full value was better reflected by actual performance and understood by the stakeholder. Alternatively, shares to be distributed to the population may be held by a specially created fund e.g. in the case of capital-intensive industries with small employee numbers. The Fund can then administer the assets until such time as value is realisable and it can find an equitable or attractive distribution strategy not only to the direct employees but also perhaps to a wider base of beneficiaries (e.g. regional or geographic within certain proscribed guidelines).

A. Debt Forgiveness & Re-Scheduling

An important feature of the economic plan is clear and final resolution of the debt issue as it impacts almost all aspects of the program. New lenders need to know what other creditors are owed before extending new facilities. Investors need to understand the solvency status of the country, the local government must properly budget to meet its obligations and individuals must achieve a level of confidence before they start investing or saving.

Bona-fide commercial debt should be re-scheduled in conjunction with the Paris Club. Government debt extended by the old supporters of the Saddam regime must be totally forgiven for obvious reasons. War reparations incurred as a result of Saddam's adventurism must not be allowed to become an albatross around the neck of future generations. Part of such forgiveness can be traded for a points program that the old creditors would receive; these points can then be used (redeemed) to enhance bids for licenses, contracts, concessions or other agreements. As the value of such points becomes recognized a separate market in these points will develop internationally (e.g. amongst the oil companies) thereby creating value to the original holders of these points.

B. Foreign Direct Investment

Funds need to be attracted from a variety of foreign sources, government, private, multi-national and multi-lateral; both commercial profit-motivated and charitable aid-related. If the economic plan is structured correctly the need for aid should be minimal and is better allocated to other countries in serious need. Already foreign investors are lining up at the gates of the Iraqi economy armed with know-how and capital. A proper regulatory framework and a clear path to open markets must be elaborated to encourage the making of such investments in the country. The conventional wisdom is unanimous in its view that if the Iraqi economic experiment is successful, it will result in a major economic boom that can spill over into the whole region.

However by the same token it is critical to avoid economic pillage by foreign investors. It should be recognized that while a lot of emphasis will be placed on the indigenous private sector, it will take some time before the local population is up on its feet and able to participate as an equal partner with foreign players. Here also it is imperative to establish a level playing field that gives breathing room and establishes safeguards for the local population during the first phase (five years) of the Plan.

C. Restitution & Private Property

During the past four decades respect for private property has been virtually non-existent. Starting with the nationalization in the early sixties the situation became progressively worse as the Baath regime could expropriate any property for any value or no value at any time and for any reason. Lack of respect for human life extended indiscriminately to property and ownership.

An independent Property Restitution Authority must be set up to look into all legitimate claims and provide proper compensation or restitution. In this regard the experience of Eastern Europe is valuable and needs to be carefully assessed to provide guidance. In addition to being ethically correct such action will have two added benefits; first, it will go some way towards redistributing assets away from the state and its cronies and second, it will inject a measure of wealth back into the middle class which having been totally dispossessed and decimated, will be able to revive and participate in the economy again. While the work of such an Authority may not be straightforward, nevertheless a concerted and consistent effort has to be made.

F. Currency Stabilization

A stable local currency must be created as an ongoing tool of monetary policy and the creation of credit in the banking sector. The new currency should be pegged to a basket of the US dollar and the Euro reflecting the country's primary import and export position. Such currency stability will not only help the average Iraqi feel secure but also help to allay the concerns of foreign investors. At a later point in time and subject to the building up of adequate reserves the Central Bank may decide on changing the basket mix or free market floatation.

G. The Banking Sector

At present there is no proper banking sector to speak of. There are two large government owned and about twenty minuscule commercial and investment banks. The sector is utterly rudimentary by almost every standard. It is imperative to develop a strong and modern banking infrastructure to support economic growth both at the retail and the corporate level. A vibrant banking sector will accelerate the circulation of money, promote investment and capital expenditure to boost every sector of the economy, encourage consumer spending and saving, and contribute to an active deeper stock market.

Specialized lending such as consumer credit, leasing, mortgage lending, trade finance, agricultural finance and micro lending must be introduced and vigorously promoted. Foreign expertise will also be required in this sector and international banks should be encouraged to participate in a dynamic manner. Here again the participation of the Iraqi private sector must be safeguarded at the initial stage, which can be done by requiring foreign investors to have local partners with a minimum ownership during a pre-agreed initial period. As with other sectors involving large international players, ESOP and/or public listing requirements can be built into the license agreements as a partial means of providing such safeguards.

A. Capital Markets

Underpinning the whole economy a program to re-invigorate the country's stock market is of paramount importance. Such a market already exists but it is small and shallow. An independent regulatory authority is needed to promote and develop this vital aspect of the economy resulting in three main benefits; first, it will allow for a broader participation in economic activity and the resultant distribution of wealth. Second, it will allow for the classic ability of enterprise to raise capital. Third, it can be an efficient tool in the privatisation program, its ESOP features, the listing requirements and put/call options that may be negotiated with large foreign buyers.

The Capital Markets can be brought to a reasonable size fairly quickly if a requirement is imposed on certain large privatisation industries to list within a specific time frame. These industries can include oil, petrochemical, power and telecom as an example. Strict requirements on transparency, disclosure, collusion and insider trading must be put in place to avoid the "oligarch syndrome" experienced in other countries both in the region and internationally.

VIII. Other Critical Issues

In addition to the above a number of other issues have a critical impact on the Phoenix plan, these are:

A. Employment & Empowerment: the Private Sector

The local professional and mercantile segment of the population has been reduced to poverty subsistence over the past 20 years. It is not realistic to expect them to participate in the economic program in any meaningful manner very quickly. This needs to be taken into account during an interim period (the first 5 years) while a reasonable amount of intrinsic wealth, self-confidence and skills are accumulated.

Vocational Training Centres (VTC) need to be established across the country to deliver technical training in a variety of skills with a very heavy emphasis on IT. This will not only help absorb the youth, significantly upgrade the quality of the labour force but also indicate to the population at large the start of new economic horizons. Vocational training will also play a key role in harnessing and re-directing the energy of the recently de-commissioned army, channelling this energy into a productive force in the economy.

Real and effective protections need to be put in place during the first five years of the plan to achieve a proper distribution of wealth to the population at large, limit the emergence of oligarchs and avoid economic pillage by cronies of the old regime and foreign vulture investors. Furthermore, specific provisions and benefits programs need to be introduced that start the process of reversing the "brain drain" and attracting competent professional Iraqi exiles back to the country. One example is that followed in the GCC whereby regulation requires that 51% of any business activity is locally owned.

Furthermore it is not enough to limit control to Iraqi ownership, but in certain cases the identity of the owners must also be vetted. Already dubious characters and vulture investors are beginning to circle. The first category is more dangerous as it comprises many local cronies of the old regime who quietly accumulated large amounts of clandestine wealth in shady deals on their on behalf and on behalf of senior members of the Baath regime. Large and unaccounted for amounts of money held by persons with no discernable business backgrounds or worse still from unsavoury business backgrounds are waiting to transform their liquid assets into legitimate businesses in Iraq. Some of these characters are teaming up with gullible international investors, to gain legitimacy, by selling their supposed access and knowledge of the country. This also must not be allowed to happen. As the international community has cracked down on money laundering activities in other parts of the world, it must remain vigilant that another equally virulent strain of this activity does not happen in Iraq.

B. The Iraq Development Fund

There has been talk in the press of plans to set up an Iraq Development Fund that would receive all the oil revenues and be responsible in a transparent manner for reconstruction expenditure. While this sounds acceptable in theory there are two major questions that have to be answered.

First, what is the mandate of the Fund? If the Fund is just an accounting body, albeit transparent, then that is of very limited use. The Fund if it is to be set up must become a synergistic organ of the overall economic plan. It must work within the parameters and guidelines of the economic blueprint and must have some authority to make decisions not just take instructions to write checks and pay bills.

Second, what is the governance and oversight of the Fund? The Fund must have an un-conflicted and qualified Board with local participation. Such governance should have a phased transition to full local authority over a specific period of time. It is intelligent not to repeat the problems and inefficiencies that plagued the Oil For Food Program partially resulting from the governance of that program.

Finally thought should be given to The Iraq Development Board that was set up in the country in the 1950's, whereby 70% of oil revenues were allocated exclusively, outside of government budgets, to the fund to be expended towards economic development. Such a model or a variation thereof may be very relevant in the present circumstances.

B. Infrastructure De-Regulation

There are certain infrastructure sectors that would benefit from phased de-regulation and expedite the economic revival of the country. These include; power, water, transportation and telecommunications initially, to be followed by other sectors such as education and healthcare. The objective is to either get the state completely out of these sectors, fast (e.g. telecom & transportation), or over the medium term (e.g. power & water), or at least to run in parallel with the private sector (e.g. education & healthcare).

There are a number of well-documented examples one can learn from such as the successful British experience with extensive infrastructure privatisation under Margaret Thatcher; the minimal role of the state from the healthcare system in the USA which is one of the best in the world; and the recent mixed experience with de-regulating the power sector again in the USA.

In the context of de-regulation a separate note must be made of the role of the Media, which in the past was dominated by the Baath state and used solely to serve their purposes. A number of different media outlets have already started springing up, however all controlled by the different political parties. It is important to encourage independent and non-political outlets in radio, television, newspapers and the Internet not just for education and information but also for entertainment and especially for the young.

IX. <u>Role of the USA & other International Players</u>

The US must continue in its leadership role in the reconstruction of Iraq; it is critical not to abdicate it to any other single or multinational authority. This leadership role is important for Iraq but also for the US. From the US perspective what was started must be successfully completed and should not be left half-baked. As the vision for the new Iraq was explained to Iraqis, the region and indeed the world only the US can bring it about. It is no secret that many countries, some overtly and some covertly are looking for the United States to stumble and be ultimately humiliated in the bold and noble initiative it has undertaken to remove tyranny and bring freedom and stability to the "cradle of civilization" and ultimately to the whole region. Only the close and continued involvement of the US can shoulder the burden and transform this vision into reality.

For Iraq this relationship is equally if not more critical. Devastated by a pathological tyrant, war and sanctions; surrounded by hostile and sceptical neighbours, the country must and can rebuild itself into a vibrant free market peaceful economy in record time. For this it needs not only a strong patron, but also one who shares its vision. From a practical perspective this translates to a number working arrangements including assistance in drafting a new constitution to using a number of the regulatory models in transportation, telecommunications, banking, securities and anti-trust laws amongst others. At another level assistance will be required in re-negotiating debt, free trade agreements where applicable, providing loan guarantees in the short term, technology transfer and other tools that will enable the country to leapfrog into the 21st century.

Iraq can be the beacon that transforms the region but will need US help to do so.

Other international countries can and should be given a role in the reconstruction of the country. Most notably other members of the G8 countries can make an important contribution and should be encouraged to come forward. In a similar manner these countries can provide financial resources, technical skills and know-how in areas as diverse as banking to education and oil-field services to water and sanitation.

Members of the Gulf Co-operation Council who share a destiny with Iraq want and should also be encouraged, to participate in the reconstruction effort. Many of the GCC countries have limited absorption capacity in their own economies relative to their wealth and are in a state of both excess financial liquidity and excess capacity in industry and services. A dynamic Iraqi economy will represent an interesting new market and can act as an economic spark to the regional insipid economic environment.

X. Conclusion

1. The Phoenix Plan must be managed by an independent "Commission" combining certain functions of various ministries as Finance, Economy, Planning and Commerce & Trade. The "Commission must be staffed by technocrats and

have the authority to draft regulations that can be fast-tracked for approval.

2. Any acceptable political system (let alone a vibrant democracy as a beacon to the region) will fail if it is not quickly underpinned by a healthy economy; these two are interlinked and mutually reinforcing in both directions.
3. Oil alone is not enough given the scale of the problem. While it is a big help it is definitely not a 'cure-all'. Empowering the private sector in a comprehensive, transparent and publicly elaborated manner is the only solution.
4. The price of 'losing the peace' is not limited to Iraq or even the region. It will stab at the heart of America's leadership in the 21st century and certainly there are a lot of parties, alone and in collusion, waiting to push and twist the dagger. The "Domino Effect" can start in Iraq; better make sure it tips in the right direction.

There is not much time. At most the honeymoon in Iraq (if one could call it that) will last three to six months. Already other suitors (some unsavoury) are making 'courting' noises. A population, long oppressed, having recently found freedom will turn desperate without productive occupation and basic means of earning a livelihood. Immediate gainful employment is of the highest priority.

The Phoenix Plan is a way to get people off the streets and to work, fill their time, minds, stomachs and pockets in a constructive manner and start the "virtuous cycle" of economic growth.

PREPARED STATEMENT OF MR. HERNANDO DE SOTO, PRESIDENT, INSTITUTE FOR LIBERTY AND DEMOCRACY

The Property Challenge in Iraq

After 20 years of experience analyzing the world's property systems, the ILD has found that the property recording organizations in most developing and former communist nations tend to be in decent working order. Like their counterparts in the West, they have departments specializing in surveying, mapping, and digitalization of real estate and business registries. The odds are that up until Operation Desert Storm in 1991 Iraq's property records were also in good condition (at least for Baghdad). Since then, however, these records have probably degraded. And many or most of them, it is now feared, may have been looted and torched after the fall of the Iraqi regime. If so, they will have to be reconstructed —and fast— to help settle real property claims and provide space for displaced persons and returning refugees.

The real problem, however, is that even if that Humpty-Dumpty can be put together again, Iraq's records are still unlikely to reflect the reality of Iraqi property, much less provide authorities with the legal tools to build an inclusive market economy. History has shown us, again and again over the past two centuries, that once an existing authoritarian legal and administrative system breaks down, it is impossible to reconstitute the previous order. What automatically followed the collapse of the age-old patrimonial system, of feudalism, and, more recently, of communism was not a market economy but anarchy and widespread black markets, or another form of authoritarianism to rein in unruly behavior.

In the Ukraine today, for instance, 14 years after the end of communism, 60% of the people operate in the underground economy. Unable to adapt to burgeoning markets and emerging new practices, the Ukrainian system cannot provide affordable and thus enforceable rules, leaving people no alternative but to make their living in the extralegal sector. And while the Egyptians may have invented surveying and mapping 3,000 years ago to calculate and virtually represent boundaries after the Nile overflow, today 90% of Egyptians operate their businesses and hold their assets outside the law. The same kind of underground economic activity is bound to thrive in Iraq, including the transactions taking place in a vast extralegal micro and small enterprise sector that is probably now one of the largest absorbers of unemployed Iraqis, particularly young people.

The consequences for a genuine property system and the future of capital formation in Iraq are profound. A spanking new computerized property database, neat maps, and property claims commissions do no good if the records they contain do not reflect real possessory rights on the ground. And even if Iraq's legal system could be jump-started tomorrow, it is doomed to failure because its laws will not connect to the reality of how most people do business when freed from authoritarianism and will thus be unenforceable.

Throughout the developing and post-communist world, from Russia to Brazil —and now in Iraq— the real challenge of creating a property system is to design it in such a way that the poor and middle class citizens holding extralegal assets will voluntarily register those assets and transactions and bring them under the rule of law of a market economy —not because they are forced to but because they recognize that it is easier and more profitable to comply with the law than to work outside it. Law will have to be redesigned and adapted to the changing needs and expectations of common people no longer controlled by a dictatorship. That is the only way a property system can work in a non-authoritarian country.

Why Property is so Important for Creating the Rule of Law in Iraq

Creating a property system is more than just building a system to record ownership; it is the cornerstone of the rule of law and the market economy. We believe that a property system has to be designed so that it can integrate *all* of a nation's assets and provides the framework of rules that organize the market, the titles and records that identify economic agents, and the contractual mechanisms that allow people to exchange goods and services in the expanded market. It is property law that provides the means to enforce rules and contracts along with the procedures that allow citizens to transform their assets into leverageable capital. Therefore, if the property system is not designed to enable owners to enter into the market economy, property will be reduced to its ownership protection function and the poor, even with titles in hand, will be excluded from the market economy.

That is also why the ILD program to create an inclusive property system is more than just about land. We want everything that people use and possess to come under the rule of law so that everyone is not partly "legal" and partly in the shadows but fully governed by the rule of law. A property system should be able to represent all kinds of assets —not only land, but also businesses, chattel, and whatever other things people own— in standardized and universally accepted records that allow owners to use their belongings and track records to guarantee credit and contracts. We make sure that beneficiaries of property programs are also in a position to access the instruments that store and transfer the value of their assets, such as shares of corporate stock, patent rights, promissory notes, bills of exchange, and bonds. We design the property system so that addresses can be systematically verified, so that assets can be described according to standard business practices, so that people can be made to pay their debts, and so that authors of fraud and losses can be easily identified in a expanded market.

That is how the rule of law begins —with property law that protects what poor people cherish the most and leads them quickly to understand the value of a system of rules that applies to everyone.

What needs to be done before implementing an Inclusive Property System for Iraq

The ILD program rests on a strategy whose objective is not just to consolidate the legal rights of those who had property under the Baath regime or its predecessor but to give all Iraqis the right to have property rights. Bestowing such "meta rights," emancipating people from bad law, and creating an inclusive property system is not about drafting elegant statutes, interconnecting shiny computers, or printing multicolored maps. Iraqis know all about that. What Iraqis need is a property program supported by a well-thought-out political strategy that motivates Iraqi leaders to be deeply committed to putting property and capital in the hands of the whole nation, thus giving citizens the incentives to create the institutions of a democratic and free society which they can use to safeguard and advance their objective interests.

That is exactly what the Western nations did – create legal property systems supported by well-thought-out political strategies. That is, for example, what Thomas Jefferson did in Virginia at the end of the eighteenth century, when he increased the fungibility of property by abolishing, among other things, the practice of entail. Similarly, when Stein and Hardenberg set the stage for universal property rights in Germany at the beginning of the nineteenth century, when Eugen Huber in Switzerland at the beginning of the twentieth century and the Japanese reformers after World War II began to integrating the dispersed property systems of their countries, they too employed carefully planned strategies to storm the barricades of the status quo. They also made sure they were armed with astutely aimed legislation that permitted government to create popularly supported, bloodless revolutions that could not be halted.

That is why the program we propose for Iraq takes the form of a transformation strategy that is based not only on our experience in the field but on the lessons that the ILD has learned from the successful transitions to market systems in the USA, Europe, and Japan during the 19th and 20th centuries.

Before creating a new property system for Iraqi authorities, it is important to get the facts: all extralegal and legal assets must be identified, located, quantified and classified according to the different rules —formal and informal—that govern the right to possession and exchange.

The rule of law can be established only if the new property law: reflects the extralegal customs and practices of the poor and middle classes; and gives them more easily enforceable rights than they can obtain through bribes and protection provided by extralegal organizations.

The program will begin by identifying, locating and classifying extralegal rights over assets, whether they are created by feudal, tribal, refugee, or black market organizations. Such information is an essential prerequisite for writing modern law and shaping recording procedures that will be enforceable and respected in practice.

Simultaneously, we will investigate the current laws and regulations that thwart Iraqis who try to gain legal title to assets they are holding, forcing even honest people to operate in the extralegal sector and continue to conduct business in a corrupt environment. The ILD has found that in most developing countries such obstacles to playing by the rules can be truly Sisyphean. Today, in Egypt, for example, which helped set up the Iraqi civil code of 1953, titling a bakery can take up to 540 days of moving from one bureaucracy to another at a cost of 84 times the average wage. In Mexico, even after 15 years of structural adjustment, foreclosing a mortgage takes no less than 43 months.

With the information obtained above, we will acquire the material and criteria needed to create an official property law that is more efficient at protecting rights and creating capital than the fragmented extralegal rules and bribes that characterize the shadow economy. In this manner, records and maps can be transformed from quickly outdated snapshots into "living" cadastres. Instead of slipping back into the corrupt practices of the extralegal economy, owners will have the incentive to keep registering their subsequent transactions, thus maintaining current official property records (and the legitimacy of the market economy law).

We would be very surprised if the information obtained would not confirm that a substantial amount of the poor and middle classes of Iraq are already working within a market economy, albeit an extralegal one and constitute a wide-based constituency for market reforms. This diagnosis would debunk any myth about a market system being incompatible with the local culture.

In our experience, presenting proof to a government that the extralegal sector of its nation is enormous and composed of private firms run by ordinary people loaded with potential capital motivates the leadership to move quickly towards reform. For instance, the ILD diagnosis in Egypt found that 90% of the population holds their assets and does business outside the law. We also estimated that these assets were worth about $245 billion —55 times larger than all foreign direct investment in Egypt and 30 times the value of the nation's existing legal business. Egyptian leaders were astounded. They were no less amazed by another ILD discovery: that the cost of legalizing those assets was prohibitive for most Egyptians: typically, it took 2 years to license a business and 17 years to title a home that could work as collateral, thus depriving the poor of access to their capital. The ILD diagnosis demonstrated that the reason most Egyptians worked outside the law and refused to enter a legal market economy was not due to an Islamic or Arabic cultural trait but to bad law. We are now helping the Egyptians reform their legal property system.

Faced with evidence of such vast potential wealth held by ordinary people, leaders in Iraq will have to recognize, sooner or later, that: The poor are not the problem, but the solution. That they are the most important constituency to create a market economy based on a rule of law compatible with their needs. The poor are vibrant, creative entrepreneurs. The poor already hold the assets required to create capital.

The lack of liquidity for entrepreneurial purposes is the result of a bad legal structure that can be reformed to create an acceptable rule of law. Property reform will allow their macroeconomic policies to work because legal incentives become meaningful and assets and transactions can be taxed.

Reform will defeat terrorism rather than incite it. If the new property law emphasizes the protection of the assets and transactions of the poor, given the fact that they are the majority, this will create a solid constituency for the rule of law in a market economy. (This is in contrast with other countries where market reforms are driven by —and mostly beneficial to— small elites and therefore do not have widespread support.)The best way to win elections and stay in power is by creating an inclusive market economy.

The goal would be to produce a common bedrock law for all citizens. The current extralegal rules that govern most Iraqis should be deconstructed in order to identify the principles that underlie them and see how they can be integrated into a new property law that can be trusted by everyone. One can then proceed to design and help enact a legal property system that consolidates the meaningful aspects of the disparate and dispersed extralegal arrangements (including procedural regulations for refugees and displaced persons) into one modern, codified system that Iraqis will freely choose to abide by and that will meet with a minimum of resistance from official bureaucracies and the formal sector.

In this way, the new government can begin to catch the wave of rising expectations instead of being engulfed by it.

Lawlessness is terrible, but the whole notion of security is far more complex than what would be achieved by putting a cop on every corner. The rule of law is not the iron fist imposed from above, it is a consensus about people's respect for one another's person and property. It is a social contract that people agree to keep because it protects the sources of their lively hood, their assets, and the customs that they respect and obey.

PREPARED STATEMENT OF DAVID P. ELLERMAN, PH.D., AUTHOR AND FORMER ECONOMIST AT THE WORLD BANK

Mr. Chairman, members of the Committee, I am David Ellerman, recently retired from the World Bank[1] where I was an economic advisor to the Chief Economist. Prior to joining the World Bank ten years ago, I started and ran for two years a consulting firm in East Europe to assist in the transition. While in the World Bank, most of my work was on the post-socialist transition with only a small part on the Middle East and North Africa region. The bulk of my remarks today will be based on the many hard lessons learned in trying to help the post-socialist countries make the transition to a private property market economy. While I am not an expert on Iraq, I imagine that many of these lessons would also apply to the post-Baath-socialism transition in that country.

1. The Case for Humility, Caution, and Incrementalism. Western economic advice to the former Soviet Union was partly responsible for the debacle in that region. Professor N. Gregory Mankiw of Harvard, the newly appointed head of the Council of Economic Advisors, noted in a recent book review that the book's author blamed much of the debacle in Russian on the shock therapy advice which came from some of the best and brightest of the economics profession (mostly from Harvard in this case). While Mankiw was more agnostic about the blame, he noted that if the advice "was a mistake..., its enormity makes it one of the greatest blunders in world history."[2] After a debacle of such historic proportions, surely we should have some humility about "nation-building" and be skeptical of those academic economists, brimming with self-confidence from building castles in the air, who now think they can socially engineer a new "shock therapy" program for a quick economic transformation in Iraq.

2. Pragmatism about Party Affiliation. The disastrous advice for institutional shock therapy in the FSU arose partly out of very understandable concerns that most of the people in positions of any power were in the Communist Party. Hence much of the western

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[1] My remarks are solely in personal capacity.

[2] Mankiw, N. Gregory 2003. Review of: Reinventing the Bazaar (book by John McMillan). *Journal of Economic Literature.* XLI(March): p. 257.

policy advice was wrapped in a cloak of Cold War self-righteousness: "Let's wipe the slate clean of the evil from the past to make a fresh new beginning." But we might recall the results of the Jacobins in the French Revolution or of the Bolsheviks in the Russian Revolution. For whatever reason, the U.S. supported the slate-cleaning "market Bolsheviks" in Russia to use the same methods for the reverse transition from Communism to the Market—with predictable results. Yet many of the professional, scientific, technical, and otherwise educated people were in the Party because it was the only way to get the jobs. If the qualified people hadn't join the Party, then the jobs would have gone to complete Party hacks. In Iraq, an organizational line should be clearly drawn so that above that line are the people who have to go. Below that line are the people whose professional knowledge and best energies will be needed for the reconstruction. They should not be thrown out along with the "dirty Baath water."

3. New Leaders Should Come from Within. It is important to understand the "returning-exiles" dynamics that played itself out in Eastern Europe and the FSU. When the old system collapsed, many who had been in exile (including various types of internal exile) returned to try to take over. They lead the chorus to demonize everyone who was a Party member, even those who had stayed in the country and worked for decades for reforms from within. Only those who were outside were presented as being sufficiently "clean" and untainted by involvement in the old system. By disqualifying those in the country who had any capabilities, the returning exiles tried to fill the power vacuum. But it did not work. Those in the country, in effect, said: "We who stayed suffered under the old system and tried to get along as best we could with passive resistance and active reforms. You got out and had a wonderful life in the West. Now that the system has finally collapsed, you want to come back in and take power." In all the post-socialist countries (with a few minor exceptions that were quickly discredited), the new governments were run by leaders who had grown up from within.

4. Avoid Symbolic Cargo-Cult Reforms. During WWII in the Pacific, the natives on many of the islands saw wonderful cargo being disgorged by the huge silver birds that came from the sky. After the war ended and the refueling stations were gone, the natives started cargo cults to "go through the motions" to get the cargo. They ran crude model airplanes up and down runways and talked into leftover orange crates with vines attached to "radio" to the birds to come back—but all to no avail. After the post-socialist revolutions, many aid agencies promoted similar Hollywood-storefront "stock markets" along with voucher privatization so people could "go through the motions" of trading vouchers and shares—and thus "get the cargo" like in the West. What better photo-op for aid officials than cutting the ribbon in front of the Great Totem of the Stock Market? Never mind that after a century of perfecting the watchdog institutions, the U.S. still has its ENRONs. Aid officials should not have been surprised when their voucher privatization schemes and ersatz stock markets quickly degenerated into wall-to-wall ENRONs. People who lost their national patrimony in voucher ripoffs and lost their savings in Ponzi schemes expressed their despair with black humor: "Everything the Communists told us about communism was false, but everything they told us about capitalism was true."

5. Reverse the Disenfranchisement of War/Revolution/Shock-Therapy. The revolutions in the socialist countries and the shock therapy that followed in many of them quickly destroyed the "old way of doing things" but then found that it would take years or decades to construct new working institutions. A type of chaos ensued and a variety of economic and political thugs took over. The old system had never worked well but people got along in a twilight system held together "with chewing gum and baling wire." They knew that if they did X and Y, they could get something like Z. But after the old way was destroyed, they were disenfranchised and discombobulated. Things that never worked right, now didn't work at all. The helplessness and despair that followed in many countries lead to extremism and the election of neo-communist governments. Instead of going down this road again by naively trying to socially engineer new institutions overnight, it is better to start by seeing what worked before in some tinkered way and to see how it could be revivified in some more legitimate retinkered way—which can then evolve. Instead of trying to jump over the chasm between the old and new institutions in one great leap forward (only to fall into a chasm of chaos), it is better to incrementally build a bridge—even though one foot of the bridge must always rest on the old ground.

6. Promote Small and Medium-sized Enterprises. In the current situation, the Iraqi people feel helpless. The first aim of economic transformation should be to promote and stabilize small and medium-sized businesses where people can regain some measure of control over their lives. Small business support organizations such as chambers of commerce can give businesses an organized voice, incubators can help new firms get going, domestic franchising can rapidly multiply successes in the retail businesses, and business education can give hope to a new generation. Instead of setting up cargo-cult stock markets, what is required is quiet and patient work with the banking system so that it can serve small businesses. Where businesses are informal and property rights are *de facto*, they should be formalized and protected as urged by Hernando de Soto so that people can use these "erector sets" to build more. In the small business and family farm, ownership is closely tied to control. There is no long hard-to-police and ripoff-prone chain of authority from shareholders to boards of directors to managers to middle managers and finally to workers. People feel they are empowered and responsible. For larger firms or organizations to be restarted and privatized, the same principle applies. Try to find pragmatic arrangements so that the formal structures of ownership and responsibility are "shrink-wrapped" around the set of stakeholders who have to co-operate in order for the firms to function again. On that basis, they can build a better economy.

7. Don't give aid to the Iraqi people; give them the tools to help themselves. Lincoln said he would like to be neither a slave nor a master. In like manner, just as Americans would not like to receive charity from others, so we should not aspire to bestow charity upon others. Instead we should aspire to get the tools into the hands of the Iraqi people so they can sow and reap on their own—so they can help themselves. Aid recipients in the former Soviet Union sometimes complained that they were being treated like a conquered people. Since the Iraqi people are in that unfortunate position, we must be doubly careful to show respect rather than benevolence. Charity corrupts, and long-term charity corrupts long term. For instance, there is the short-term rush to supply aid in commodity form (e.g., food and supplies) but that will tend in the longer term to undercut the markets that might provide those goods. Phasing in something like a food stamp program would help to restart the Iraqi supply chain of businesses that used to supply those goods. Or, for another example, there will be the temptation to demonstrate American goodwill and know-how by paying U.S. firms to do the reconstruction work. But the Iraqis will see this as adding the insult of presumed helplessness to their injuries. Instead the contracts should go to the Iraqi organizations and firms that can reconstruct local infrastructure perhaps with some additional learning as the work goes along.

8. A Regional Bank for Reconstruction and Development. One of the strokes of genius in the Marshall Plan was that the resources for European reconstruction were channeled through the Organization for

European Economic Cooperation where the European countries had seats but not the United States. The Europeans had to come to a *modus vivendi* and justify to each other how the scarce resources would be allocated. The U.S. role was indirect. If we look at the Middle East and North Africa (MENA) region today, it is the only region in the world without a regional development bank. The idea is an old one but there have been a few problems with "regional cooperation." Perhaps the time for this idea has finally come. Reconstruction efforts will be more successful if they come from within the region as part of regional self-help rather than from Washington. I suspect that the direct strategy: "We'll stay here until we have finished the job" is not viable for Americans and is not welcomed by Iraqis. Perhaps the U.S. Government should adopt an indirect strategy: help the countries of the region work out a *modus vivendi* in the concrete form of a regional development bank so that those countries can better help themselves.

Prepared Statement of Rachel Bronson, Ph.D., Olin Senior Fellow and Director, Middle East Programs, Council on Foreign Relations

Mr. Chairman, thank you for the invitation to speak before the Joint Economic Committee about the challenges confronting Iraq's economic transformation. As you may know, I co-directed "Guiding Principles for U.S. Post-Conflict Policy in Iraq," a December 2002 report co-sponsored by the Council on Foreign Relations and the James A. Baker III Institute for Public Policy. Ambassadors Edward P. Djerejian and Frank G. Wisner co-chaired the report. In addition, during "Operation Iraqi Freedom," and the weeks prior to it, I traveled twice to the Persian Gulf to discuss the war and its aftermath with those in the region. Although the Council on Foreign Relations makes my research possible, it bears no responsibility for these remarks.

Magnitude of the Challenge

The task we confront in Iraq is enormous. Iraq sits in the strategic heartland of the Middle East. Historically, Baghdad has been a major player in Middle Eastern affairs and has been at the center of inter-Arab politics since its independence in 1932. Economically, Iraq has the second largest proven oil reserves in the world, estimated at 112 billion barrels, with as many as 220 billion barrels of oil resources deemed probable. Culturally, Iraq's universities and religious seminaries have shaped the thinking of large sectors of the region's citizenship. In short, what happens in Iraq matters immensely to millions of people in the region and beyond, as it does, of course, to the Iraqis themselves.

We have set high expectations for ourselves and the Iraqis. But even establishing a basic level of stability, security and economic recovery will be time-consuming and expensive. As Secretary of Defense Donald Rumsfeld has pointed out, after the American Revolution "it took eight years of contentious debate before [the United States] finally adopted a Constitution and inaugurated our first president." In Germany, it took four years to move from the end of the war to a constitution. The German experience, of course, also benefitted from approximately $8 billion of Marshall Aid money (in current dollars), a robust American and international security presence, and an international political context that America organized around Europe's recovery. Time, money and security were required in Germany. In Iraq, there is no reason to expect it will take anything less. If anything, it could take more.

The challenge confronting the United States is to initiate a process that creates a reasonable level of security, maximizes international political and economic support, addresses the aspirations and needs of Iraq's various ethnic and religious groups and allows as many Iraqis as possible to participate in the positive political and economic transformation of their country. Such an Iraq could provide the region with a new political and economic model. It would supply a win for America's dwindling base of support throughout the Muslim world. But it will require a strong and serious American commitment. Failure to stay committed, politically, militarily and financially would have pernicious effects throughout the Middle East, North Africa, South Asia and beyond. The costs of getting Iraq right will be exceedingly high, second only, perhaps, to the costs of getting it wrong.

THE COMPONENTS OF ECONOMIC RECOVERY

Unfortunately, hard economic data or statistics for what is needed in Iraq are few and disputed. Still, the obstacles confronting recovery are many and include:

<u>Re-establishing law and order</u>. Iraq's recovery is challenged primarily by a lack of law and order. The looting and violence that has occurred, and is still occurring, has all but undone the hard work of military planners who largely tried to avoid targeting sites necessary to Iraq's reconstruction. Destroyed infrastructure along with missing documents and equipment are delaying reconstruction projects and attempts to get Iraq's oil flowing.

Iraq's economic recovery depends on its workforce returning to productive economic activity. But today a large portion of Iraq's workforce remains sequestered in their homes, fearful that leaving would risk the safety of family and property. Others simply can not go back to their jobs because of the damage done by the war, the civil disorder that followed, or both. Unless this situation is reversed, the time-table for Iraq's recovery will continue to slip.

Worse, the breakdown of law and order and the resulting power vacuum is providing Saddam's loyalists from the Ba'ath party, the military and other armed groups the opportunity to reconstitute. Knowledgeable Iraqis suggest that Saddam's security forces, that melted away during the fighting and that have not been disarmed, are trying to hasten an American withdrawal by inflicting a steady stream of low-level casualties. The use of guerilla tactics that is beginning to emerge in western Iraq is an ominous warning of things to come. Unless America and its partners deal firmly with such opposition, and make clear their commitment to provide for a better future for all Iraqis, all other goals for Iraq will be illusory.

A heavy security presence will be necessary to fill the power vacuum left in Iraq. Prior to the war, a Council on Foreign Relations task force estimated that a stability force of 75,000 American troops would cost no less than $15 billion per year. This estimate did not include reconstruction and humanitarian costs. U.S. administration officials now estimate that the current force levels of about 150,000 (and expected to remain steady for the near future) are costing in excess of $3 billion per month. The original hope of reducing American presence to 30,000 by this fall is no longer viable given the chaotic reality on the ground.

The Administration deserves credit for the growing evidence that law and order is slowly being restored. Maintaining large number of soldiers in the country, supplemented by military police and Special Forces, is helping to stabilize the situation. However, the looting and violence that occurred unchecked during the first weeks of the post-conflict phase has set back Iraq's reconstruction.

Recovering Iraq's oil potential. Even if law and order had seamlessly transitioned from occupational authority to local control, Iraq would still require considerable outside assistance.

Iraq's reconstruction will not be self-financing. Oil is its major source of government revenue. Iraq's oil infrastructure is in decline. After years of sanctions and poor political rule, Iraq's production capacity is decreasing at an annual rate of 100,000 barrels per day. Prior to the war, Iraq generated $10-12 billion in oil revenue per year. Over 70% was spent on basic humanitarian assistance such as food and medicine that still is required today. While official assessments have yet to be concluded, repairing and restoring Iraq's previously used oil facilities may cost $5 billion, in addition to the $3 billion needed for annual operating costs. Up to $20 billion may be required to restore Iraq to its pre-1990 electricity capacity.

Before the war, questionable assumptions were made about the cost of the conflict, and the likely speed of reconstruction. Despite heady predictions for Iraq's recovery, there are limited short-term resources available for repairing Iraq's oil industry and decaying infrastructure. Considerable American and international support is required. It is unlikely that the Administration's one time request of $1.7 billion will produce the stable promising Iraq that many advocated before the war.

Diversifying the economy. To get Iraq back on its feet economically, greater attention must be given to diversifying Iraq's economy. Over 90% of its export earning comes from oil. In 1980, Iraq relied on oil for only 39% of its gross domestic product. Reliance on a single source of revenue makes Iraq vulnerable to the chronic corruption, monopolistic behavior, under-development, and under-employment that have afflicted other energy-reliant economies in the region, while leaving Iraq hostage to the whims of the market. Throughout the twentieth century, the value of economic output for those working with raw materials, in this case energy has declined by 50%, relative to skilled labor.

Re-structuring Iraq's debt. Iraq shoulders a massive debt load. While the exact debt amount is unclear, it is generally agreed to be between \$100 and 200 billion. Iraq's debt is largely a result of the Iran-Iraq war of the 1980s, reparations from Desert Storm of 1991, and payments for pending contracts with foreign companies.

UN resolution 1483 "welcomes the readiness of creditors, including those of the Paris Club, to seek a solution to Iraq's sovereign debt problems." When possible, incentives will be required to encourage debt forgiveness. Unfortunately, even if they wanted to forgive Iraq's debt, some of Iraq's creditors are by law unable to do so. In such cases, generous refinancing conditions should be encouraged.

Supporting a stable, transparent political order. The Middle East has been woefully unable to attract foreign direct investment. Opaque authoritarian leadership has chased away such funds. To successfully attract capital and keep local capital at home, Iraq will require a transparent, stable, rule-based political system. While a transfer of power from the occupiers to local leaders is necessary, it will not happen quickly. America must plan to remain actively involved until local political experiments in places such as Mosul and Kirkuk can be replicated at the national level. A speedy transition will either return to power the scions of the old system, as happened in many former communist societies, or result in the assumption of power of a regime viewed as an illegitimate puppet of the occupiers. Neither alternative is attractive to foreign capital. For this reason, the Administration's decision to delay the selection of an Iraqi Interim Authority was a correct one. Initially raising the possibility of an early transfer unnecessarily increased expectations and distracted Iraq's potential leadership from the difficult tasks of recovery.

MANAGING EXPECTATIONS

We must remember that the pre-Saddam Iraq that many hold in their memories is not the Iraq of today, nor will it be the Iraq of tomorrow, even under the best of circumstances. With high unemployment and 42% of its population below the age of 15, Iraq's economic base is considerably worse off than it was before Saddam took office and during the first few years of his rule. At all times, America must make clear to the Iraqi people the reason for our actions and seek to include them in the implementation of policies to the greatest degree possible. Inflated expectations will only lead to discontent and instability.

THE WAY FORWARD

If done well, the reconstruction of Iraq holds the promise of a better and more enduring security situation for the entire region. Successful reconstruction is a hope that many around the globe share with the United States. To the greatest extent possible, the United States should harness the capabilities of those who are able to contribute to the Herculean task we have set before us. The road to Iraq's reconstruction will be long, difficult, dangerous and costly. We can travel it alone, or we can travel it with others. It is our choice.

1800

S. HRG. 109–687

THE EMPLOYMENT SITUATION: FEBRUARY 2006

HEARING

BEFORE THE

JOINT ECONOMIC COMMITTEE
CONGRESS OF THE UNITED STATES

ONE HUNDRED NINTH CONGRESS

SECOND SESSION

MARCH 10, 2006

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THE EMPLOYMENT SITUATION: FEBRUARY 2006

FRIDAY, MARCH 10, 2006

CONGRESS OF THE UNITED STATES,
JOINT ECONOMIC COMMITTEE,
Washington, DC.

The Committee met, pursuant to notice, at 9:30 a.m., in room 2212, Rayburn House Office Building, Hon. Jim Saxton (Chairman of the Committee) presiding.

Present: Representative Saxton.

Staff present: Chris Frenze, Robert Keleher, Brian Higginbotham, Colleen Healy, Katie Jones, Chad Stone, Matt Salomon and Nan Gibson.

OPENING STATEMENT OF HON. JIM SAXTON, CHAIRMAN, A U.S. REPRESENTATIVE FROM NEW JERSEY

Chairman Saxton. Good morning. Commissioner Utgoff, it is a pleasure to welcome you once again to testify before the Joint Economic Committee.

The economic figures released today reflect more good news for American workers. According to the payroll survey, 243,000 jobs were created during the month of February. The level of the diffusion index shows that job gains were widespread last month. According to the household survey, the unemployment rate at 4.8 percent was statistically unchanged.

The U.S. economy has created 5 million jobs since August of 2003. The strength of the economy since 2003 has led to sustained job growth and downward pressure on unemployment. The resilience and flexibility of the economy have overcome a number of serious shocks, most recently the hurricanes of last year.

The pick-up in economic growth since 2003 is explained by a rebound in investment activity. The bursting of the stock market and technology bubbles in the first quarter of 2000 had exposed a lot of bad investments. These investments took years to liquefy and had a negative effect on investment. Falling investment was a drag on economic growth and undermined the early expansion period.

In 2003, the new policy mix caused a sharp rebound in investment activity. The combination of low interest rates set by the Fed, together with increased tax for investment, led to a sustained upward trend in investment that boosted economic and employment growth. The result is that the economic expansion is healthy, and the outlook is good.

In a recent policy report to Congress, the Fed noted that, quote, "The U.S. economy delivered a solid performance in 2005." Furthermore, the Fed observed that the U.S. economy should continue to perform well in 2006 and 2007. The Fed, along with a number of private and Government agencies, expects economic growth in 2006 to be about 3½ percent. The economic growth will continue to expand employment and further reduce unemployment.

[The prepared statement of Representative Saxton appears in the Submissions for the Record on page 8.]

Chairman Saxton. At this time I would like to ask unanimous consent that Senator Reed's statement be included in the record. He had fully intended to be here today, but another hearing on the Senate side, which was originally scheduled for 10, was moved forward to 9:30, so he will be unable to be here.

[The prepared statement of Senator Reed appears in the Submissions for the Record on page 9.]

Chairman Saxton. Commissioner Utgoff, we are ready for your testimony.

STATEMENT OF HON. KATHLEEN P. UTGOFF, COMMISSIONER, BUREAU OF LABOR STATISTICS, ACCOMPANIED BY JOHN GALVIN, ASSOCIATE COMMISSIONER FOR EMPLOYMENT AND UNEMPLOYMENT STATISTICS; AND JOHN GREENLEES, ASSOCIATE COMMISSIONER FOR PRICES AND LIVING CONDITIONS

Commissioner Utgoff. Mr. Chairman, I appreciate this opportunity to comment on the employment and unemployment data we released this morning.

Nonfarm payroll employment rose by 243,000 in February, and the unemployment rate was little changed at 4.8 percent. February's employment increase reflected gains in construction, mining, and several service-producing industries.

Within the goods-producing sector, construction employment increased by 41,000 in February following another sizable gain in January. Over the past 12 months, job growth in construction has totaled 346,000. In February, employment continued to rise in mining, mainly in support activities, especially for those for oil and gas operations.

Manufacturing employment overall was virtually unchanged in February. There were, however, offsetting movements in several industries. The largest job losses were in motor vehicles and parts and primary metals. Job gains occurred in machinery, petroleum products, and computers and electronic products. The manufacturing workweek and factory overtime each rose by 1/10 of an hour.

Over the month, financial activities added 22,000 jobs, reflecting increases in depository institutions and in insurance carriers. Health care employment expanded by 18,000, with continued growth in hospitals, doctors' offices and home health care. Professional and business services, private education, food services and drinking places, and government also had job gains in February.

Average hourly earnings for private production or nonsupervisory workers rose by 5 cents in February, following increases of 7 cents in both December and January. Over the year, hourly earnings increased by 3.5 percent. The average workweek was down by 1/10 of an hour in February to 33.7 hours.

Turning to data from the household survey, both the number of unemployed persons and the unemployment rate were little changed over the month. The number of persons employed for 27 weeks or more returned to its December level of 1.4 million after declining in January. These long-term unemployed constituted 19.0 percent of all unemployed persons, down slightly from a year earlier.

Total employment in the labor force continued to trend up in February. However, the employment-to-population ratio has held steady in recent months, and the labor force participation rate has shown little movement for about 2½ years.

This month we again report on the labor force status of survey respondents who evacuated from their homes due to Hurricane Katrina. The data are derived from a special set of questions that have been included in the household survey since October to gather information about evacuees. The estimates do not account for all persons who evacuated from their homes due to Hurricane Katrina. Information is not gathered on those evacuees who remain outside the scope of the survey, such as those currently living in hotels or shelters.

The February data indicate that there were about 1 million persons age 16 and over who evacuated from their August residences due to Hurricane Katrina. In February, about one-half of the evacuees were back in the homes they vacated in August. Among Katrina evacuees identified in February, 58.1 percent were in the labor force, and their unemployment rate was 12.6 percent. Unemployment rates were much lower for those evacuees who returned home than for those evacuees who had not.

To summarize February's labor market data, nonfarm payroll employment rose by 243,000, and the unemployment rate was little changed at 4.8 percent. Payroll employment has increased by 2.1 million over the year, and the unemployment rate is down by half a percentage point.

My colleagues and I would now be glad to respond to your questions.

[The prepared statement of Commissioner Utgoff, together with Press Release No. 06-396, appears in the Submissions for the Record on page 10.]

Chairman Saxton. Commissioner, thank you very much.

Commissioner, let me ask this question. You mentioned that there was a slight change in the unemployment rate. It actually increased from 4.7 to 4.8 percent.

Commissioner Utgoff. Yes.

Chairman Saxton. Is that a statistically significant change?

Commissioner Utgoff. No, it was not.

Chairman Saxton. Are there any special factors distorting or overstating the payroll job gains reported this month?

Commissioner Utgoff. No. We haven't identified any special factors.

Chairman Saxton. You mentioned Katrina a minute ago. Has the aftermath of Katrina continued to have some effect on the economy generally, or is that more of a regional phenomenon?

Commissioner Utgoff. I wouldn't know about the economy in general, but the unemployment rate in Louisiana is quite low, and about half of the people who evacuated from their homes in Katrina have returned, and they have an unemployment rate of 4.8 percent.

Chairman Saxton. You mentioned that the evacuees who have not returned home have a higher unemployment rate; is that right?

Commissioner Utgoff. Yes; 22.6 percent.

Chairman Saxton. And they are in Houston and in other places?

Commissioner Utgoff. Yes.

Chairman Saxton. And continue to live in temporary housing?

Commissioner Utgoff. Yes.

Chairman Saxton. Does the current level of the diffusion index indicate that payroll job gains in February were fairly widespread?

Commissioner Utgoff. Yes, it does.

Chairman Saxton. Were there any sectors of the economy where job creation was significantly higher than others?

Commissioner Utgoff. In construction and in several service industries.

Chairman Saxton. You mention construction. Is that business construction or residential construction? Do you have those indicators?

Commissioner Utgoff. Most of the increase was in specialty trade.

Mr. Galvin. I think our analysis indicates most of the increase was in residential construction.

Chairman Saxton. I am curious. There has been some evidence of cooling in the real estate sector. Do your statistics shed any light on what is happening with real estate generally, real estate construction?

Commissioner Utgoff. As Mr. Galvin said, previous to this, most of the increase had been in residential construction, and last month it was in—much more in heavy construction. I should also note that for many months the increase in—there was a marked increase in mortgage bankers and brokers, and for the last 2 months we have seen a flattening of that.

Chairman Saxton. So your figures on residential construction would tend to bolster the notion that the real estate market has cooled some?

Commissioner Utgoff. The very limited evidence that we have would.

Chairman Saxton. January was the warmest January in recorded history, and some attributed the job growth in January to climatological factors, warm weather. Was there anything about February's weather that you can attribute to the very healthy job growth that we saw?

Commissioner Utgoff. There was a snowstorm in the Northeast, but it occurred on a Saturday and Sunday, and it was the kind of snow that was easily removable, so we didn't see anything in the data that would indicate that there were special weather factors in February.

Chairman Saxton. What do payroll job gains suggest about the strength of commission growth in the first quarter of 2006, which many forecasts expect to be strong? Are the payroll job gains consistent with solid economic growth?

Commissioner Utgoff. The payroll job gains are very consistent with solid economic growth. I can't predict what will happen for the rest of the quarter. There is 1 month left in the quarter.

Chairman Saxton. The last quarter of last year was weaker than we expected. Has there been any change in the rate of growth as measured by your statistics in the last quarter of last year?

Commissioner Utgoff. Compared to the first quarter of this year?

Chairman Saxton. No. The last quarter of last year was 1.6 percent GDP growth, and we expected that figure to be adjusted. Was there an adjustment?

Commissioner Utgoff. Yes, there was an adjustment. From the preliminary announcement of GDP to the revised announcement, there was an increase in measured GDP.

Chairman Saxton. Mr. Frenze tells me that it was adjusted from 1.1 percent to 1.6 percent. Is that correct?

Commissioner Utgoff. That is correct.

Chairman Saxton. Thank you.

Do you have any indicators as to what we can expect? Can we expect a rebound during the first quarter of this year?

Commissioner Utgoff. I can't predict that.

Chairman Saxton. OK. Thank you.

What can you tell us about the revisions in the recent payroll data?

Commissioner Utgoff. They were very small.

Chairman Saxton. And is the gain in February payroll employment statistically significant?

Commissioner Utgoff. Yes, it is.

Chairman Saxton. How do we account for the slight tick up in the unemployment rate while we see such healthy job growth?

Commissioner Utgoff. Household survey and the payroll survey, as you know, come from different sources, and the unemployment rate has to do with participation and a number of other factors so that there can be an increase in the unemployment rate. There really wasn't an increase. It was the same. So that what happened was the employment-to-population ratio stayed the same, and the unemployment rate stayed the same.

I have to say the answer is every month household and payroll series can show differences, and in this month they do that.

Chairman Saxton. Of course, I ask you questions, and you say that you can't speculate, but let me just ask one anyway. With the trend in job creation being, now, 5 million jobs since August of 2003, and seeing good job growth this month, I might be able to anticipate some downward trends in the unemployment rate in the months ahead, couldn't I?

Commissioner Utgoff. Right. Right. Certainly that is your right.

Chairman Saxton. Seasonal adjustment factors affected the February numbers? And if so, which sectors are affected most significantly by these seasonals?

Commissioner Utgoff. It is going to take me a minute.

Mr. Galvin. It is not really a very seasonal month. Normal seasonal movements are about 600,000 at the total nonfarm level. And the sector with the biggest normal seasonal movement looks to be education and health services. But we did not see anything unusual from a seasonal perspective this month.

Chairman Saxton. And are there any other particular statistical anomalies affecting this month's payroll or household numbers?

Commissioner Utgoff. We don't see any.

Chairman Saxton. OK. I thank you for being here this morning. We always enjoy it when you come with good news and good numbers. And we will look forward to seeing you in the months ahead. Thank you very much.

[Whereupon, at 9:49 a.m., the Joint Committee was adjourned.]

Submissions for the Record

CONGRESS OF THE UNITED STATES

JOINT ECONOMIC COMMITTEE

CHAIRMAN JIM SAXTON

PRESS RELEASE

For Immediate Release
March 10, 2006

STATEMENT OF CHAIRMAN JIM SAXTON

Press Release #109-63
Contact: Christopher Frenze
Executive Director
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FEBRUARY EMPLOYMENT GROWTH

Commissioner Utgoff, it is a pleasure to welcome you once again to testify before the Joint Economic Committee.

The employment figures released today reflect more good news for American workers. According to the payroll survey, 243,000 jobs were created during the month of February. The level of the diffusion index shows that job gains were widespread last month. According to the household survey, the unemployment rate, at 4.8 percent, was statistically unchanged.

The U.S. economy has created 5 million jobs since August of 2003. The strength of the economy since 2003 has led to sustained job growth and downward pressure on the unemployment rate. The resilience and flexibility of the economy have overcome a number of serious shocks, most recently the hurricanes of last year.

The pick-up in economic growth since 2003 is explained by a rebound in investment activity. The bursting of the stock market and technology bubbles in the first quarter of 2000 had exposed a lot of bad investments. These investments took years to liquefy and had a negative effect on new investment. Falling investment was a drag on economic growth, and undermined the early expansion period.

In 2003, a new policy mix caused a sharp rebound in investment activity. The combination of low interest rates set by the Fed, together with increased tax incentives for investment, led to a sustained upward trend in investment that boosted economic and employment growth. The result is that the economic expansion is healthy and the outlook is good.

In a recent policy report to Congress, the Fed noted that "the U.S. economy delivered a solid performance in 2005." Furthermore, the Fed observed that "The U.S. economy should continue to perform well in 2006 and 2007." The Fed, along with a number of private and government agencies, expects that economic growth in 2006 will be about 3.5 percent. This economic growth will continue to expand employment and further reduce unemployment.

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CHAD STONE
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Opening Statement
Senator Jack Reed
Joint Economic Committee Hearing
March 10, 2006

Thank you, Chairman Saxton. I want to welcome Commissioner Utgoff and thank her for testifying here today.

Today's report that 243,000 payroll jobs were created in February is welcome news for workers. However, the labor market is not yet back to full strength. During this recovery, the decline in the unemployment rate has not been accompanied by a recovery in labor force participation and strong productivity growth has not translated into rising real wages.

Overall growth in payroll employment has been modest by the standards of most economic recoveries. The five million jobs created since job losses peaked in August 2003 works out to only about 166,000 per month—not much more than what is necessary just to keep up with normal growth in the labor force.

While the jobless rate has come down during the recovery, unemployment remains higher than it was when President Bush took office, long-term unemployment persists, and evidence of hidden unemployment is reflected in the continued depressed levels of the labor force participation rate and the fraction of the population with a job.

Corporate profits and worker productivity have been growing, but wages are not keeping pace with inflation. Average hourly earnings were stagnant during 2003 and have fallen during each of the past two years, after adjusting for inflation. Paychecks are being stretched thinner as families face higher prices for gasoline, home heating, health care, and education.

The ability of the job market to come back after the hurricanes is a testament to the resiliency of the American economy. I am skeptical, however, about the role the President's policies have played in stimulating job growth, and it is clear in the data that ordinary workers are still waiting for the benefits of the economic recovery to show up in their paychecks.

The President doesn't seem well attuned to the concerns of most workers. While he was abroad last week, for example, the President hailed the economic benefits to the U.S. from outsourcing to other countries, but failed to acknowledge that he has no plan to address the effects of outsourcing or other problems that persist in our labor market.

I look forward to Commissioner Utgoff's statement and to a further discussion of the February employment situation.

Prepared Statement of Hon. Kathleen P. Utgoff, Commissioner, Department of Labor, Bureau of Labor Statistics

Mr. Chairman and Members of the Committee:

I appreciate this opportunity to comment on the employment and unemployment data that we released this morning.

Nonfarm payroll employment rose by 243,000 in February, and the unemployment rate was little changed at 4.8 percent. February's employment increase reflected gains in construction, mining, and several service-providing industries.

Within the goods-producing sector, construction employment increased by 41,000 in February, following another sizeable gain in January. Over the past 12 months, job growth in construction has totaled 346,000. In February, employment continued to rise in mining, mainly in support activities, especially those for oil and gas operations.

Manufacturing employment overall was virtually unchanged in February. There were, however, offsetting movements in several industries. The largest job losses were in motor vehicles and parts and primary metals. Job gains occurred in machinery, petroleum products, and computer and electronic products. The manufacturing workweek (at 41.0 hours) and factory overtime (at 4.6 hours) each rose by 0.1 hour.

Over the month, financial activities added 22,000 jobs, reflecting increases in depository institutions and in insurance carriers. Health care employment expanded by 18,000, with continued growth in hospitals, doctors offices, and home health care. Professional and business services, private education, food services and drinking places, and government also had job gains in February.

Average hourly earnings for private production or nonsupervisory workers rose by 5 cents in February, following increases of 7 cents in both December and January. Over the year, hourly earnings increased by 3.5 percent. The average workweek was down by 0.1 hour in February to 33.7 hours.

Turning to data from the household survey, both the number of unemployed persons (7.2 million) and the unemployment rate (4.8 percent) were little changed over the month. The number of persons unemployed for 27 weeks or more returned to its December level of 1.4 million, after declining in January. These long-term unemployed constituted 19.0 percent of all unemployed persons, down slightly from a year earlier.

Total employment and the labor force continued to trend up in February. However, the employment-population ratio has held steady in recent months, and the labor force participation rate has shown little movement for about 2½ years.

This month, we again report on the labor force status of survey respondents who evacuated from their homes due to Hurricane Katrina. The data are derived from a special set of questions that have been included in the household survey since October to gather information about evacuees. The estimates do not account for all persons who evacuated from their homes due to Hurricane Katrina. Information is not gathered on those evacuees who remain outside the scope of the survey, such as those currently living in hotels or shelters.

The February data indicate that there were about 1 million persons age 16 and over who evacuated from their August residences due to Hurricane Katrina. In February, about one-half of the evacuees were back in the homes they vacated in August. Among Katrina evacuees identified in February, 58.1 percent were in the labor force, and their unemployment rate was 12.6 percent. Unemployment rates were much lower for those evacuees who had returned home (4.8 percent) than for those evacuees who had not (22.6 percent).

To summarize February's labor market data, nonfarm payroll employment rose by 243,000, and the unemployment rate was little changed at 4.8 percent. Payroll employment has increased by 2.1 million over the year, and the unemployment rate is down by about half a percentage point.

My colleagues and I now would be glad to respond to your questions.

News United States Department of Labor

Bureau of Labor Statistics Washington, D.C. 20212

Technical information:
Household data: (202) 691-6378 http://www.bls.gov/cps/
Establishment data: 691-6555 http://www.bls.gov/ces/
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USDL 06-396

Transmission of material in this release is embargoed until 8:30 A.M. (EST), Friday, March 10, 2006.

THE EMPLOYMENT SITUATION: FEBRUARY 2006

Nonfarm payroll employment grew by 243,000 in February, and the unemployment rate was little changed at 4.8 percent, the Bureau of Labor Statistics of the U.S. Department of Labor reported today. Job gains occurred in construction, financial activities, health care, and several other industries.

Chart 1. Unemployment rate, seasonally adjusted, March 2003 – February 2006

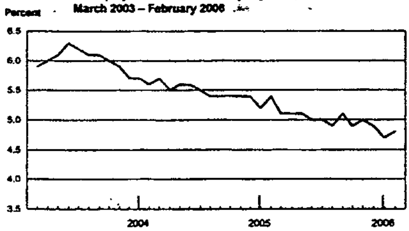
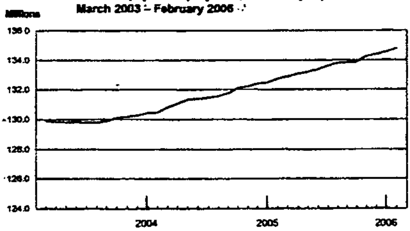


Chart 2. Nonfarm payroll employment, seasonally adjusted, March 2003 – February 2006



Unemployment (Household Survey Data)

Both the number of unemployed persons, 7.2 million, and the unemployment rate, 4.8 percent, were little changed in February. A year earlier, the number of unemployed was 8.0 million, and the jobless rate was 5.4 percent.

Following a decline in January, the unemployment rate for adult men edged up to 4.2 percent in February. The jobless rates for the other major worker groups—adult women (4.3 percent), teenagers (15.4 percent), whites (4.1 percent), blacks (9.3 percent), and Hispanics (5.5 percent)—showed little or no change over the month. The unemployment rate for Asians was 3.2 percent, not seasonally adjusted. (See tables A-1, A-2, and A-3.)

After declining in January, the number of unemployed persons who had been without a job for 27 weeks or longer returned to its December level of 1.4 million. These long-term unemployed accounted for 19.0 percent of total unemployment in February, down slightly from a year earlier. (See table A-9.)

Table A. Major indicators of labor market activity, seasonally adjusted

(Numbers in thousands)

Category	Quarterly averages		Monthly data			Jan.-Feb. change
	2005		2005	2006		
	III	IV	Dec.	Jan.	Feb.	
HOUSEHOLD DATA	Labor force status					
Civilian labor force	149,827	150,126	150,153	150,114	150,449	335
Employment	142,324	142,671	142,779	143,074	143,257	183
Unemployment	7,503	7,455	7,375	7,040	7,193	153
Not in labor force	76,595	77,070	77,271	77,439	77,314	-125
	Unemployment rates					
All workers	5.0	5.0	4.9	4.7	4.8	0.1
Adult men	4.4	4.3	4.3	4.0	4.2	.2
Adult women	4.6	4.5	4.5	4.3	4.3	.0
Teenagers	16.1	16.1	15.2	15.3	15.4	.1
White	4.3	4.3	4.3	4.1	4.1	.0
Black or African American	9.5	9.7	9.3	8.9	9.3	.4
Hispanic or Latino ethnicity	6.0	6.0	6.0	5.8	5.5	-.3
ESTABLISHMENT DATA	Employment					
Nonfarm employment	133,750	134,161	134,376	p134,546	p134,789	p243
Goods-producing [1]	22,140	22,242	22,282	p22,347	p22,392	p45
Construction	7,305	7,391	7,416	p7,471	p7,512	p41
Manufacturing	14,208	14,211	14,222	p14,229	p14,228	p-1
Service-providing [1]	111,610	111,920	112,094	p112,199	p112,397	p198
Retail trade [2]	15,297	15,284	15,300	p15,287	p15,294	p7
Professional and business services	16,942	17,058	17,121	p17,138	p17,177	p39
Education and health services	17,411	17,476	17,507	p17,557	p17,604	p47
Leisure and hospitality	12,840	12,873	12,898	p12,923	p12,948	p25
Government	21,843	21,870	21,878	p21,847	p21,885	p38
	Hours of work [3]					
Total private	33.8	33.8	33.8	p33.8	p33.7	p-0.1
Manufacturing	40.6	40.9	40.8	p40.9	p41.0	p.1
Overtime	4.5	4.6	4.5	p4.5	p4.6	p.1
	Indexes of aggregate weekly hours (2002=100) [3]					
Total private	102.9	103.4	103.7	p103.9	p103.8	p-0.1
	Earnings [3]					
Average hourly earnings, total private	$16.16	$16.30	$16.35	p$16.42	p$16.47	p$0.05
Average weekly earnings, total private	545.78	551.05	552.63	p555.00	p555.04	p.04

[1] Includes other industries, not shown separately.

[2] Quarterly averages and the over-the-month change are calculated using unrounded data.

[3] Data relate to private production or nonsupervisory workers.

p = preliminary.

Total Employment and the Labor Force (Household Survey Data)

The civilian labor force and total employment continued to trend up in February. The labor force participation rate was essentially unchanged at 66.1 percent, and the employment-population ratio held at 62.9 percent. (See table A-1.)

Persons Not in the Labor Force (Household Survey Data)

Nearly 1.5 million persons (not seasonally adjusted) were marginally attached to the labor force in February, down from about 1.7 million a year earlier. These individuals wanted and were available for work and had looked for a job sometime in the prior 12 months. They were not counted as unemployed because they had not searched for work in the 4 weeks preceding the survey. Among the marginally attached, there were 386,000 discouraged workers in February, down from 485,000 a year earlier. Discouraged workers were not currently looking for work specifically because they believed no jobs were available for them. The other 1.1 million marginally attached had not searched for work for reasons such as school attendance or family responsibilities. (See table A-13.)

Employment Status of Hurricane Katrina Evacuees (Household Survey Data)

Beginning in October, questions were added to the household survey to identify persons who evacuated from their homes, even temporarily, due to Hurricane Katrina. Data collected through these questions do not account for all evacuees; persons living outside of the scope of the survey—such as those living in hotels or shelters—are not included. The questions were asked of persons in the household survey sample throughout the country, since some evacuees relocated far from the storm-affected areas. An additional question determined whether evacuees had returned to their homes and were living there at the time of the survey. The total number of evacuees estimated from the household survey may change from month to month as people move in and out of the scope of the survey. In addition, because the estimates are obtained from a sample survey, they may vary from month to month due to sampling error.

Information gathered in February showed that about 1.0 million persons age 16 and over had evacuated from where they were living in August due to Hurricane Katrina. These evacuees either had returned to their homes or were living in other residential units covered in the survey in February. About one-half of the evacuees were living in their August 2005 residences. Of all evacuees identified, 58.1 percent were in the labor force in February. The unemployment rate for persons identified as evacuees was 12.6 percent. The rate was much higher for evacuees who were not living in their former homes (22.6 percent) than for those who were at home (4.8 percent). (See table B.)

Industry Payroll Employment (Establishment Survey Data)

Total nonfarm payroll employment rose by 243,000 in February to 134.8 million, seasonally adjusted. Over the year, payroll employment grew by 2.1 million. Construction, mining, and several service-providing industries added jobs. (See table B-1.)

In the goods-producing sector, construction employment increased by 41,000 in February, following a gain of 55,000 in the prior month. Over the year, construction employment has risen by 346,000. Specialty trade contractors added 32,000 jobs over the month. Mining continued its upward trend in February, adding 5,000 jobs. Support activities for mining, particularly those related to oil and gas, accounted for nearly all of the over-the-month gain.

Table B. Employment status in February 2006 of persons 16 years and over who evacuated from their August residence, even temporarily, due to Hurricane Katrina [1]

(Numbers in thousands, not seasonally adjusted)

Employment status in February 2006	Total	Residence in February: Same as in August	Residence in February: Different than in August
Civilian noninstitutional population	1,017	540	478
Civilian labor force	591	333	258
Participation rate	58.1	61.7	53.9
Employed	516	317	200
Employment-population ratio	50.8	58.7	41.8
Unemployed	74	16	58
Unemployment rate	12.6	4.8	22.6
Not in labor force	427	207	220

[1] Represents persons in the civilian noninstitutional population age 16 and over who resided in households that were eligible to be selected for the Current Population Survey (CPS). These data are not representative of the total evacuee population because they do not include children or people residing in shelters, hotels, places of worship, or other units outside the scope of the CPS. The total number of evacuees estimated from the CPS may change from month to month as people move in and out of the scope of the survey and because of sampling variability.

NOTE: These data use population controls that have been adjusted to account for interstate moves by evacuees.

Manufacturing employment was about unchanged in February; it has decreased by 48,000 over the year. Over the month, employment gains in machinery, petroleum products, and computer and electronic products were offset by declines in motor vehicles and parts and primary metals.

In the service-providing sector, employment in education and health services rose by 47,000 in February. Health care employment continued to grow, up by 18,000. Job growth occurred in ambulatory health care services (11,000), which includes doctors' offices and home health care, and in hospitals (6,000). Employment in private educational services increased by 23,000.

Financial activities employment grew by 22,000 over the month, following a similar-sized gain in January. Employment in depository institutions and in insurance carriers rose in February, increasing by 4,000 and 6,000, respectively. Over the year, financial activities employment has risen by 169,000.

Employment in food services and drinking places increased by 21,000 in February. Over the year, this industry has added 203,000 jobs. Employment was flat in both wholesale and retail trade in February.

Professional and business services employment continued to trend up in February (39,000). The industry has added 466,000 jobs over the year. Over the month, employment rose by 13,000 in services to buildings and dwellings. Temporary help services employment was little changed over the month.

<u>Weekly Hours (Establishment Survey Data)</u>

The average workweek for production or nonsupervisory workers on private nonfarm payrolls decreased by 0.1 hour to 33.7 hours in February, seasonally adjusted. The manufacturing workweek increased by 0.1 hour to 41.0 hours in February, and factory overtime was up by 0.1 hour to 4.6 hours. (See table B-2.)

The index of aggregate weekly hours of production or nonsupervisory workers on private nonfarm payrolls decreased by 0.1 percent in February to 103.8 (2002=100). The manufacturing index increased by 0.2 percent over the month to 95.5. (See table B-5.)

<u>Hourly and Weekly Earnings (Establishment Survey Data)</u>

Average hourly earnings of production or nonsupervisory workers on private nonfarm payrolls increased by 5 cents in February to $16.47, seasonally adjusted. This followed increases of 7 cents in both December and January. Average weekly earnings were little changed over the month at $555.04. Over the year, both average hourly and weekly earnings increased by 3.5 percent. (See table B-3.)

The Employment Situation for March 2006 is scheduled to be released on Friday, April 7, at 8:30 A.M. (EDT).

Explanatory Note

This news release presents statistics from two major surveys, the Current Population Survey (household survey) and the Current Employment Statistics survey (establishment survey). The household survey provides the information on the labor force, employment, and unemployment that appears in the A tables, marked HOUSEHOLD DATA. It is a sample survey of about 60,000 households conducted by the U.S. Census Bureau for the Bureau of Labor Statistics (BLS).

The establishment survey provides the information on the employment, hours, and earnings of workers on nonfarm payrolls that appears in the B tables, marked ESTABLISHMENT DATA. This information is collected from payroll records by BLS in cooperation with state agencies. The sample includes about 160,000 businesses and government agencies covering approximately 400,000 individual worksites. The active sample includes about one-third of all nonfarm payroll workers. The sample is drawn from a sampling frame of unemployment insurance tax accounts.

For both surveys, the data for a given month relate to a particular week or pay period. In the household survey, the reference week is generally the calendar week that contains the 12th day of the month. In the establishment survey, the reference period is the pay period including the 12th, which may or may not correspond directly to the calendar week.

Coverage, definitions, and differences between surveys

Household survey. The sample is selected to reflect the entire civilian noninstitutional population. Based on responses to a series of questions on work and job search activities, each person 16 years and over in a sample household is classified as employed, unemployed, or not in the labor force.

People are classified as *employed* if they did any work at all as paid employees during the reference week; worked in their own business, profession, or on their own farm; or worked without pay at least 15 hours in a family business or farm. People are also counted as employed if they were temporarily absent from their jobs because of illness, bad weather, vacation, labor-management disputes, or personal reasons.

People are classified as *unemployed* if they meet all of the following criteria: They had no employment during the reference week; they were available for work at that time; and they made specific efforts to find employment sometime during the 4-week period ending with the reference week. Persons laid off from a job and expecting recall need not be looking for work to be counted as unemployed. The unemployment data derived from the household survey in no way depend upon the eligibility for or receipt of unemployment insurance benefits.

The *civilian labor force* is the sum of employed and unemployed persons. Those not classified as employed or unemployed are *not in the labor force*. The *unemployment rate* is the number unemployed as a percent of the labor force. The *labor force participation rate* is the labor force as a percent of the population, and the *employment-population ratio* is the employed as a percent of the population.

Establishment survey. The sample establishments are drawn from private nonfarm businesses such as factories, offices, and stores, as well as federal, state, and local government entities. *Employees on nonfarm payrolls* are those who received pay for any part of the reference pay period, including persons on paid leave. Persons are counted in each job they hold. *Hours and earnings* data are for private businesses and relate only to production workers in the goods-producing sector and nonsupervisory workers in the service-providing sector. Industries are classified on the basis of their principal activity in accordance with the 2002 version of the North American Industry Classification System.

Differences in employment estimates. The numerous conceptual and methodological differences between the household and establishment surveys result in important distinctions in the employment estimates derived from the surveys. Among these are:

- The household survey includes agricultural workers, the self-employed, unpaid family workers, and private household workers among the employed. These groups are excluded from the establishment survey.
- The household survey includes people on unpaid leave among the employed. The establishment survey does not.
- The household survey is limited to workers 16 years of age and older. The establishment survey is not limited by age.
- The household survey has no duplication of individuals, because individuals are counted only once, even if they hold more than one job. In the establishment survey, employees working at more than one job and thus appearing on more than one payroll would be counted separately for each appearance.

Seasonal adjustment

Over the course of a year, the size of the nation's labor force and the levels of employment and unemployment undergo sharp fluctuations due to such seasonal events as changes in weather, reduced or expanded production, harvests, major holidays, and the opening and closing of schools. The effect of such seasonal variation can be very large; seasonal fluctuations may account for as much as 95 percent of the month-to-month changes in unemployment.

Because these seasonal events follow a more or less regular pattern each year, their influence on statistical trends can be eliminated by adjusting the statistics from month to month. These adjustments make nonseasonal developments, such as declines in economic activity or increases in the participation of women in the labor force, easier to spot. For example, the large number of youth entering the labor force each June is likely to obscure any other changes that have taken place relative to May, making it difficult to determine if the level of economic activity has risen or declined. However, because the effect of students finishing school in previous years is known, the statistics for the current year can be adjusted to allow for a comparable change. Insofar as the seasonal adjustment is made correctly, the adjusted figure provides a more useful tool with which to analyze changes in economic activity.

Most seasonally adjusted series are independently adjusted in both the household and establishment surveys. However, the adjusted series for many major estimates, such as total payroll employment, employment in most supersectors, total employment, and unemployment are computed by aggregating independently adjusted component series. For example, total unemployment is derived by summing the adjusted series for four major age-sex components; this differs from the unemployment estimate that would be obtained by directly adjusting the total or by combining the duration, reasons, or more detailed age categories.

For both the household and establishment surveys, a concurrent seasonal adjustment methodology is used in which new seasonal factors are calculated each month, using all relevant data, up to and including the data for the current month. In the household survey, new seasonal factors are used to adjust only the current month's data. In the establishment survey, however, new seasonal factors are used each month to adjust the three most recent monthly estimates. In both surveys, revisions to historical data are made once a year.

Reliability of the estimates

Statistics based on the household and establishment surveys are subject to both sampling and nonsampling error. When a sample rather than the entire population is surveyed, there is a chance that the sample estimates may differ from the "true" population values they represent. The exact difference, or *sampling error*, varies depending on the particular sample selected, and this variability is measured by the standard error of the estimate. There is about a 90-percent chance, or level of confidence, that an estimate based on a sample will differ by no more than 1.6 standard errors from the "true" population value because of sampling error. BLS analyses are generally conducted at the 90-percent level of confidence.

For example, the confidence interval for the monthly change in total employment from the household survey is on the order of plus or minus 430,000. Suppose the estimate of total employment increases by 100,000 from one month to the next. The 90-percent confidence interval on the monthly change would range from -330,000 to 530,000 (100,000 +/- 430,000). These figures do not mean that the sample results are off by these magnitudes, but rather that there is about a 90-percent chance that the "true" over-the-month change lies within this interval. Since this range includes values of less than zero, we could not say with confidence that employment had, in fact, increased. If, however, the reported employment rise was half a million, then all of the values within the 90-percent confidence interval would be greater than zero. In this case, it is likely (at least a 90-percent chance) that an employment rise had, in fact, occurred. At an unemployment rate of around 5.5 percent, the 90-percent confidence interval for the monthly change in unemployment is about +/- 280,000, and for the monthly change in the unemployment rate it is about +/- .19 percentage point.

In general, estimates involving many individuals or establishments have lower standard errors (relative to the size of the estimate) than estimates which are based on a small number of observations. The precision of estimates is also improved when the data are cumulated over time such as for quarterly and annual averages. The seasonal adjustment process can also improve the stability of the monthly estimates.

The household and establishment surveys are also affected by *nonsampling error*. Nonsampling errors can occur for many reasons, including the failure to sample a segment of the population, inability to obtain information for all respondents in the sample, inability or unwillingness of respondents to provide correct information on a timely basis, mistakes made by respondents, and errors made in the collection or processing of the data.

For example, in the establishment survey, estimates for the most recent 2 months are based on incomplete returns; for this reason, these estimates are labeled preliminary in the tables. It is only after two successive revisions to a monthly estimate, when nearly all sample reports have been received, that the estimate is considered final.

Another major source of nonsampling error in the establishment survey is the inability to capture, on a timely basis, employment generated by new firms. To correct for this systematic underestimation of employment growth, an estimation procedure with two components is used to account for business births. The first component uses business deaths to impute employment for business births. This is incorporated into the sample-based link relative estimate procedure by simply not reflecting sample units going out of business, but imputing to them the same trend as the other firms in the sample. The second component is an ARIMA time series model designed to estimate the residual net birth/death employment not accounted for by the imputation. The historical time series used to create and test the ARIMA model was derived from the unemployment insurance universe micro-level database, and reflects the actual residual net of births and deaths over the past five years.

The sample-based estimates from the establishment survey are adjusted once a year (on a lagged basis) to universe counts of payroll employment obtained from administrative records of the unemployment insurance program. The difference between the March sample-based employment estimates and the March universe counts is known as a benchmark revision, and serves as a rough proxy for total survey error. The new benchmarks also incorporate changes in the classification of industries. Over the past decade, the benchmark revision for total nonfarm employment has averaged 0.2 percent, ranging from less than 0.05 percent to 0.4 percent.

Additional statistics and other information

More comprehensive statistics are contained in *Employment and Earnings*, published each month by BLS. It is available for $27.00 per issue or $53.00 per year from the U.S. Government Printing Office, Washington, DC 20402. All orders must be prepaid by sending a check or money order payable to the Superintendent of Documents, or by charging to Mastercard or Visa.

Employment and Earnings also provides measures of sampling error for the household and establishment survey data published in this release. For unemployment and other labor force categories, these measures appear in tables 1-B through 1-D of its "Explanatory Notes." For the establishment survey data, the sampling error measures and the actual size of revisions due to benchmark adjustments appear in tables 2-B through 2-F of *Employment and Earnings*.

Information in this release will be made available to sensory impaired individuals upon request. Voice phone: 202-691-5200; TDD message referral phone: 1-800-877-8339.

HOUSEHOLD DATA

Table A-1. Employment status of the civilian population by sex and age

(Numbers in thousands)

Employment status, sex, and age	Not seasonally adjusted			Seasonally adjusted [1]					
	Feb. 2005	Jan. 2006	Feb. 2006	Feb. 2005	Oct. 2005	Nov. 2005	Dec. 2005	Jan. 2006	Feb. 2006
TOTAL									
Civilian noninstitutional population	225,041	227,553	227,763	225,041	226,959	227,204	227,425	227,553	227,763
Civilian labor force	147,649	149,090	149,686	148,271	150,043	150,183	150,153	150,114	150,449
Participation rate	65.6	65.5	65.7	65.9	66.1	66.1	66.0	66.0	66.1
Employed	139,100	141,481	141,994	140,285	142,625	142,611	142,779	143,074	143,257
Employment-population ratio	61.8	62.2	62.3	62.3	62.8	62.8	62.8	62.9	62.9
Unemployed	8,549	7,608	7,692	7,986	7,418	7,572	7,375	7,040	7,193
Unemployment rate	5.8	5.1	5.1	5.4	4.9	5.0	4.9	4.7	4.8
Not in labor force	77,392	78,463	78,077	76,770	76,916	77,021	77,271	77,439	77,314
Persons who currently want a job	4,844	5,095	4,800	4,985	4,894	4,867	5,167	4,962	4,949
Men, 16 years and over									
Civilian noninstitutional population	108,598	109,936	110,048	108,598	109,616	109,748	109,863	109,936	110,048
Civilian labor force	78,950	79,814	80,148	79,490	80,249	80,394	80,431	80,525	80,771
Participation rate	72.7	72.6	72.8	73.2	73.2	73.3	73.2	73.2	73.4
Employed	73,990	75,605	75,749	75,075	76,396	76,410	76,529	76,857	76,888
Employment-population ratio	68.1	68.8	68.8	69.1	69.7	69.6	69.7	69.9	69.9
Unemployed	4,959	4,208	4,400	4,415	3,853	3,984	3,902	3,668	3,883
Unemployment rate	6.3	5.3	5.5	5.6	4.8	5.0	4.9	4.6	4.8
Not in labor force	29,648	30,122	29,900	29,108	29,367	29,351	29,432	29,411	29,278
Men, 20 years and over									
Civilian noninstitutional population	100,321	101,560	101,657	100,321	101,265	101,383	101,489	101,560	101,657
Civilian labor force	75,640	76,513	76,753	75,929	76,780	76,722	76,786	76,928	77,115
Participation rate	75.4	75.3	75.5	75.7	75.8	75.7	75.7	75.7	75.9
Employed	71,413	72,864	72,988	72,246	73,500	73,441	73,468	73,844	73,857
Employment-population ratio	71.2	71.7	71.8	72.0	72.6	72.4	72.4	72.7	72.7
Unemployed	4,226	3,648	3,765	3,683	3,281	3,282	3,318	3,084	3,258
Unemployment rate	5.6	4.8	4.9	4.9	4.3	4.3	4.3	4.0	4.2
Not in labor force	24,680	25,047	24,904	24,392	24,485	24,660	24,703	24,631	24,542
Women, 16 years and over									
Civilian noninstitutional population	116,443	117,617	117,715	116,443	117,343	117,459	117,562	117,617	117,715
Civilian labor force	68,699	69,276	69,538	68,781	69,794	69,789	69,722	69,589	69,679
Participation rate	59.0	58.9	59.1	59.1	59.5	59.4	59.3	59.2	59.2
Employed	65,109	65,876	66,246	65,209	66,229	66,200	66,250	66,217	66,369
Employment-population ratio	55.9	56.0	56.3	56.0	56.4	56.4	56.4	56.3	56.4
Unemployed	3,590	3,399	3,292	3,572	3,565	3,588	3,473	3,372	3,309
Unemployment rate	5.2	4.9	4.7	5.2	5.1	5.1	5.0	4.8	4.7
Not in labor force	47,744	48,341	48,177	47,662	47,549	47,670	47,840	48,028	48,037
Women, 20 years and over									
Civilian noninstitutional population	108,403	109,478	109,582	108,403	109,228	109,332	109,425	109,478	109,582
Civilian labor force	65,411	65,929	66,151	65,284	66,175	66,223	66,215	66,022	66,081
Participation rate	60.3	60.2	60.4	60.2	60.6	60.6	60.5	60.3	60.3
Employed	62,292	62,997	63,306	62,220	63,162	63,170	63,249	63,163	63,262
Employment-population ratio	57.6	57.5	57.8	57.4	57.8	57.8	57.8	57.7	57.7
Unemployed	3,119	2,933	2,845	3,064	3,013	3,053	2,966	2,859	2,819
Unemployment rate	4.8	4.4	4.3	4.7	4.6	4.6	4.5	4.3	4.3
Not in labor force	42,992	43,548	43,410	43,119	43,053	43,109	43,209	43,456	43,481
Both sexes, 16 to 19 years									
Civilian noninstitutional population	16,317	16,515	16,545	16,317	16,465	16,489	16,511	16,515	16,545
Civilian labor force	6,598	6,648	6,782	7,058	7,088	7,238	7,152	7,164	7,253
Participation rate	40.4	40.3	41.0	43.3	43.0	43.9	43.3	43.4	43.8
Employed	5,396	5,620	5,700	5,818	5,964	6,000	6,061	6,067	6,138
Employment-population ratio	33.1	34.0	34.5	35.7	36.2	36.4	36.7	36.7	37.1
Unemployed	1,203	1,028	1,082	1,240	1,124	1,238	1,091	1,097	1,115
Unemployment rate	18.2	15.5	15.9	17.6	15.9	17.1	15.2	15.3	15.4
Not in labor force	9,719	9,867	9,764	9,259	9,377	9,251	9,359	9,352	9,292

[1] The population figures are not adjusted for seasonal variation; therefore, identical numbers appear in the unadjusted and seasonally adjusted columns.

NOTE: Beginning in January 2006, data reflect revised population controls used in the household survey.

Table A-2. Employment status of the civilian population by race, sex, and age

(Numbers in thousands)

Employment status, race, sex, and age	Not seasonally adjusted			Seasonally adjusted [1]					
	Feb. 2005	Jan. 2006	Feb. 2006	Feb. 2005	Oct. 2005	Nov. 2005	Dec. 2005	Jan. 2006	Feb. 2006
WHITE									
Civilian noninstitutional population	183,767	185,436	185,570	183,767	185,028	185,187	185,327	185,436	185,570
Civilian labor force	121,293	122,351	122,539	121,669	122,810	122,813	122,994	123,168	123,022
Participation rate	66.0	66.0	66.0	66.2	66.4	66.3	66.4	66.4	66.3
Employed	115,188	116,745	116,967	116,081	117,396	117,598	117,729	118,071	117,926
Employment-population ratio	62.7	63.0	63.0	63.2	63.4	63.5	63.5	63.7	63.5
Unemployed	6,105	5,605	5,572	5,588	5,415	5,215	5,264	5,097	5,096
Unemployment rate	5.0	4.6	4.5	4.6	4.4	4.2	4.3	4.1	4.1
Not in labor force	62,474	63,085	63,031	62,098	62,218	62,374	62,333	62,268	62,548
Men, 20 years and over									
Civilian labor force	63,192	63,890	63,921	63,406	63,901	63,827	64,028	64,250	64,181
Participation rate	75.9	76.0	76.0	76.2	76.2	76.0	76.2	76.4	76.3
Employed	60,116	61,100	61,129	60,808	61,465	61,498	61,586	61,924	61,836
Employment-population ratio	72.3	72.7	72.7	73.1	73.3	73.3	73.3	73.7	73.5
Unemployed	3,076	2,790	2,791	2,598	2,436	2,328	2,441	2,326	2,345
Unemployment rate	4.9	4.4	4.4	4.1	3.8	3.6	3.8	3.6	3.7
Women, 20 years and over									
Civilian labor force	52,543	52,900	53,056	52,331	52,998	53,037	53,067	52,913	52,890
Participation rate	59.8	59.7	59.8	59.5	59.9	59.9	59.9	59.7	59.6
Employed	50,448	50,847	51,046	50,258	50,858	50,976	51,034	50,938	50,895
Employment-population ratio	57.4	57.4	57.6	57.2	57.5	57.6	57.6	57.5	57.4
Unemployed	2,094	2,052	2,010	2,073	2,141	2,061	2,034	1,974	1,994
Unemployment rate	4.0	3.9	3.8	4.0	4.0	3.9	3.8	3.7	3.8
Both sexes, 16 to 19 years									
Civilian labor force	5,559	5,561	5,562	5,931	5,912	5,949	5,899	6,005	5,951
Participation rate	44.0	43.6	43.6	46.9	46.5	46.7	46.3	47.1	46.6
Employed	4,624	4,798	4,792	5,014	5,074	5,123	5,110	5,209	5,195
Employment-population ratio	36.6	37.6	37.5	39.6	39.9	40.2	40.1	40.8	40.7
Unemployed	934	763	770	917	838	826	789	797	756
Unemployment rate	16.8	13.7	13.9	15.5	14.2	13.9	13.4	13.3	12.7
BLACK OR AFRICAN AMERICAN									
Civilian noninstitutional population	26,342	26,788	26,826	26,342	26,663	26,705	26,744	26,788	26,826
Civilian labor force	16,536	16,764	17,049	16,748	17,150	17,116	16,979	16,982	17,273
Participation rate	62.8	62.6	63.6	63.6	64.3	64.1	63.5	63.4	64.4
Employed	14,686	15,231	15,405	14,941	15,591	15,299	15,397	15,476	15,660
Employment-population ratio	55.8	56.9	57.4	56.7	58.5	57.3	57.6	57.8	58.4
Unemployed	1,850	1,532	1,644	1,807	1,559	1,819	1,582	1,506	1,614
Unemployment rate	11.2	9.1	9.6	10.8	9.1	10.6	9.3	8.9	9.3
Not in labor force	9,804	10,024	9,778	9,595	9,513	9,587	9,766	9,806	9,553
Men, 20 years and over									
Civilian labor force	7,394	7,473	7,605	7,464	7,659	7,556	7,553	7,520	7,682
Participation rate	69.9	69.4	70.5	70.5	71.4	70.4	70.2	69.8	71.2
Employed	6,523	6,840	6,877	6,672	7,006	6,849	6,903	6,959	7,030
Employment-population ratio	61.6	63.5	63.7	63.0	65.3	63.8	64.2	64.6	65.2
Unemployed	872	633	728	792	653	707	651	561	652
Unemployment rate	11.8	8.5	9.6	10.6	8.5	9.4	8.6	7.5	8.5
Women, 20 years and over									
Civilian labor force	8,476	8,587	8,602	8,532	8,726	8,714	8,633	8,681	8,668
Participation rate	63.7	63.7	63.7	64.1	64.9	64.8	64.1	64.4	64.2
Employed	7,700	7,892	7,925	7,759	8,069	7,927	7,896	7,981	7,990
Employment-population ratio	57.9	58.5	58.7	58.3	60.0	58.9	58.6	59.2	59.2
Unemployed	776	695	676	773	658	787	738	700	678
Unemployment rate	9.2	8.1	7.9	9.1	7.5	9.0	8.5	8.1	7.8
Both sexes, 16 to 19 years									
Civilian labor force	668	703	842	752	765	849	792	781	924
Participation rate	27.2	27.9	33.3	30.6	30.5	33.8	31.5	30.9	36.5
Employed	465	499	603	510	517	523	598	536	640
Employment-population ratio	19.0	19.8	23.8	20.8	20.7	20.8	23.8	21.2	25.3
Unemployed	202	204	239	242	248	326	194	245	284
Unemployment rate	30.3	29.0	28.4	32.1	32.4	38.4	24.4	31.4	30.8
ASIAN									
Civilian noninstitutional population	9,659	9,990	10,032	(2)	(2)	(2)	(2)	(2)	(2)
Civilian labor force	6,378	6,565	6,647	(2)	(2)	(2)	(2)	(2)	(2)
Participation rate	66.0	65.7	66.3	(2)	(2)	(2)	(2)	(2)	(2)
Employed	6,092	6,357	6,437	(2)	(2)	(2)	(2)	(2)	(2)
Employment-population ratio	63.1	63.6	64.2	(2)	(2)	(2)	(2)	(2)	(2)
Unemployed	286	208	210	(2)	(2)	(2)	(2)	(2)	(2)
Unemployment rate	4.5	3.2	3.2	(2)	(2)	(2)	(2)	(2)	(2)
Not in labor force	3,281	3,425	3,385	(2)	(2)	(2)	(2)	(2)	(2)

[1] The population figures are not adjusted for seasonal variation; therefore, identical numbers appear in the unadjusted and seasonally adjusted columns.
[2] Data not available.

NOTE: Estimates for the above race groups will not sum to totals shown in table A-1 because data are not presented for all races. Beginning in January 2006, data reflect revised population controls used in the household survey.

HOUSEHOLD DATA

Table A-3. Employment status of the Hispanic or Latino population by sex and age

(Numbers in thousands)

Employment status, sex, and age	Not seasonally adjusted			Seasonally adjusted [1]					
	Feb. 2005	Jan. 2006	Feb. 2006	Feb. 2005	Oct. 2005	Nov. 2005	Dec. 2005	Jan. 2006	Feb. 2006
HISPANIC OR LATINO ETHNICITY									
Civilian noninstitutional population	28,729	29,622	29,707	28,729	29,456	29,552	29,645	29,622	29,707
Civilian labor force	19,385	20,272	20,342	19,478	20,047	20,214	20,292	20,528	20,485
Participation rate	67.5	68.4	68.5	67.8	68.1	68.4	68.4	69.3	69.0
Employed	18,031	18,969	19,116	18,243	18,871	18,991	19,066	19,344	19,356
Employment-population ratio	62.8	64.0	64.3	63.5	64.1	64.3	64.3	65.3	65.2
Unemployed	1,354	1,303	1,226	1,235	1,176	1,223	1,226	1,184	1,129
Unemployment rate	7.0	6.4	6.0	6.3	5.9	6.1	6.0	5.8	5.5
Not in labor force	9,344	9,349	9,365	9,251	9,409	9,338	9,353	9,094	9,222
Men, 20 years and over									
Civilian labor force	11,143	11,647	11,731	([2])	([2])	([2])	([2])	([2])	([2])
Participation rate	83.2	84.3	84.6	([2])	([2])	([2])	([2])	([2])	([2])
Employed	10,508	11,002	11,076	([2])	([2])	([2])	([2])	([2])	([2])
Employment-population ratio	78.5	79.6	79.9	([2])	([2])	([2])	([2])	([2])	([2])
Unemployed	635	645	655	([2])	([2])	([2])	([2])	([2])	([2])
Unemployment rate	5.7	5.5	5.6	([2])	([2])	([2])	([2])	([2])	([2])
Women, 20 years and over									
Civilian labor force	7,266	7,605	7,625	([2])	([2])	([2])	([2])	([2])	([2])
Participation rate	57.3	58.2	58.2	([2])	([2])	([2])	([2])	([2])	([2])
Employed	6,754	7,142	7,191	([2])	([2])	([2])	([2])	([2])	([2])
Employment-population ratio	53.2	54.7	54.9	([2])	([2])	([2])	([2])	([2])	([2])
Unemployed	512	464	433	([2])	([2])	([2])	([2])	([2])	([2])
Unemployment rate	7.1	6.1	5.7	([2])	([2])	([2])	([2])	([2])	([2])
Both sexes, 16 to 19 years									
Civilian labor force	976	1,020	987	([2])	([2])	([2])	([2])	([2])	([2])
Participation rate	36.8	37.3	36.0	([2])	([2])	([2])	([2])	([2])	([2])
Employed	769	825	849	([2])	([2])	([2])	([2])	([2])	([2])
Employment-population ratio	29.0	30.2	30.9	([2])	([2])	([2])	([2])	([2])	([2])
Unemployed	207	195	138	([2])	([2])	([2])	([2])	([2])	([2])
Unemployment rate	21.2	19.1	14.0	([2])	([2])	([2])	([2])	([2])	([2])

[1] The population figures are not adjusted for seasonal variation; therefore, identical numbers appear in the unadjusted and seasonally adjusted columns.
[2] Data not available.

NOTE: Persons whose ethnicity is identified as Hispanic or Latino may be of any race. Beginning in January 2006, data reflect revised population controls used in the household survey.

Table A-4. Employment status of the civilian population 25 years and over by educational attainment

(Numbers in thousands)

Educational attainment	Not seasonally adjusted			Seasonally adjusted					
	Feb. 2005	Jan. 2006	Feb. 2006	Feb. 2005	Oct. 2005	Nov. 2005	Dec. 2005	Jan. 2006	Feb. 2006
Less than a high school diploma									
Civilian labor force	12,269	12,621	12,415	12,618	12,502	12,529	12,368	12,628	12,739
Participation rate	44.3	45.9	45.8	45.6	45.4	45.4	46.3	46.0	47.0
Employed	11,142	11,580	11,375	11,626	11,611	11,602	11,465	11,742	11,823
Employment-population ratio	40.2	42.1	41.9	42.0	42.1	42.1	41.9	42.7	43.6
Unemployed	1,126	1,041	1,040	992	891	927	923	886	915
Unemployment rate	9.2	8.2	8.4	7.9	7.1	7.4	7.5	7.0	7.2
High school graduates, no college [1]									
Civilian labor force	38,230	38,018	37,894	38,166	38,467	38,372	38,173	38,001	37,913
Participation rate	63.0	62.5	62.5	62.9	63.8	63.4	63.1	62.5	62.6
Employed	36,101	36,075	35,989	36,317	36,627	36,547	36,417	36,324	36,240
Employment-population ratio	59.5	59.3	59.4	59.8	60.6	60.4	60.2	59.7	59.8
Unemployed	2,129	1,943	1,906	1,849	1,840	1,825	1,756	1,678	1,673
Unemployment rate	5.6	5.1	5.0	4.8	4.8	4.8	4.6	4.4	4.4
Some college or associate degree									
Civilian labor force	35,071	35,265	36,075	34,769	35,310	35,411	35,498	35,535	35,745
Participation rate	72.8	71.9	72.2	72.2	72.3	72.3	72.4	72.5	71.6
Employed	33,529	33,917	34,675	33,331	33,967	34,059	34,115	34,290	34,442
Employment-population ratio	69.6	69.2	69.4	69.2	69.6	69.5	69.6	69.9	69.0
Unemployed	1,543	1,348	1,400	1,439	1,343	1,352	1,383	1,246	1,302
Unemployment rate	4.4	3.8	3.9	4.1	3.8	3.8	3.9	3.5	3.6
Bachelor's degree and higher [2]									
Civilian labor force	40,621	41,818	41,686	40,502	41,616	41,600	42,097	41,837	41,731
Participation rate	78.2	78.2	78.2	78.0	77.7	78.1	78.4	78.3	78.3
Employed	39,657	40,907	40,773	39,528	40,670	40,665	41,187	40,955	40,808
Employment-population ratio	76.4	76.5	76.5	76.1	75.9	76.3	76.7	76.6	76.6
Unemployed	964	911	913	974	946	936	910	882	923
Unemployment rate	2.4	2.2	2.2	2.4	2.3	2.2	2.2	2.1	2.2

[1] Includes persons with a high school diploma or equivalent.
[2] Includes persons with bachelor's, master's, professional, and doctoral degrees.

NOTE: Beginning in January 2006, data reflect revised population controls used in the household survey.

Table A-5. Employed persons by class of worker and part-time status

(In thousands)

Category	Not seasonally adjusted			Seasonally adjusted					
	Feb. 2005	Jan. 2006	Feb. 2006	Feb. 2005	Oct. 2005	Nov. 2005	Dec. 2005	Jan. 2006	Feb. 2006
CLASS OF WORKER									
Agriculture and related industries	1,889	1,970	1,946	2,161	2,126	2,154	2,130	2,198	2,224
Wage and salary workers	1,023	1,118	1,084	1,215	1,161	1,187	1,187	1,268	1,281
Self-employed workers	845	834	843	915	936	928	921	897	919
Unpaid family workers	22	17	19	(1)	(1)	(1)	(1)	(1)	(1)
Nonagricultural industries	137,211	139,512	140,048	138,111	140,577	140,427	140,638	140,862	141,000
Wage and salary workers	127,615	129,918	130,404	128,312	131,123	131,001	131,170	131,185	131,189
Government	20,321	19,970	20,013	20,097	20,330	20,224	20,192	19,952	19,966
Private industries	107,294	109,948	110,392	108,061	110,799	110,787	111,021	111,266	111,229
Private households	777	839	812	(1)	(1)	(1)	(1)	(1)	(1)
Other industries	106,517	109,109	109,580	107,249	109,986	110,039	110,261	110,440	110,394
Self-employed workers	9,468	9,534	9,578	9,707	9,358	9,274	9,370	9,550	9,730
Unpaid family workers	127	59	68	(1)	(1)	(1)	(1)	(1)	(1)
PERSONS AT WORK PART TIME [2]									
All industries:									
Part time for economic reasons	4,487	4,597	4,403	4,291	4,240	4,175	4,138	4,133	4,204
Slack work or business conditions	2,820	3,108	2,843	2,828	2,643	2,595	2,541	2,649	2,655
Could only find part-time work	1,315	1,182	1,247	1,290	1,299	1,246	1,246	1,226	1,238
Part time for noneconomic reasons	20,145	19,908	20,134	19,531	19,698	19,612	19,582	19,708	19,564
Nonagricultural industries:									
Part time for economic reasons	4,380	4,513	4,298	4,170	4,161	4,105	4,051	4,064	4,107
Slack work or business conditions	2,761	3,063	2,783	2,573	2,592	2,567	2,508	2,606	2,590
Could only find part-time work	1,308	1,170	1,246	1,273	1,284	1,230	1,230	1,198	1,225
Part time for noneconomic reasons	19,865	19,546	19,822	19,198	19,255	19,235	19,214	19,368	19,199

[1] Data not available.

[2] Persons at work excludes employed persons who were absent from their jobs during the entire reference week for reasons such as vacation, illness, or industrial dispute. Part time for noneconomic reasons excludes persons who usually work full time but worked only 1 to 34 hours during the reference week for reasons such as holidays, illness, and bad weather.

NOTE: Detail for the seasonally adjusted data shown in this table will not necessarily add to totals because of the independent seasonal adjustment of the various series. Beginning in January 2006, data reflect revised population controls used in the household survey.

HOUSEHOLD DATA

Table A-6. Selected employment indicators

(In thousands)

Characteristic	Not seasonally adjusted			Seasonally adjusted					
	Feb. 2005	Jan. 2006	Feb. 2006	Feb. 2005	Oct. 2005	Nov. 2005	Dec. 2005	Jan. 2006	Feb. 2006
AGE AND SEX									
Total, 16 years and over	139,100	141,481	141,994	140,285	142,625	142,611	142,779	143,074	143,257
16 to 19 years	5,395	5,620	5,700	5,818	5,964	6,000	6,061	6,067	6,136
16 to 17 years	2,098	2,099	2,177	2,288	2,290	2,285	2,334	2,280	2,348
18 to 19 years	3,297	3,522	3,523	3,535	3,673	3,694	3,713	3,788	3,791
20 years and over	133,704	135,861	136,294	134,466	136,661	136,610	136,717	137,007	137,119
20 to 24 years	13,275	13,382	13,482	13,569	13,945	13,931	13,840	13,713	13,801
25 years and over	120,429	122,479	122,812	120,828	122,719	122,731	122,906	123,302	123,261
25 to 54 years	97,598	98,514	98,701	98,002	98,834	98,849	98,934	99,218	99,146
25 to 34 years	30,359	30,541	30,571	30,547	30,864	30,920	30,866	30,860	30,789
35 to 44 years	34,404	34,388	34,459	34,569	34,601	34,513	34,581	34,632	34,630
45 to 54 years	32,835	33,586	33,672	32,886	33,369	33,416	33,486	33,724	33,727
55 years and over	22,832	23,965	24,111	22,826	23,885	23,883	23,972	24,086	24,114
Men, 16 years and over	73,990	75,605	75,749	75,075	76,396	76,410	76,529	76,857	76,888
16 to 19 years	2,578	2,741	2,760	2,829	2,896	2,970	3,061	3,013	3,031
16 to 17 years	950	942	968	1,060	1,043	1,062	1,090	1,064	1,078
18 to 19 years	1,628	1,799	1,792	1,763	1,848	1,890	1,951	1,943	1,968
20 years and over	71,413	72,864	72,988	72,246	73,500	73,441	73,468	73,844	73,857
20 to 24 years	6,957	7,057	7,185	7,147	7,310	7,330	7,356	7,297	7,373
25 years and over	64,455	65,807	65,803	65,075	66,192	66,142	66,157	66,534	66,460
25 to 54 years	52,346	52,985	52,950	52,858	53,429	53,419	53,375	53,621	53,504
25 to 34 years	16,681	16,855	16,766	16,893	17,107	17,103	17,080	17,106	17,012
35 to 44 years	18,565	18,616	18,614	18,745	18,800	18,745	18,739	18,818	18,796
45 to 54 years	17,100	17,514	17,570	17,220	17,522	17,571	17,556	17,697	17,696
55 years and over	12,109	12,822	12,853	12,217	12,763	12,723	12,782	12,913	12,956
Women, 16 years and over	65,109	65,876	66,246	65,209	66,229	66,200	66,250	66,217	66,369
16 to 19 years	2,818	2,879	2,940	2,989	3,068	3,031	3,000	3,054	3,107
16 to 17 years	1,149	1,157	1,208	1,226	1,247	1,223	1,245	1,216	1,270
18 to 19 years	1,669	1,723	1,731	1,753	1,825	1,804	1,762	1,845	1,824
20 years and over	62,292	62,997	63,306	62,220	63,162	63,170	63,249	63,163	63,262
20 to 24 years	6,318	6,325	6,297	6,422	6,635	6,601	6,484	6,415	6,428
25 years and over	55,974	56,672	57,009	55,753	56,527	56,569	56,749	56,769	56,801
25 to 54 years	45,252	45,529	45,751	45,144	45,405	45,430	45,559	45,596	45,643
25 to 34 years	13,678	13,685	13,805	13,654	13,757	13,817	13,786	13,754	13,777
35 to 44 years	15,838	15,772	15,845	15,824	15,801	15,768	15,843	15,814	15,834
45 to 54 years	15,735	16,071	16,101	15,666	15,847	15,845	15,930	16,027	16,031
55 years and over	10,722	11,143	11,258	10,609	11,122	11,159	11,190	11,173	11,158
MARITAL STATUS									
Married men, spouse present	45,160	45,530	45,486	45,356	45,634	45,480	45,469	45,790	45,679
Married women, spouse present	34,754	35,388	35,176	34,602	34,868	34,910	34,948	35,167	35,039
Women who maintain families	8,969	8,711	8,930	([1])	([1])	([1])	([1])	([1])	([1])
FULL- OR PART-TIME STATUS									
Full-time workers [2]	114,022	116,395	116,823	115,470	117,783	117,860	118,135	118,186	118,402
Part-time workers [3]	25,078	25,086	25,171	24,823	24,898	24,814	24,743	24,931	24,794
MULTIPLE JOBHOLDERS									
Total multiple jobholders	7,667	7,428	7,437	7,539	7,584	7,545	7,473	7,603	7,408
Percent of total employed	5.5	5.3	5.2	5.4	5.3	5.3	5.2	5.3	5.2

[1] Data not available.

[2] Employed full-time workers are persons who usually work 35 hours or more per week.

[3] Employed part-time workers are persons who usually work less than 35 hours per week.

NOTE: Detail for the seasonally adjusted data shown in this table will not necessarily add to totals because of the independent seasonal adjustment of the various series. Beginning in January 2006, data reflect revised population controls used in the household survey.

Table A-7. Selected unemployment indicators, seasonally adjusted

Characteristic	Number of unemployed persons (in thousands)			Unemployment rates [1]					
	Feb. 2005	Jan. 2006	Feb. 2006	Feb. 2005	Oct. 2005	Nov. 2005	Dec. 2005	Jan. 2006	Feb. 2006
AGE AND SEX									
Total, 16 years and over	7,986	7,040	7,193	5.4	4.9	5.0	4.9	4.7	4.8
16 to 19 years	1,240	1,097	1,115	17.6	15.9	17.1	15.2	15.3	15.4
16 to 17 years	587	461	512	20.4	18.7	21.4	17.8	16.5	17.9
18 to 19 years	661	635	612	15.8	14.2	14.2	13.5	14.4	13.9
20 years and over	6,746	5,943	6,077	4.8	4.4	4.4	4.4	4.2	4.2
20 to 24 years	1,497	1,224	1,275	9.9	8.5	8.4	8.5	8.2	8.5
25 years and over	5,282	4,737	4,843	4.2	3.9	3.9	3.9	3.7	3.8
25 to 54 years	4,405	3,924	4,111	4.3	4.1	4.1	4.1	3.8	4.0
25 to 34 years	1,680	1,482	1,697	5.2	4.8	5.0	5.0	4.6	5.2
35 to 44 years	1,513	1,317	1,275	4.2	3.9	3.9	3.8	3.7	3.6
45 to 54 years	1,212	1,125	1,140	3.6	3.6	3.5	3.5	3.2	3.3
55 years and over	847	791	731	3.6	3.2	3.1	3.3	3.2	2.9
Men, 16 years and over	4,415	3,668	3,883	5.8	4.8	5.0	4.9	4.6	4.8
16 to 19 years	732	584	625	20.6	18.5	19.1	16.0	16.2	17.1
16 to 17 years	348	218	292	24.7	18.1	23.6	19.8	17.0	21.3
18 to 19 years	386	355	337	17.8	15.5	15.6	13.8	15.4	14.6
20 years and over	3,683	3,084	3,258	4.9	4.3	4.3	4.3	4.0	4.2
20 to 24 years	898	711	738	11.2	9.4	9.1	9.2	8.9	9.1
25 years and over	2,791	2,388	2,554	4.1	3.7	3.7	3.8	3.5	3.7
25 to 54 years	2,322	1,960	2,174	4.2	3.8	3.8	3.9	3.5	3.9
25 to 34 years	897	748	932	5.0	4.4	4.5	4.4	4.2	5.2
35 to 44 years	788	625	613	4.0	3.5	3.6	3.7	3.2	3.2
45 to 54 years	638	588	629	3.8	3.5	3.3	3.5	3.2	3.4
55 years and over	469	426	380	3.7	3.2	3.1	3.3	3.2	2.8
Women, 16 years and over	3,572	3,372	3,309	5.2	5.1	5.1	5.0	4.8	4.7
16 to 19 years	508	513	490	14.5	15.2	15.0	14.4	14.4	13.6
16 to 17 years	238	233	220	16.3	19.1	19.5	16.1	16.1	14.7
18 to 19 years	275	281	274	13.6	12.8	12.7	13.2	13.2	13.1
20 years and over	3,064	2,859	2,819	4.7	4.6	4.6	4.5	4.3	4.3
20 to 24 years	599	614	537	8.5	7.5	7.5	7.7	7.4	7.7
25 years and over	2,471	2,351	2,288	4.2	4.2	4.3	4.1	4.0	3.9
25 to 54 years	2,083	1,963	1,937	4.4	4.4	4.5	4.4	4.1	4.1
25 to 34 years	783	734	764	5.4	5.3	5.7	5.7	5.1	5.3
35 to 44 years	725	692	662	4.4	4.4	4.2	4.0	4.2	4.0
45 to 54 years	574	537	510	3.5	3.7	3.7	3.5	3.2	3.1
55 years and over [2]	386	381	358	3.5	3.1	3.1	2.9	3.3	3.1
MARITAL STATUS									
Married men, spouse present	1,375	1,136	1,138	2.9	2.6	2.6	2.6	2.4	2.4
Married women, spouse present	1,145	1,102	1,053	3.2	3.3	3.3	3.2	3.0	2.9
Women who maintain families [2]	783	778	729	8.0	7.3	7.2	6.9	6.2	7.5
FULL- OR PART-TIME STATUS									
Full-time workers [3]	6,539	5,782	5,807	5.4	4.9	4.9	4.8	4.7	4.7
Part-time workers [4]	1,425	1,261	1,354	5.5	5.4	5.7	6.5	4.8	5.2

[1] Unemployment as a percent of the civilian labor force.

[2] Not seasonally adjusted.

[3] Full-time workers are unemployed persons who have expressed a desire to work full time (35 hours or more per week) or are on layoff from full-time jobs.

[4] Part-time workers are unemployed persons who have expressed a desire to work part time (less than 35 hours per week) or are on layoff from part-time jobs.

NOTE: Detail shown in this table will not necessarily add to totals because of the independent seasonal adjustment of the various series. Beginning in January 2006, data reflect revised population controls used in the household survey.

HOUSEHOLD DATA

Table A-8. Unemployed persons by reason for unemployment

(Numbers in thousands)

Reason	Not seasonally adjusted			Seasonally adjusted					
	Feb. 2005	Jan. 2006	Feb. 2006	Feb. 2005	Oct. 2005	Nov. 2005	Dec. 2005	Jan. 2006	Feb. 2006
NUMBER OF UNEMPLOYED									
Job losers and persons who completed temporary jobs	4,461	3,990	3,846	3,886	3,508	3,455	3,488	3,336	3,361
On temporary layoff	1,330	1,319	1,228	960	944	899	935	873	885
Not on temporary layoff	3,130	2,671	2,618	2,927	2,564	2,556	2,552	2,462	2,477
Permanent job losers	2,201	1,861	1,834	(1)	(1)	(1)	(1)	(1)	(1)
Persons who completed temporary jobs	929	810	784	(1)	(1)	(1)	(1)	(1)	(1)
Job leavers	976	831	878	950	889	900	841	839	849
Reentrants	2,488	2,252	2,381	2,406	2,349	2,538	2,430	2,314	2,313
New entrants	624	535	588	741	654	679	644	622	660
PERCENT DISTRIBUTION									
Total unemployed	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Job losers and persons who completed temporary jobs	52.2	52.4	50.0	48.7	47.4	45.6	47.1	46.9	46.7
On temporary layoff	15.6	17.3	16.0	12.0	12.8	11.9	12.6	12.3	12.3
Not on temporary layoff	36.6	35.1	34.0	36.7	34.7	33.8	34.5	34.6	34.4
Job leavers	11.4	10.9	11.4	11.9	12.0	11.9	11.4	11.8	11.8
Reentrants	29.1	29.6	30.9	30.1	31.7	33.5	32.8	32.5	32.1
New entrants	7.3	7.0	7.8	9.3	8.8	9.0	8.7	8.7	9.4
UNEMPLOYED AS A PERCENT OF THE CIVILIAN LABOR FORCE									
Job losers and persons who completed temporary jobs	3.0	2.7	2.6	2.6	2.3	2.3	2.3	2.2	2.2
Job leavers	.7	.6	.6	.6	.6	.6	.6	.6	.6
Reentrants	1.7	1.5	1.6	1.6	1.6	1.7	1.6	1.5	1.5
New entrants	.4	.4	.4	.5	.4	.5	.4	.4	.5

[1] Data not available.

NOTE: Beginning in January 2006, data reflect revised population controls used in the household survey.

Table A-9. Unemployed persons by duration of unemployment

(Numbers in thousands)

Duration	Not seasonally adjusted			Seasonally adjusted					
	Feb. 2005	Jan. 2006	Feb. 2006	Feb. 2005	Oct. 2005	Nov. 2005	Dec. 2005	Jan. 2006	Feb. 2006
NUMBER OF UNEMPLOYED									
Less than 5 weeks	2,829	2,833	2,473	2,743	2,708	2,779	2,764	2,556	2,595
5 to 14 weeks	2,789	2,433	2,485	2,320	2,283	2,288	2,240	2,263	2,074
15 weeks and over	3,132	2,343	2,736	2,862	2,477	2,492	2,417	2,241	2,482
15 to 26 weeks	1,445	1,143	1,338	1,236	1,046	1,108	1,068	1,090	1,126
27 weeks and over	1,687	1,200	1,398	1,626	1,432	1,383	1,350	1,151	1,356
Average (mean) duration, in weeks	19.2	16.0	17.9	19.1	18.0	17.6	17.3	16.8	17.6
Median duration, in weeks	9.8	8.3	9.6	9.2	8.6	8.5	8.5	8.4	8.9
PERCENT DISTRIBUTION									
Total unemployed	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Less than 5 weeks	30.7	37.2	32.1	34.6	36.4	36.9	37.2	36.2	36.3
5 to 14 weeks	32.6	32.0	32.3	29.3	30.4	30.1	30.2	32.1	29.0
15 weeks and over	36.6	30.8	35.6	36.1	33.3	33.0	32.6	31.7	34.7
15 to 26 weeks	16.9	15.0	17.4	15.6	14.0	14.7	14.4	15.4	15.7
27 weeks and over	19.7	15.8	18.2	20.5	19.2	18.3	18.2	16.3	19.0

NOTE: Beginning in January 2006, data reflect revised population controls used in the household survey.

Table A-10. Employed and unemployed persons by occupation, not seasonally adjusted

(Numbers in thousands)

Occupation	Employed		Unemployed		Unemployment rates	
	Feb. 2005	Feb. 2006	Feb. 2005	Feb. 2006	Feb. 2005	Feb. 2006
Total, 16 years and over [1]	139,100	141,994	8,549	7,692	5.8	5.1
Management, professional, and related occupations	48,495	50,205	1,231	1,064	2.5	2.1
Management, business, and financial operations occupations	19,876	21,216	527	445	2.6	2.1
Professional and related occupations	28,618	28,989	704	619	2.4	2.1
Service occupations	22,179	22,921	1,678	1,755	7.0	7.1
Sales and office occupations	35,687	35,734	1,992	1,705	5.3	4.6
Sales and related occupations	16,316	16,364	945	850	5.5	4.9
Office and administrative support occupations	19,371	19,369	1,048	855	5.1	4.2
Natural resources, construction, and maintenance occupations	14,542	15,279	1,544	1,186	9.6	7.2
Farming, fishing, and forestry occupations	838	876	102	138	10.8	13.6
Construction and extraction occupations	8,570	9,162	1,195	829	12.2	8.3
Installation, maintenance, and repair occupations	5,134	5,241	248	220	4.6	4.0
Production, transportation, and material moving occupations	18,198	17,855	1,444	1,367	7.4	7.1
Production occupations	9,446	9,248	770	684	7.5	6.9
Transportation and material moving occupations	8,752	8,607	674	683	7.2	7.4

[1] Persons with no previous work experience and persons whose last job was in the Armed Forces are included in the unemployed total.
NOTE: Beginning in January 2006, data reflect revised populationcontrols used in the household survey.

Table A-11. Unemployed persons by industry and class of worker, not seasonally adjusted

Industry and class of worker	Number of unemployed persons (in thousands)		Unemployment rates	
	Feb. 2005	Feb. 2006	Feb. 2005	Feb. 2006
Total, 16 years and over [1]	8,549	7,692	5.8	5.1
Nonagricultural private wage and salary workers	6,984	6,161	6.1	5.3
Mining	25	25	4.0	3.8
Construction	1,150	836	12.3	8.6
Manufacturing	889	821	5.3	4.9
Durable goods	532	477	5.1	4.4
Nondurable goods	357	344	5.8	5.7
Wholesale and retail trade	1,301	1,141	6.2	5.4
Transportation and utilities	245	280	4.4	4.6
Information	204	119	6.5	3.7
Financial activities	301	268	3.2	2.8
Professional and business services	916	841	7.2	6.5
Education and health services	619	528	3.4	2.8
Leisure and hospitality	1,009	1,040	8.8	9.1
Other services	325	281	5.3	4.4
Agriculture and related private wage and salary workers	107	139	9.9	11.8
Government workers	472	472	2.3	2.3
Self employed and unpaid family workers	363	332	3.4	3.1

[1] Persons with no previous work experience are included in the unemployed total.
NOTE: Beginning in January 2006, data reflect revised populationcontrols used in the household survey.

HOUSEHOLD DATA

Table A-12. Alternative measures of labor underutilization

(Percent)

Measure	Not seasonally adjusted			Seasonally adjusted					
	Feb. 2005	Jan. 2006	Feb. 2006	Feb. 2005	Oct. 2005	Nov. 2005	Dec. 2005	Jan. 2006	Feb. 2006
U-1 Persons unemployed 15 weeks or longer, as a percent of the civilian labor force	2.1	1.6	1.8	1.9	1.7	1.7	1.8	1.5	1.8
U-2 Job losers and persons who completed temporary jobs, as a percent of the civilian labor force	3.0	2.7	2.6	2.6	2.3	2.3	2.3	2.2	2.2
U-3 Total unemployed, as a percent of the civilian labor force (official unemployment rate)	5.8	5.1	5.1	5.4	4.9	5.0	4.9	4.7	4.8
U-4 Total unemployed plus discouraged workers, as a percent of the civilian labor force plus discouraged workers	6.1	5.4	5.4	5.7	5.2	5.3	5.2	4.9	5.0
U-5 Total unemployed, plus discouraged workers, plus all other marginally attached workers, as a percent of the civilian labor force plus all marginally attached workers	6.8	6.1	6.1	6.4	5.8	5.9	5.9	5.7	5.7
U-6 Total unemployed, plus all marginally attached workers, plus total employed part time for economic reasons, as a percent of the civilian labor force plus all marginally attached workers	9.9	9.2	9.0	9.3	8.8	8.7	8.6	8.4	8.5

NOTE: Marginally attached workers are persons who currently are neither working nor looking for work but indicate that they want and are available for a job and have looked for work sometime in the recent past. Discouraged workers, a subset of the marginally attached, have given a job-market related reason for not currently looking for a job. Persons employed part time for economic reasons are those who want and are available for full-time work but have had to settle for a part-time schedule. For further information, see "BLS introduces new range of alternative unemployment measures," in the October 1995 issue of the *Monthly Labor Review*. Beginning in January 2006, data reflect revised population controls used in the household survey.

Table A-13. Persons not in the labor force and multiple jobholders by sex, not seasonally adjusted

(Numbers in thousands)

Category	Total		Men		Women	
	Feb. 2005	Feb. 2006	Feb. 2005	Feb. 2006	Feb. 2005	Feb. 2006
NOT IN THE LABOR FORCE						
Total not in the labor force	77,392	78,077	29,648	29,900	47,744	48,177
Persons who currently want a job	4,844	4,800	2,128	2,071	2,716	2,729
Searched for work and available to work now [1]	1,673	1,471	838	784	835	687
Reason not currently looking:						
Discouragement over job prospects [2]	485	386	268	237	218	149
Reasons other than discouragement [3]	1,187	1,085	571	546	617	538
MULTIPLE JOBHOLDERS						
Total multiple jobholders [4]	7,667	7,437	3,867	3,731	3,800	3,706
Percent of total employed	5.5	5.2	5.2	4.9	5.8	5.6
Primary job full time, secondary job part time	3,882	3,899	2,207	2,171	1,675	1,728
Primary and secondary jobs both part time	1,746	1,700	586	505	1,160	1,195
Primary and secondary jobs both full time	274	302	158	202	116	100
Hours vary on primary or secondary job	1,703	1,503	888	839	815	664

[1] Data refer to persons who have searched for work during the prior 12 months and were available to take a job during the reference week.

[2] Includes thinks no work available, could not find work, lacks schooling or training, employer thinks too young or old, and other types of discrimination.

[3] Includes those who did not actively look for work in the prior 4 weeks for such reasons as school or family responsibilities, ill health, and transportation problems, as well as a small number for which reason for nonparticipation was not determined.

[4] Includes persons who work part time on their primary job and full time on their secondary job(s), not shown separately.

NOTE: Beginning in January 2006, data reflect revised population controls used in the household survey.

ESTABLISHMENT DATA

Table B-1. Employees on nonfarm payrolls by industry sector and selected industry detail

(In thousands)

Industry	Not seasonally adjusted				Seasonally adjusted						
	Feb. 2005	Dec. 2005	Jan. 2006p	Feb. 2006p	Feb. 2005	Oct. 2005	Nov. 2005	Dec. 2005	Jan. 2006p	Feb. 2006p	Change from: Jan. 2006-Feb. 2006p
Total nonfarm	131,195	135,041	132,381	133,265	132,736	133,877	134,231	134,376	134,546	134,789	243
Total private	109,146	112,819	110,632	111,057	110,995	112,025	112,351	112,498	112,699	112,904	205
Goods-producing	21,462	22,160	21,764	21,812	22,052	22,179	22,264	22,282	22,347	22,392	45
Natural resources and mining	595	643	631	637	610	638	641	644	647	652	5
Logging	65.0	62.5	60.2	59.6	66.7	62.1	62.1	62.0	61.8	61.7	-.1
Mining	529.7	580.8	571.1	577.3	543.1	573.8	579.3	582.1	585.0	590.1	5.1
Oil and gas extraction	122.6	128.6	127.6	128.5	123.3	127.4	128.9	128.7	128.9	129.5	.6
Mining, except oil and gas[1]	200.2	211.7	204.7	205.5	209.4	214.5	215.0	214.3	214.4	214.8	.4
Coal mining	72.0	76.0	75.6	76.0	72.5	75.1	75.1	75.4	75.9	76.5	.6
Support activities for mining	206.9	240.5	238.8	243.3	210.4	231.9	235.4	239.1	241.7	245.8	4.1
Construction	6,699	7,282	7,024	7,048	7,166	7,347	7,409	7,416	7,471	7,512	41
Construction of buildings	1,616.2	1,721.4	1,685.6	1,681.5	1,683.3	1,702.4	1,722.4	1,727.2	1,741.3	1,743.7	2.4
Residential building	899.3	963.7	945.3	938.8	938.7	952.8	963.8	966.8	975.4	975.5	.1
Nonresidential building	716.9	757.7	740.3	742.7	744.6	749.6	758.8	760.4	765.9	768.2	2.3
Heavy and civil engineering construction	810.6	931.2	876.2	880.8	928.8	965.3	977.1	974.8	988.9	996.1	7.2
Specialty trade contractors	4,272.2	4,629.2	4,461.9	4,485.5	4,554.3	4,679.2	4,709.4	4,714.3	4,741.0	4,772.6	31.6
Residential specialty trade contractors	2,091.2	2,314.4	2,228.7	2,237.2	2,218.6	2,326.0	2,339.4	2,347.3	2,366.4	2,386.2	19.8
Nonresidential specialty trade contractors	2,181.0	2,314.8	2,233.2	2,248.3	2,335.7	2,353.2	2,370.0	2,367.0	2,374.6	2,386.4	11.8
Manufacturing	14,168	14,235	14,109	14,127	14,276	14,196	14,214	14,222	14,229	14,228	-1
Production workers	9,969	10,138	10,056	10,074	10,054	10,069	10,103	10,123	10,151	10,154	3
Durable goods	8,914	8,967	8,920	8,935	8,963	8,952	8,960	8,970	8,979	8,980	1
Production workers	6,145	6,319	6,277	6,291	6,181	6,249	6,274	6,299	6,321	6,323	2
Wood products	547.3	558.5	549.6	547.3	556.9	560.7	556.7	558.9	559.8	557.1	-2.7
Nonmetallic mineral products	485.0	497.1	487.1	484.8	505.6	500.8	502.0	500.7	504.6	504.6	.0
Primary metals	468.2	471.4	473.1	470.5	468.7	470.5	471.5	469.4	473.1	469.6	-3.5
Fabricated metal products	1,506.6	1,528.3	1,521.4	1,525.5	1,512.4	1,520.8	1,524.1	1,526.7	1,528.3	1,532.3	4.0
Machinery	1,151.2	1,171.5	1,162.4	1,168.6	1,152.1	1,174.5	1,184.4	1,186.9	1,163.7	1,168.3	4.6
Computer and electronic products[1]	1,314.6	1,323.1	1,312.7	1,320.0	1,317.3	1,323.5	1,322.0	1,322.2	1,317.5	1,322.5	5.0
Computer and peripheral equipment	204.4	206.0	201.7	202.5	205.0	207.9	206.3	205.7	201.4	202.5	1.1
Communications equipment	148.9	149.0	147.5	148.5	148.3	148.2	148.0	149.2	147.3	148.4	1.1
Semiconductors and electronic components	449.3	450.9	448.2	452.1	451.2	450.7	450.6	451.0	451.5	453.5	2.0
Electronic instruments	434.5	442.2	441.4	443.9	435.1	441.6	442.0	441.7	443.1	444.8	1.7
Electrical equipment and appliances	438.5	435.4	435.5	436.3	439.5	431.1	434.3	434.4	435.3	435.3	.0
Transportation equipment[1]	1,783.6	1,787.0	1,774.7	1,773.1	1,785.7	1,765.5	1,771.8	1,776.7	1,784.3	1,775.0	-9.3
Motor vehicles and parts[2]	1,118.3	1,100.9	1,091.5	1,089.3	1,115.8	1,088.4	1,092.4	1,092.1	1,098.8	1,088.2	-10.6
Furniture and related products	567.4	558.6	553.7	562.4	570.2	560.5	558.4	558.0	557.2	556.6	-.6
Miscellaneous manufacturing	651.3	658.0	650.0	656.5	654.9	653.6	654.7	655.6	655.4	659.0	3.6
Nondurable goods	5,254	5,248	5,189	5,192	5,313	5,244	5,254	5,252	5,250	5,248	-2
Production workers	3,824	3,819	3,779	3,783	3,873	3,820	3,829	3,824	3,830	3,831	1
Food manufacturing	1,454.0	1,471.0	1,441.7	1,436.6	1,482.6	1,458.5	1,465.0	1,466.0	1,464.3	1,463.0	-1.3
Beverages and tobacco products	188.2	191.8	190.2	190.0	192.9	192.4	193.4	192.3	194.5	194.3	-.2
Textile mills	223.4	207.1	206.5	205.8	225.5	213.2	210.9	209.0	209.3	207.9	-1.4
Textile product mills	169.3	172.0	172.8	171.6	172.0	173.8	174.5	173.9	175.1	174.1	-1.0
Apparel	268.4	251.4	246.0	250.1	269.3	251.8	253.7	253.5	252.6	251.7	-.9
Leather and allied products	39.4	39.7	38.5	38.3	39.8	39.6	39.5	39.7	39.1	38.7	-.4
Paper and paper products	487.4	477.8	475.7	476.7	490.1	478.5	478.5	478.1	478.0	479.3	1.3
Printing and related support activities	646.3	646.5	637.7	639.0	651.6	645.1	644.8	644.0	643.2	643.9	.7
Petroleum and coal products	108.8	109.5	107.4	109.9	112.0	113.1	112.3	112.3	111.4	112.9	1.5
Chemicals	873.9	883.1	881.7	883.6	876.4	879.3	881.5	884.0	885.1	884.9	-.2
Plastics and rubber products	796.8	798.0	790.3	790.7	800.7	799.1	799.4	798.9	797.1	796.8	-.3

See footnotes at the end of table.

ESTABLISHMENT DATA

Table B-1. Employees on nonfarm payrolls by industry sector and selected industry detail—Continued

(In thousands)

Industry	Not seasonally adjusted				Seasonally adjusted						
	Feb. 2005	Dec. 2005	Jan. 2006^p	Feb. 2006^p	Feb. 2005	Oct. 2005	Nov. 2005	Dec. 2005	Jan. 2006^p	Feb. 2006^p	Change from: Jan. 2006-Feb. 2006^p
Service-providing	109,733	112,881	110,597	111,453	110,684	111,698	111,967	112,094	112,199	112,397	198
Private service-providing	87,684	90,659	88,868	89,245	88,943	89,846	90,087	90,216	90,352	90,512	160
Trade, transportation, and utilities	25,405	26,631	25,829	25,638	25,787	25,945	26,006	26,015	26,028	26,043	15
Wholesale trade	5,666.6	5,794.6	5,752.9	5,756.6	5,712.6	5,767.8	5,782.7	5,783.8	5,799.1	5,802.1	3.0
Durable goods	2,955.4	3,024.2	3,010.9	3,012.3	2,972.6	3,002.3	3,010.5	3,017.6	3,026.2	3,027.7	1.5
Nondurable goods	1,991.2	2,025.2	1,998.9	2,004.0	2,016.2	2,021.7	2,028.9	2,023.9	2,025.3	2,028.1	2.8
Electronic markets and agents and brokers	720.0	745.2	743.1	740.3	723.8	743.8	743.3	742.3	747.6	746.3	-1.3
Retail trade	14,907.5	15,873.9	15,168.5	14,985.0	15,198.1	15,259.6	15,292.9	15,300.3	15,286.8	15,293.5	6.7
Motor vehicle and parts dealers[1]	1,891.1	1,904.7	1,882.8	1,890.4	1,913.5	1,921.5	1,914.3	1,914.7	1,911.8	1,915.9	4.1
Automobile dealers	1,250.4	1,248.7	1,236.2	1,239.7	1,257.2	1,260.5	1,254.5	1,252.4	1,249.0	1,250.0	1.0
Furniture and home furnishings stores	587.3	606.0	593.3	585.4	571.7	581.5	583.3	583.0	589.8	590.8	1.0
Electronics and appliance stores	519.0	569.5	538.6	532.3	520.3	540.5	541.2	540.5	534.2	538.8	4.6
Building material and garden supply stores	1,207.7	1,261.5	1,238.2	1,247.7	1,269.3	1,273.1	1,281.6	1,290.9	1,299.3	1,307.9	8.6
Food and beverage stores	2,787.6	2,843.1	2,791.0	2,769.5	2,815.4	2,809.5	2,806.6	2,805.9	2,804.7	2,801.4	-3.3
Health and personal care stores	944.4	961.8	957.9	950.2	948.3	959.3	964.7	966.1	958.2	963.2	-5.0
Gasoline stations	858.2	865.5	857.0	856.0	870.7	874.6	869.1	869.6	867.9	868.9	1.0
Clothing and clothing accessories stores	1,345.4	1,574.2	1,436.4	1,388.2	1,390.1	1,413.5	1,434.5	1,448.1	1,435.2	1,439.1	3.9
Sporting goods, hobby, book, and music stores	628.3	705.3	648.7	624.2	643.2	638.7	641.5	640.0	641.0	640.3	-.7
General merchandise stores[1]	2,835.7	3,162.0	2,907.9	2,829.3	2,918.7	2,910.6	2,920.4	2,906.9	2,912.9	2,911.3	-1.6
Department stores	1,550.3	1,789.6	1,604.9	1,542.5	1,604.7	1,590.6	1,595.2	1,595.6	1,594.4	1,594.2	-.2
Miscellaneous store retailers	894.9	927.7	884.0	888.1	905.9	899.1	897.3	899.0	899.2	898.1	-1.1
Nonstore retailers	427.9	472.6	434.7	423.7	431.0	437.7	438.4	435.6	432.6	427.8	-4.8
Transportation and warehousing	4,276.3	4,406.1	4,348.9	4,338.3	4,319.3	4,358.4	4,370.2	4,371.6	4,382.3	4,386.8	4.5
Air transportation	503.4	487.3	485.0	478.3	508.4	493.7	488.9	486.9	488.4	483.1	-5.3
Rail transportation	226.3	227.7	225.1	224.9	228.6	228.1	227.8	227.3	227.3	227.2	-.1
Water transportation	55.1	62.7	61.3	59.6	58.0	62.6	63.6	63.7	63.4	62.9	-.5
Truck transportation	1,348.8	1,403.4	1,379.8	1,374.9	1,380.3	1,402.0	1,403.7	1,404.0	1,406.5	1,407.1	.6
Transit and ground passenger transportation	400.5	409.5	404.0	410.0	388.5	388.5	394.9	392.2	393.0	396.2	3.2
Pipeline transportation	37.7	37.0	37.5	37.4	38.0	37.2	37.2	37.0	37.5	37.5	.0
Scenic and sightseeing transportation	20.3	25.6	22.6	22.9	26.1	31.5	31.4	31.1	31.1	31.7	.6
Support activities for transportation	547.8	558.9	567.3	558.3	549.7	549.8	553.9	556.2	560.4	562.7	2.3
Couriers and messengers	561.7	591.9	581.8	576.3	564.4	576.3	576.8	579.7	578.9	580.9	2.0
Warehousing and storage	574.7	602.1	594.5	595.7	577.3	588.7	592.0	593.5	595.8	597.5	1.7
Utilities	535.0	556.7	558.3	558.5	557.3	559.4	560.1	559.7	560.1	560.6	.5
Information	3,046	3,077	3,049	3,056	3,063	3,058	3,064	3,066	3,067	3,074	7
Publishing industries, except Internet	901.7	905.9	896.8	901.6	903.5	903.7	902.8	902.5	901.2	904.0	2.8
Motion picture and sound recording industries	355.9	392.3	382.1	378.3	366.2	379.3	383.5	387.7	390.5	390.9	.4
Broadcasting, except Internet	324.3	327.3	323.4	324.2	325.9	327.6	325.7	325.1	324.4	326.2	.8
Internet publishing and broadcasting	30.1	30.2	29.4	30.7	30.4	30.1	30.1	30.4	29.7	30.8	1.1
Telecommunications	1,006.4	993.3	991.2	994.2	1,007.3	991.2	995.1	993.3	993.9	995.4	1.5
ISPs, search portals, and data processing	377.6	378.3	375.8	378.1	379.2	376.9	376.7	377.8	377.3	378.4	1.1
Other information services	50.3	49.3	50.3	49.2	50.9	49.4	49.9	49.6	50.3	49.6	-.7
Financial activities	8,054	8,213	8,184	8,216	8,097	8,201	8,217	8,223	8,244	8,266	22
Finance and insurance	5,978.7	6,068.3	6,061.9	6,091.5	5,984.9	6,053.3	6,066.7	6,068.2	6,081.8	6,098.0	16.2
Monetary authorities - central bank	20.7	21.0	21.1	21.2	20.7	20.7	20.9	21.0	21.2	21.3	.1
Credit intermediation and related activities[1]	2,840.3	2,890.3	2,888.7	2,901.4	2,846.2	2,892.9	2,895.8	2,894.2	2,899.0	2,905.1	6.1
Depository credit intermediation[1]	1,759.7	1,790.0	1,791.1	1,795.4	1,761.7	1,790.8	1,793.3	1,793.2	1,792.5	1,796.7	4.2
Commercial banking	1,290.4	1,303.4	1,301.4	1,303.4	1,292.2	1,306.9	1,309.0	1,308.0	1,302.7	1,305.0	2.3
Securities, commodity contracts, investments	781.9	790.6	789.6	795.7	780.4	790.5	790.7	790.4	792.7	796.2	3.5
Insurance carriers and related activities	2,249.0	2,278.7	2,275.3	2,284.9	2,250.4	2,262.1	2,271.8	2,274.8	2,281.3	2,287.6	6.3
Funds, trusts, and other financial vehicles	87.8	87.7	87.2	88.3	87.2	87.1	87.5	87.8	87.6	87.8	.2
Real estate and rental and leasing	2,075.0	2,144.9	2,122.2	2,124.9	2,112.2	2,147.5	2,150.2	2,154.5	2,161.8	2,167.5	5.7
Real estate	1,414.3	1,476.8	1,464.5	1,466.3	1,437.6	1,474.7	1,478.4	1,481.6	1,490.1	1,493.4	3.3
Rental and leasing services	634.8	640.1	630.5	631.2	648.5	645.1	643.9	645.0	643.9	646.2	2.3
Lessors of nonfinancial intangible assets	25.9	28.0	27.2	27.4	26.1	27.7	27.9	27.9	27.8	27.9	.1

See footnotes at the end of table.

ESTABLISHMENT DATA

Table B-1. Employees on nonfarm payrolls by industry sector and selected industry detail—Continued

(In thousands)

Industry	Not seasonally adjusted				Seasonally adjusted						
	Feb. 2005	Dec. 2005	Jan. 2006p	Feb. 2006p	Feb. 2005	Oct. 2005	Nov. 2005	Dec. 2005	Jan. 2006p	Feb. 2006p	Change from: Jan. 2006-Feb. 2006p
Professional and business services	16,392	17,128	16,733	16,859	16,711	16,991	17,061	17,121	17,138	17,177	39
Professional and technical services[1]	7,011.2	7,122.1	7,149.6	7,225.7	6,936.6	7,074.8	7,087.2	7,118.9	7,133.9	7,152.2	18.3
Legal services	1,155.7	1,164.4	1,154.4	1,153.9	1,164.8	1,159.2	1,160.0	1,160.8	1,162.6	1,162.7	.1
Accounting and bookkeeping services	966.9	841.9	936.9	985.5	829.3	851.0	847.5	859.0	848.8	850.9	2.1
Architectural and engineering services	1,259.5	1,333.0	1,318.9	1,318.5	1,284.0	1,326.1	1,335.3	1,335.6	1,340.4	1,344.3	3.9
Computer systems design and related services	1,174.8	1,218.4	1,219.4	1,224.6	1,176.7	1,204.4	1,204.9	1,212.1	1,222.9	1,226.4	3.5
Management and technical consulting services	816.4	871.8	857.8	868.4	825.3	855.5	861.4	865.4	869.0	873.8	4.8
Management of companies and enterprises	1,731.8	1,758.9	1,758.9	1,760.3	1,748.7	1,749.9	1,743.2	1,756.7	1,771.5	1,775.6	4.1
Administrative and waste services	7,649.1	8,247.3	7,824.4	7,873.2	8,026.1	8,165.8	8,230.5	8,245.1	8,232.3	8,248.9	16.6
Administrative and support services[1]	7,319.7	7,915.5	7,494.4	7,543.3	7,689.6	7,835.6	7,897.8	7,911.0	7,894.8	7,912.9	18.1
Employment services[1]	3,310.2	3,754.2	3,443.5	3,448.6	3,507.1	3,617.2	3,663.7	3,671.0	3,655.1	3,645.5	-9.6
Temporary help services	2,331.1	2,687.3	2,454.5	2,457.3	2,491.0	2,578.2	2,616.2	2,628.1	2,621.7	2,614.4	-7.3
Business support services	765.1	760.0	746.7	755.8	765.2	752.7	754.7	751.8	755.3	756.0	.7
Services to buildings and dwellings	1,553.2	1,670.1	1,587.3	1,597.2	1,710.5	1,741.1	1,755.4	1,751.1	1,747.3	1,759.8	12.5
Waste management and remediation services	329.4	331.8	330.0	329.9	336.5	330.2	332.7	334.1	337.5	336.0	-1.5
Education and health services	17,287	17,665	17,437	17,726	17,168	17,440	17,481	17,507	17,557	17,604	47
Educational services	2,939.3	2,962.8	2,756.6	3,016.2	2,801.8	2,815.9	2,820.2	2,827.5	2,836.8	2,859.9	23.1
Health care and social assistance	14,347.6	14,702.0	14,680.0	14,709.5	14,365.8	14,624.5	14,661.2	14,679.6	14,719.7	14,743.6	23.9
Health care[3]	12,160.8	12,453.7	12,433.4	12,441.9	12,205.6	12,392.7	12,423.8	12,435.8	12,466.7	12,484.9	18.2
Ambulatory health care services[1]	5,030.8	5,192.0	5,182.8	5,192.3	5,053.3	5,152.9	5,172.7	5,181.4	5,202.1	5,213.3	11.2
Offices of physicians	2,068.7	2,146.3	2,139.7	2,141.0	2,074.3	2,119.8	2,128.4	2,135.8	2,142.5	2,146.3	3.8
Outpatient care centers	463.1	484.3	485.2	485.5	464.3	480.6	482.4	484.1	486.2	487.3	1.1
Home health care services	797.4	825.0	822.6	823.5	806.5	820.8	824.3	822.1	827.8	830.2	2.4
Hospitals	4,302.7	4,384.6	4,379.8	4,383.7	4,311.7	4,371.7	4,379.2	4,382.5	4,385.9	4,391.5	5.6
Nursing and residential care facilities[1]	2,827.3	2,877.1	2,870.8	2,865.9	2,840.6	2,868.1	2,871.9	2,871.9	2,878.7	2,880.1	1.4
Nursing care facilities	1,568.4	1,586.6	1,579.0	1,571.3	1,576.3	1,578.9	1,582.5	1,582.5	1,583.3	1,580.8	-2.5
Social assistance[1]	2,186.8	2,248.3	2,246.6	2,267.6	2,180.2	2,231.8	2,237.4	2,243.8	2,253.0	2,258.7	5.7
Child day care services	785.4	801.6	800.3	808.5	775.2	793.2	792.9	793.3	797.6	797.9	.3
Leisure and hospitality	12,151	12,577	12,306	12,392	12,703	12,840	12,881	12,898	12,923	12,948	25
Arts, entertainment, and recreation	1,659.8	1,746.0	1,674.6	1,693.7	1,861.0	1,897.8	1,907.5	1,905.9	1,901.8	1,908.3	6.5
Performing arts and spectator sports	341.0	348.4	320.5	336.1	365.7	365.0	362.8	362.1	357.3	363.1	5.8
Museums, historical sites, zoos, and parks	106.9	115.4	110.8	111.4	117.5	121.6	121.0	121.6	121.8	122.4	.6
Amusements, gambling, and recreation	1,211.7	1,282.2	1,243.3	1,246.2	1,377.8	1,411.2	1,423.7	1,422.2	1,422.7	1,422.8	.1
Accommodations and food services	10,491.2	10,831.1	10,631.2	10,698.1	10,841.8	10,942.4	10,973.9	10,992.3	11,020.8	11,040.0	19.2
Accommodations	1,731.4	1,741.8	1,717.2	1,722.6	1,809.9	1,812.9	1,811.1	1,809.2	1,806.7	1,805.1	-1.6
Food services and drinking places	8,759.8	9,089.3	8,914.0	8,975.5	9,031.9	9,129.5	9,162.8	9,183.1	9,214.1	9,234.9	20.8
Other services	5,349	5,368	5,330	5,358	5,394	5,371	5,377	5,386	5,395	5,400	5
Repair and maintenance	1,230.8	1,236.1	1,228.4	1,235.9	1,237.4	1,227.1	1,232.0	1,241.4	1,240.5	1,240.9	.4
Personal and laundry services	1,256.5	1,265.4	1,260.5	1,261.1	1,276.3	1,270.3	1,271.1	1,270.3	1,277.9	1,279.0	1.1
Membership associations and organizations	2,861.2	2,866.1	2,840.6	2,860.8	2,880.0	2,873.2	2,873.6	2,874.5	2,877.0	2,879.6	2.6
Government	22,049	22,222	21,729	22,208	21,741	21,852	21,880	21,878	21,847	21,885	38
Federal	2,710	2,714	2,685	2,690	2,727	2,724	2,728	2,713	2,705	2,707	2
Federal, except U.S. Postal Service	1,938.4	1,929.3	1,918.1	1,924.2	1,952.3	1,949.5	1,953.1	1,941.2	1,935.8	1,939.2	3.4
U.S. Postal Service	771.3	784.7	767.1	765.5	774.6	774.1	774.9	772.1	768.7	768.1	-.6
State government	5,125	5,134	4,908	5,140	5,016	5,022	5,032	5,036	5,011	5,030	19
State government education	2,371.7	2,374.1	2,151.0	2,373.5	2,249.1	2,248.1	2,256.6	2,258.1	2,233.0	2,249.6	16.6
State government, excluding education	2,752.8	2,760.2	2,756.8	2,768.3	2,767.2	2,773.5	2,775.8	2,777.4	2,777.6	2,780.1	2.5
Local government	14,214	14,374	14,136	14,378	13,998	14,106	14,120	14,129	14,131	14,148	17
Local government education	8,144.9	8,222.6	8,012.3	8,242.5	7,830.2	7,894.9	7,899.3	7,906.9	7,903.0	7,915.2	12.2
Local government, excluding education	6,068.8	6,151.1	6,123.3	6,135.0	6,167.9	6,211.5	6,220.6	6,222.2	6,228.0	6,232.5	4.5

[1] Includes other industries, not shown separately.
[2] Includes motor vehicles, motor vehicle bodies and trailers, and motor vehicle parts.
[3] Includes ambulatory health care services, hospitals, and nursing and residential care facilities.
p = preliminary.

ESTABLISHMENT DATA

Table B-2. Average weekly hours of production or nonsupervisory workers[1] on private nonfarm payrolls by industry sector and selected industry detail

Industry	Not seasonally adjusted				Seasonally adjusted						
	Feb. 2005	Dec. 2005	Jan. 2006p	Feb. 2006p	Feb. 2005	Oct. 2005	Nov. 2005	Dec. 2005	Jan. 2006p	Feb. 2006p	Change from: Jan. 2006-Feb. 2006p
Total private	33.5	33.7	33.8	33.5	33.7	33.8	33.8	33.8	33.8	33.7	-0.1
Goods-producing	39.4	40.4	40.1	39.9	39.9	40.3	40.4	40.2	40.4	40.3	-.1
Natural resources and mining	44.6	45.6	45.6	44.2	45.1	46.0	45.0	45.6	46.1	44.8	-1.3
Construction	37.0	38.1	38.2	38.0	38.3	38.5	39.2	38.7	39.1	38.8	-.3
Manufacturing	40.4	41.4	40.9	40.7	40.6	41.0	40.8	40.8	40.9	41.0	.1
Overtime hours	4.4	4.9	4.4	4.3	4.6	4.6	4.6	4.5	4.5	4.6	.1
Durable goods	40.9	41.8	41.2	41.1	41.0	41.6	41.3	41.2	41.3	41.3	.0
Overtime hours	4.5	5.0	4.4	4.4	4.7	4.8	4.7	4.5	4.5	4.7	.2
Wood products	39.2	40.3	39.7	39.7	39.9	40.8	40.5	40.1	40.3	40.6	.3
Nonmetallic mineral products	41.2	42.3	42.3	42.4	42.0	42.6	43.5	42.7	43.1	43.0	-.1
Primary metals	43.0	44.0	44.0	44.1	43.1	43.5	43.5	43.5	43.7	43.9	.2
Fabricated metal products	40.7	41.7	41.4	41.1	40.8	41.6	41.2	41.1	41.3	41.3	.0
Machinery	42.1	42.7	41.9	41.9	41.9	42.2	42.0	41.9	41.8	42.0	.2
Computer and electronic products	39.5	40.8	40.3	40.3	39.8	40.5	40.3	40.3	40.5	40.4	-.1
Electrical equipment and appliances	39.7	41.5	40.9	40.4	40.0	41.4	41.0	40.9	40.9	40.9	.0
Transportation equipment	42.5	43.6	42.5	42.3	42.3	43.0	42.7	42.6	42.5	42.4	-.1
Motor vehicles and parts[2]	42.4	43.4	42.0	41.9	42.4	42.9	42.4	42.2	42.0	42.0	.0
Furniture and related products	39.2	39.2	37.9	38.4	39.4	39.2	38.5	38.3	38.1	38.6	.5
Miscellaneous manufacturing	38.7	38.9	38.6	38.5	38.6	39.0	38.6	38.5	38.6	38.5	-.1
Nondurable goods	39.6	40.7	40.4	40.1	39.9	40.1	40.0	40.2	40.3	40.4	.1
Overtime hours	4.2	4.8	4.3	4.2	4.4	4.4	4.4	4.6	4.5	4.5	.0
Food manufacturing	38.7	39.8	39.6	39.2	39.3	38.9	39.0	39.3	39.7	39.7	.0
Beverages and tobacco products	39.5	39.7	39.0	38.9	39.8	40.8	40.1	40.0	39.7	39.5	-.2
Textile mills	39.6	41.4	40.7	40.1	39.8	40.2	40.6	41.0	40.5	40.5	.0
Textile product mills	39.2	40.7	40.4	39.8	39.4	38.8	39.6	40.0	40.2	40.2	.0
Apparel	35.7	36.0	35.8	36.0	35.8	36.1	35.9	35.6	35.9	35.9	.0
Leather and allied products	37.3	39.7	39.3	39.3	37.4	38.7	39.5	39.4	39.5	39.5	.0
Paper and paper products	41.7	43.5	42.8	42.3	42.1	42.9	42.5	42.6	42.6	42.7	.1
Printing and related support activities	38.3	38.8	38.7	39.1	38.5	38.5	38.3	38.4	38.7	39.0	.3
Petroleum and coal products	44.5	44.5	44.5	43.3	44.7	47.3	45.8	44.5	45.0	44.2	-.8
Chemicals	42.4	43.0	43.0	42.7	42.3	42.9	42.3	42.5	42.7	42.7	.0
Plastics and rubber products	40.0	41.2	40.5	40.3	40.1	40.0	40.1	40.5	40.4	40.4	.0
Private service-providing	32.2	32.3	32.4	32.2	32.4	32.4	32.4	32.4	32.4	32.3	-.1
Trade, transportation, and utilities	33.2	33.4	33.0	32.9	33.5	33.3	33.4	33.4	33.3	33.2	-.1
Wholesale trade	37.5	37.8	38.0	37.8	37.8	37.8	37.8	37.9	37.9	38.0	.1
Retail trade	30.3	30.7	30.0	29.9	30.7	30.4	30.6	30.5	30.4	30.3	-.1
Transportation and warehousing	36.7	37.0	36.3	36.0	37.3	36.7	36.8	36.7	36.5	36.6	.1
Utilities	40.5	41.3	40.7	40.9	40.6	41.3	41.2	41.4	41.0	41.1	.1
Information	36.2	36.6	36.8	36.2	36.4	36.7	36.5	36.6	36.6	36.4	-.2
Financial activities	35.7	35.7	36.5	35.5	35.8	36.1	35.9	35.9	36.0	35.7	-.3
Professional and business services	33.9	34.3	34.6	34.3	34.0	34.3	34.3	34.3	34.6	34.4	-.2
Education and health services	32.5	32.5	32.8	32.4	32.6	32.7	32.5	32.5	32.5	32.5	.0
Leisure and hospitality	25.5	25.2	25.3	25.3	25.7	25.7	25.7	25.6	25.7	25.6	-.1
Other services	30.8	30.8	31.0	30.8	30.9	30.9	30.9	30.9	30.9	30.9	.0

[1] Data relate to production workers in natural resources and mining and manufacturing, construction workers in construction, and nonsupervisory workers in the service-providing industries. These groups account for approximately four-fifths of the total employment on private nonfarm payrolls.

[2] Includes motor vehicles, motor vehicle bodies and trailers, motor vehicle parts.

p = preliminary.

ESTABLISHMENT DATA

Table B-3. Average hourly and weekly earnings of production or nonsupervisory workers[1] on private nonfarm payrolls by industry sector and selected industry detail

Industry	Average hourly earnings				Average weekly earnings			
	Feb. 2005	Dec. 2005	Jan. 2006[p]	Feb. 2006[p]	Feb. 2005	Dec. 2005	Jan. 2006[p]	Feb. 2006[p]
Total private	$15.95	$16.37	$16.52	$16.52	$534.33	$551.67	$558.38	$553.42
Seasonally adjusted	15.91	16.35	16.42	16.47	536.17	552.63	555.00	555.04
Goods-producing	17.34	17.82	17.75	17.72	683.20	719.93	711.78	707.03
Natural resources and mining	18.44	19.23	19.47	19.31	822.42	876.89	887.83	853.50
Construction	19.18	19.68	19.51	19.58	709.66	749.81	745.28	744.04
Manufacturing	16.44	16.81	16.78	16.71	664.18	695.93	686.30	680.10
Durable goods	17.20	17.67	17.58	17.56	703.48	738.61	724.30	721.72
Wood products	13.06	13.23	13.14	13.14	511.95	533.17	521.66	521.66
Nonmetallic mineral products	16.22	16.53	16.51	16.54	668.26	699.22	698.37	701.30
Primary metals	18.78	19.16	19.37	19.19	807.54	843.04	852.28	846.28
Fabricated metal products	15.67	16.18	16.14	16.04	637.77	674.71	668.20	659.24
Machinery	17.03	17.07	17.12	17.11	716.96	728.89	717.33	718.91
Computer and electronic products	18.01	18.72	18.70	18.77	711.40	763.78	753.61	758.43
Electrical equipment and appliances	15.16	15.56	15.48	15.57	601.85	645.74	633.13	629.03
Transportation equipment	21.95	22.71	22.36	22.37	932.88	980.16	950.30	946.25
Furniture and related products	13.33	13.52	13.55	13.48	522.54	529.98	513.55	517.63
Miscellaneous manufacturing	14.03	14.20	14.11	14.16	542.96	552.38	544.65	545.16
Nondurable goods	15.18	15.35	15.42	15.28	601.13	624.75	622.97	612.73
Food manufacturing	13.06	13.13	13.12	13.03	505.42	522.57	519.55	510.78
Beverages and tobacco products	18.69	18.59	18.50	18.12	738.26	738.02	721.50	704.87
Textile mills	12.25	12.45	12.52	12.40	485.10	515.43	509.56	497.24
Textile product mills	11.49	11.89	11.83	11.91	450.41	483.92	477.93	474.02
Apparel	10.21	10.47	10.65	10.59	384.50	376.92	381.27	381.24
Leather and allied products	11.43	11.33	11.49	11.29	426.34	449.80	451.56	443.70
Paper and paper products	17.88	17.91	17.95	17.78	745.60	779.09	768.26	751.25
Printing and related support activities	15.77	15.92	15.90	15.64	603.99	617.70	615.33	611.52
Petroleum and coal products	24.76	24.82	24.74	24.74	1,101.82	1,095.59	1,100.93	1,071.24
Chemicals	19.33	19.85	19.98	19.79	819.59	853.55	859.14	845.03
Plastics and rubber products	14.66	14.84	15.00	14.84	586.40	611.41	607.50	598.05
Private service-providing	15.59	15.98	16.20	16.20	502.00	516.15	524.88	521.64
Trade, transportation, and utilities	14.84	14.96	15.20	15.25	492.69	499.66	501.60	501.73
Wholesale trade	17.96	18.58	18.64	18.66	673.50	702.32	708.32	705.35
Retail trade	12.35	12.25	12.46	12.48	374.21	376.08	373.80	373.15
Transportation and warehousing	16.56	16.86	16.96	17.03	607.75	623.82	615.65	613.08
Utilities	25.97	27.44	27.57	27.47	1,051.79	1,133.27	1,122.10	1,123.52
Information	21.60	22.61	23.05	22.83	781.92	827.53	848.24	826.45
Financial activities	17.72	18.23	18.45	18.44	632.60	650.81	673.43	654.62
Professional and business services	17.96	18.44	18.88	18.84	608.84	632.49	653.25	646.21
Education and health services	16.46	17.04	17.10	17.13	534.95	553.80	560.88	555.01
Leisure and hospitality	9.10	9.39	9.32	9.39	232.05	236.63	235.80	237.57
Other services	14.23	14.52	14.56	14.52	438.28	447.22	451.36	447.22

[1] See footnote 1, table B-2.

p = preliminary.

ESTABLISHMENT DATA

Table B-4. Average hourly earnings of production or nonsupervisory workers[1] on private nonfarm payrolls by industry sector and selected industry detail, seasonally adjusted

Industry	Feb. 2005	Oct. 2005	Nov. 2005	Dec. 2005	Jan. 2006[p]	Feb. 2006[p]	Percent change from: Jan. 2006-Feb. 2006[p]
Total Private:							
Current dollars	$15.91	$16.28	$16.28	$16.35	$16.42	$16.47	0.3
Constant (1982) dollars[2]	8.21	8.09	8.15	8.20	8.18	N.A.	([3])
Goods-producing	17.43	17.74	17.74	17.77	17.82	17.81	-.1
Natural resources and mining	18.40	19.04	18.95	19.12	19.34	19.29	-.3
Construction	19.28	19.58	19.59	19.65	19.68	19.70	.2
Manufacturing	16.42	16.71	16.68	16.70	16.74	16.72	-.1
Excluding overtime[4]	15.54	15.82	15.79	15.83	15.87	15.83	-.3
Durable goods	17.17	17.51	17.50	17.52	17.55	17.56	.1
Nondurable goods	15.20	15.36	15.29	15.31	15.37	15.31	-.4
Private service-providing	15.51	15.89	15.89	15.97	16.04	16.11	.4
Trade, transportation, and utilities	14.77	15.05	15.04	15.10	15.14	15.20	.4
Wholesale trade	17.93	18.32	18.45	18.56	18.53	18.61	.4
Retail trade	12.29	12.43	12.35	12.39	12.43	12.45	.2
Transportation and warehousing	16.51	16.82	16.85	16.87	16.96	17.04	.5
Utilities	26.09	27.17	27.15	27.34	27.52	27.48	-.1
Information	21.57	22.65	22.40	22.60	22.95	22.81	-.6
Financial activities	17.74	18.09	18.20	18.27	18.33	18.43	.5
Professional and business services	17.85	18.30	18.29	18.42	18.56	18.70	.8
Education and health services	16.47	16.90	16.95	17.00	17.07	17.14	.4
Leisure and hospitality	9.05	9.22	9.24	9.27	9.26	9.32	.6
Other services	14.20	14.46	14.46	14.47	14.50	14.50	.0

[1] See footnote 1, table B-2.

[2] The Consumer Price Index for Urban Wage Earners and Clerical Workers (CPI-W) is used to deflate this series.

[3] Change was -0.2 percent from Dec. 2005 to Jan. 2006, the latest month available.

[4] Derived by assuming that overtime hours are paid at the rate of time and one-half.

N.A. = not available.

[p] = preliminary.

ESTABLISHMENT DATA

Table B-5. Indexes of aggregate weekly hours of production or nonsupervisory workers[1] on private nonfarm payrolls by industry sector and selected industry detail

(2002=100)

Industry	Not seasonally adjusted				Seasonally adjusted						
	Feb. 2005	Dec. 2005	Jan. 2006[p]	Feb. 2006[p]	Feb. 2005	Oct. 2005	Nov. 2005	Dec. 2005	Jan. 2006[p]	Feb. 2006[p]	Percent change from: Jan. 2006-Feb. 2006[p]
Total private	99.1	103.8	101.8	101.3	101.6	103.1	103.5	103.7	103.9	103.8	-0.1
Goods-producing	93.0	100.0	97.3	97.0	97.5	99.6	100.5	100.1	101.1	101.0	-.1
Natural resources and mining	105.0	118.0	115.6	112.3	109.5	117.6	116.0	118.0	119.8	116.9	-2.4
Construction	93.4	106.2	102.2	101.8	105.0	108.5	111.7	110.0	112.2	111.9	-.3
Manufacturing	92.4	96.3	94.4	94.1	93.7	94.7	94.6	94.8	95.3	95.5	.2
Durable goods	94.4	99.2	97.2	97.1	95.2	97.7	97.4	97.5	98.1	98.1	.0
Wood products	96.9	102.1	99.4	98.8	100.4	102.4	102.4	102.0	102.8	103.0	.2
Nonmetallic mineral products	90.9	95.6	93.7	93.8	97.2	97.2	99.5	97.5	99.7	99.5	-.2
Primary metals	93.3	96.8	96.7	96.6	93.7	95.0	95.2	95.1	96.1	95.9	-.2
Fabricated metal products	97.5	101.8	100.8	100.4	98.1	100.5	100.3	100.4	101.2	101.4	.2
Machinery	97.4	101.6	99.2	99.5	96.8	100.3	99.0	99.3	98.9	99.7	.8
Computer and electronic products	89.7	102.8	101.2	101.3	90.5	99.8	100.3	101.1	101.7	101.6	-.1
Electrical equipment and appliances	85.5	89.5	88.5	87.6	86.2	88.1	87.7	87.7	88.2	88.5	.3
Transportation equipment	97.4	102.4	99.2	99.0	98.9	98.8	98.8	99.2	99.6	98.9	-.7
Motor vehicles and parts[2]	97.3	98.9	94.7	94.3	97.1	96.4	95.4	95.2	95.2	94.2	-1.1
Furniture and related products	91.8	91.1	87.3	88.7	92.9	91.0	89.2	88.9	88.5	90.0	1.7
Miscellaneous manufacturing	90.9	91.9	89.9	90.9	91.3	91.5	90.7	90.5	90.9	91.4	.6
Nondurable goods	89.2	91.5	89.9	89.3	91.0	90.2	90.2	90.5	90.9	91.2	.3
Food manufacturing	93.2	97.3	94.9	93.4	96.8	94.5	95.2	95.8	96.8	96.7	-.1
Beverages and tobacco products	86.3	96.9	95.3	95.5	90.9	100.3	98.9	98.0	99.6	99.8	.2
Textile mills	72.5	69.1	68.3	67.3	73.6	69.3	69.2	69.2	69.0	68.6	-.6
Textile product mills	88.4	95.1	96.3	93.2	89.9	92.2	94.2	94.3	96.6	95.8	-.8
Apparel	68.8	63.8	62.7	64.0	69.6	64.0	64.5	63.9	64.8	64.1	-1.1
Leather and allied products	75.9	82.2	78.7	77.9	77.1	79.6	81.0	81.2	80.4	79.1	-1.6
Paper and paper products	86.7	89.0	87.1	86.5	88.0	87.9	87.1	87.2	87.2	87.9	.8
Printing and related support activities	90.4	92.2	90.4	92.0	91.7	90.8	90.5	90.9	91.3	92.6	1.4
Petroleum and coal products	99.1	94.5	92.8	93.0	103.2	105.3	100.6	97.6	98.1	98.2	.1
Chemicals	96.8	98.8	98.6	98.0	96.9	97.9	96.9	97.6	98.2	98.0	-.2
Plastics and rubber products	92.0	94.2	91.9	91.7	92.6	91.9	92.1	92.9	92.6	92.7	.1
Private service-providing	100.6	104.9	102.9	102.7	102.9	104.1	104.5	104.6	104.8	104.7	-.1
Trade, transportation, and utilities	98.5	104.9	100.1	98.8	101.0	101.3	102.0	102.0	101.8	101.5	-.3
Wholesale trade	98.9	103.1	102.7	102.1	100.7	102.3	102.8	103.1	103.4	103.7	.3
Retail trade	97.1	105.9	98.3	96.4	100.5	100.0	101.1	100.7	100.4	99.9	-.5
Transportation and warehousing	101.9	106.7	103.1	101.9	104.8	104.3	105.0	104.8	104.6	104.9	.3
Utilities	91.3	94.5	93.5	94.4	91.9	94.9	95.1	95.2	94.6	95.2	.6
Information	97.5	101.0	100.7	99.2	98.4	100.5	100.3	100.6	100.7	100.2	-.5
Financial activities	102.8	105.1	107.1	104.6	103.7	105.8	105.6	105.8	106.4	105.8	-.6
Professional and business services	101.2	106.1	106.1	106.2	103.7	106.9	107.6	108.0	109.1	108.8	-.3
Education and health services	105.6	107.7	107.3	107.8	105.3	107.0	106.6	106.7	107.1	107.4	.3
Leisure and hospitality	99.4	102.0	100.1	100.8	105.2	106.2	106.7	106.5	107.2	107.0	-.2
Other services	95.1	95.3	95.1	95.1	96.2	95.8	95.8	96.0	96.1	96.2	.1

[1] See footnote 1, table B-2.
[2] Includes motor vehicles, motor vehicle bodies and trailers, and motor vehicle parts.
[p] = preliminary.

NOTE: The indexes of aggregate weekly hours are calculated by dividing the current months estimates of aggregate hours by the corresponding 2002 annual average levels. Aggregate hours estimates are the product of estimates of average weekly hours and production or nonsupervisory worker employment.

ESTABLISHMENT DATA

Table B-6. Indexes of aggregate weekly payrolls of production or nonsupervisory workers[1] on private nonfarm payrolls by industry sector and selected industry detail

(2002=100)

Industry	Not seasonally adjusted				Seasonally adjusted						
	Feb. 2005	Dec. 2005	Jan. 2006[p]	Feb. 2006[p]	Feb. 2005	Oct. 2005	Nov. 2005	Dec. 2005	Jan. 2006[p]	Feb. 2006[p]	Percent change from: Jan. 2006-Feb. 2006[p]
Total private	105.7	113.7	112.6	112.0	108.2	112.3	112.8	113.4	114.2	114.4	0.2
Goods-producing	98.8	109.1	105.8	105.2	104.0	108.2	109.2	108.9	110.3	110.2	-.1
Natural resources and mining	112.6	132.0	130.9	126.1	117.2	130.2	127.8	131.2	134.7	131.1	-2.7
Construction	96.7	112.9	107.7	107.7	109.3	114.7	118.1	116.7	119.1	119.0	-.1
Manufacturing	99.4	105.9	103.6	102.8	100.6	103.5	103.2	103.5	104.3	104.5	.2
Durable goods	101.4	109.5	106.6	106.5	102.1	106.8	106.4	106.7	107.5	107.6	.1
Nondurable goods	95.7	99.3	98.0	96.5	97.8	97.9	97.5	98.0	98.7	98.6	-.1
Private service-providing	107.7	115.2	114.6	114.3	109.6	113.6	114.0	114.8	115.5	115.9	.3
Trade, transportation, and utilities	104.2	112.0	108.5	107.5	106.5	108.8	109.4	109.9	110.0	110.0	.0
Wholesale trade	104.7	112.8	112.8	112.2	106.4	110.4	111.7	112.8	112.8	113.7	.8
Retail trade	102.8	111.2	104.9	103.1	105.9	106.6	107.0	106.9	106.9	106.7	-.2
Transportation and warehousing	107.1	114.1	110.9	110.1	109.8	111.3	112.3	112.1	112.5	113.4	.8
Utilities	98.9	108.2	107.6	108.2	100.1	107.6	107.7	108.6	108.7	109.2	.5
Information	104.2	113.0	114.9	112.1	105.1	112.7	111.2	112.5	114.4	113.2	-1.0
Financial activities	112.6	118.5	122.2	119.3	113.7	118.4	118.9	119.5	120.6	120.6	.0
Professional and business services	108.1	118.6	119.2	119.1	110.1	116.4	117.1	118.3	120.5	121.1	.5
Education and health services	114.2	120.6	120.7	121.4	114.0	118.8	118.8	119.3	120.1	121.0	.7
Leisure and hospitality	105.5	111.7	108.8	110.4	111.0	114.2	114.9	115.1	115.7	116.3	.5
Other services	98.6	100.9	100.9	100.6	99.5	100.9	100.9	101.2	101.5	101.6	.1

[1] See footnote 1, table B-2.

p = preliminary.

NOTE: The indexes of aggregate weekly payrolls are calculated by dividing the current month's estimates of aggregate payrolls by the corresponding 2002 annual average levels. Aggregate payroll estimates are the product of estimates of average hourly earnings, average weekly hours, and production or nonsupervisory worker employment.

Table B-7. Diffusion indexes of employment change

'ercent)

Time span	Jan.	Feb.	Mar.	Apr.	May	June	July	Aug.	Sept.	Oct.	Nov.	Dec.
	Private nonfarm payrolls, 278 industries [1]											
Over 1-month span:												
2002	40.8	36.5	38.3	38.7	40.1	46.0	43.7	43.3	41.7	41.9	41.5	36.0
2003	44.1	37.9	34.9	38.3	42.8	38.8	37.6	39.7	50.7	49.8	52.0	51.3
2004	51.6	49.5	62.4	65.5	62.4	57.7	52.7	52.0	57.0	54.3	55.0	54.1
2005	50.7	57.7	56.7	54.7	-54.5	56.7	59.2	54.1	51.4	53.4	61.7	58.6
2006	p 60.8	p 60.3										
Over 3-month span:												
2002	34.5	36.2	35.6	35.8	34.9	38.8	38.5	44.8	37.8	39.7	37.2	39.6
2003	40.6	34.2	34.7	32.7	35.3	41.7	38.5	33.8	42.6	47.8	49.8	50.5
2004	54.3	53.4	57.6	63.1	69.4	68.3	58.8	55.6	57.4	56.5	59.9	55.2
2005	52.9	56.7	59.2	60.4	56.8	60.8	60.4	59.7	57.9	52.2	57.0	63.7
2006	p 66.0	p 64.4										
Over 6-month span:												
2002	30.2	30.6	31.5	30.9	32.0	36.3	35.8	37.6	34.5	36.0	36.7	35.3
2003	34.4	31.8	31.8	34.0	32.7	36.2	33.3	32.4	40.5	45.3	46.4	47.7
2004	49.8	52.3	54.7	60.8	63.3	63.8	63.1	63.5	59.0	61.3	55.9	55.6
2005	55.4	57.7	57.4	58.8	55.2	58.6	60.8	59.5	60.6	57.7	58.5	60.6
2006	p 60.6	p 60.8										
Over 12-month span:												
2002	33.6	31.7	30.2	30.4	30.2	29.1	32.0	31.3	30.0	29.5	32.9	34.7
2003	34.5	31.5	32.9	33.5	34.2	35.1	32.7	33.1	37.1	36.7	37.2	39.2
2004	40.3	42.1	44.8	48.4	50.7	57.7	57.0	55.2	56.7	58.3	60.1	60.3
2005	60.1	61.0	59.5	58.6	58.6	59.4	60.8	61.0	60.8	58.3	58.8	62.1
2006	p 60.8	p 62.6										
	Manufacturing payrolls, 84 industries [1]											
er 1-month span:												
2002	19.6	21.4	18.5	29.2	25.0	30.4	36.9	25.6	28.6	17.9	17.9	19.6
2003	32.7	19.6	19.6	10.7	23.2	19.0	19.6	29.2	28.6	36.3	42.3	40.5
2004	44.0	47.6	44.6	64.9	53.6	45.8	56.5	52.4	41.7	42.3	39.9	39.3
2005	39.3	38.7	38.7	42.3	44.6	34.5	47.6	35.7	45.2	43.5	50.0	52.4
2006	p 58.9	p 46.4										
Over 3-month span:												
2002	9.5	9.5	11.3	17.9	14.9	17.9	22.6	25.6	22.6	17.3	9.5	11.9
2003	18.5	11.3	12.5	8.3	7.7	11.3	14.9	15.5	16.7	27.4	32.1	35.7
2004	43.5	42.3	43.5	53.6	57.7	58.9	53.6	48.8	48.2	40.5	38.1	31.0
2005	35.7	39.9	42.9	39.9	37.5	41.1	39.3	35.7	39.9	36.3	36.9	50.0
2006	p 58.9	p 56.0										
Over 6-month span:												
2002	7.1	8.3	7.7	8.3	8.3	11.9	12.5	11.9	13.7	8.9	7.1	7.7
2003	11.3	11.3	8.3	9.5	10.7	9.5	6.0	8.9	13.7	18.5	24.4	23.8
2004	28.6	33.3	33.3	45.8	47.6	51.2	56.0	51.8	48.2	49.4	39.3	35.7
2005	36.9	36.9	35.1	33.3	33.3	32.7	36.9	36.9	41.1	41.7	39.3	42.3
2006	p 37.5	p 48.2										
Over 12-month span:												
2002	7.1	6.0	6.0	6.5	7.1	3.6	4.8	6.0	4.8	7.1	4.8	8.3
2003	10.7	6.0	6.5	6.0	8.3	7.1	7.1	8.3	10.7	10.7	9.5	10.7
2004	13.1	14.3	13.1	20.2	23.2	35.7	36.9	38.1	36.3	44.0	44.6	44.6
2005	44.6	44.6	41.7	40.5	39.9	33.3	32.7	31.0	32.1	39.3	35.7	40.5
2006	p 39.3	p 42.9										

[1] Based on seasonally adjusted data for 1-, 3-, and 6-month spans and unadjusted data for the 12-month span.

p = preliminary.

NOTE: Figures are the percent of industries with employment increasing plus one-half of the industries with unchanged employment, where 50 percent indicates an equal balance between industries with increasing and decreasing employment.

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THE ECONOMIC REPORT OF THE PRESIDENT

HEARING

BEFORE THE

JOINT ECONOMIC COMMITTEE
CONGRESS OF THE UNITED STATES

ONE HUNDRED NINTH CONGRESS

SECOND SESSION

FEBRUARY 16, 2006

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THE ECONOMIC REPORT OF THE PRESIDENT

THURSDAY, FEBRUARY 16, 2006

CONGRESS OF THE UNITED STATES,
JOINT ECONOMIC COMMITTEE,
Washington, DC

The Committee met, pursuant to call, at 10:40 a.m. in room 2322, Rayburn House Office Building, the Honorable Robert F. Bennett, Vice Chairman of the Committee, presiding.

Representatives present: Representatives Maloney, Paul, and Cummings.

Senator present: Senator Bennett.

Staff present: Chris Frenze, Nan Gibson, Colleen Healy, Brian Higginbotham, Bob Keleher, John Kachtik, Frank Sammartino, Jeff Schlagenhauf, Chad Stone, Rachel Thomson, and Katie Jones.

OPENING STATEMENT OF HON. ROBERT F. BENNETT, VICE CHAIRMAN, A U.S. SENATOR FROM UTAH

Vice Chairman Bennett. The Committee will come to order. I am here for Chairman Saxton, who will be here later. I appreciate the indulgence of our witnesses and those who have been here on time. The Senate has just conducted a vote, and I had to be there to help save the Republic before I came to these particular hearings. Why are you all laughing?

Today, the Committee will hear testimony from two of the members of the President's Council of Economic Advisers. They will be discussing the recently released Economic Report of the President, which is appropriate. The Council of Economic Advisers and this Committee were created by the same piece of legislation as to get economic advice into the Executive Branch and then provide a forum for economic discussions in the Legislative Branch. So we welcome you in this one legislatively sanctioned activity that we engage in.

Now, the President has nominated Dr. Edward Lazear of Stanford University to serve as the chairman of the Council of Economic Advisers. We had his confirmation hearing in the Senate Banking Committee earlier this week. When he is confirmed by the Senate, he will replace Dr. Ben Bernanke, who has been in the news with other assignments. We heard from him in the Congress yesterday as the new chairman of the Board of Governors of the Federal Reserve.

But we are pleased to welcome the Council's other two members, Dr. Kathleen Baicker—is that close enough?——

Dr. Baicker. Close enough.

Senator Bennett [continuing].—close enough—and Dr. Matthew Slaughter to the Committee.

Now, as we look at the Economic Report of the President, we do so against the backdrop of a strong and growing economy which created 2 million new jobs over the past 12 months and more than 4.7 million new jobs since August of 2003. Core inflation remains relatively contained, and interest rates are historically low despite recent increases by the Federal Reserve.

That does not mean that the economy does not face significant challenges in the future. Energy prices remain a concern, and, of course, the uncertainties of the global economy are always with us, and we face serious long-term fiscal challenges tied to the retirement of the baby boomers and the entitlement programs that have served us well in the past but that are threatened by demographic changes.

I found it interesting that in this morning's paper there was an op-ed piece by Robert Samuelson that posed a very interesting question, which is, how can the economy be doing so well and people feel so insecure and industries, like Ford and General Motors, be in trouble while the entire economy has performed better over the last 20-25 years than it ever has in a similar period in our history. His answer is competition, that the power of competition has made individual industries and, therefore, their employees feel more uneasy about their economic status even as it has improved the overall economic well-being of the Nation as a whole. It is an interesting thesis, and I would like to get into that with you as we go into the question period.

[The Washington Post editorial entitled, "The Fears Under Our Prosperity," appears in the Submissions for the Record on page 24.]

It is imperative that the Congress and the Administration work together to handle these challenges head on. We have to deal with entitlement spending. I have watched politicians, for the dozen years I have been here, all tell me, yes, Senator, we have to deal with that, and we will address it right after the election because both sides want to carry the election rhetoric to see if they can win just one more election on the past rhetoric, and then they will tackle the tough problems, and as we keep putting them off, the tough problems keep getting tougher.

We all recognize the challenges that are essential for a strong economy: improving our education system, not the direct responsibility of this Committee but something we have to pay attention to; the issue that Robert Samuelson raises of international competitiveness; and we are finally recognizing that our present tax system, born in the 1930s, is no longer adequate to the challenges of a global economy in the 21st century, and at least among some of my colleagues in the Senate, we are beginning to have conversations about that.

So I look forward to hearing our witnesses describe how the system, particularly the tax system, can be replaced, not altered, not tinkered with, not "reformed," but I think we ought to start conversations about replacing it. Maybe you are not prepared to do that today, but I am giving you the warning that that is at least something that I am concerned with, and I understand, having had conversations with your new chairman, that he has an interest in that subject, too. That is a very great understatement.

So we welcome you both to the Committee and look forward to your testimony. Mrs. Maloney, there being no ranking member present, why do not you assume that responsibility and give the opening statement from that perspective?

[The prepared statement of Vice Chairman Bennett appears in the Submissions for the Record on page 23.]

OPENING STATEMENT OF HON. CAROLYN B. MALONEY, A U.S. REPRESENTATIVE FROM NEW YORK

Representative Maloney. Thank you very much, Chairman Bennett. I have appreciated your thoughtful comments today and always your sincere dedication to understanding and moving forward the American economy in a stronger position.

Unfortunately, Senator Reed is not here right now. He will possibly be here later, and I request that his statement be in the record. Apparently, he is questioning Chairman Bernanke right now, the Financial Services Committee.

[The prepared statement of Senator Reed appears in the Submissions for the Record on page 26.]

Vice Chairman Bennett. Senator Reed has the same conflict I do, and that is where I will flee as soon as Chairman Saxton shows up, to go sit down with Mr. Bernanke and see if he is easier to understand than Chairman Greenspan.

Representative Maloney. He is, and he actually answers questions. I am shocked. I think he is great. He is a former teacher, and it shows.

I want to particularly welcome our two panelists, Dr. Baicker and Dr. Slaughter and mention that I am always delighted when competent women are appointed to policy positions. We are far underrepresented in our Government and in many industries in our country. I want to welcome our male friends, too.

The statute that created both the Council of Economic Advisers and the Joint Economic Committee mandates that the Joint Economic Committee should review the Economic Report of the President, and I am pleased that you are here today to discuss this truly important report for every American.

In its 11 chapters, this year's report covers a broad range of topics and reflects the talent and professionalism of you and the other economists on the CEA staff, but what concerns me is the disconnect between the policies that the Bush administration has been pursuing for the past five years and the policies that can be justified by sound economic analysis. I hope that you would agree that persistent, large budget deficits and debts are not conducive to long-term growth and our standard of living.

I hope you would also agree that even if there is not a lockstep relationship between budget deficits and international imbalances, it cannot be good for our national savings and our trade deficit when the Federal budget moves from a substantial surplus in 2000 to an even larger deficit in 2004, especially when our personal savings rate has fallen and is now a negative. Nor can it be good for our economy or our society when workers are not seeing the benefits of economic growth in their paychecks, and the gap between the haves and the have-nots is widening. I think this is a trend that every Republican and Democrat is deeply concerned about because that is a very bad trend for, I would say, the economic well-being and the spirit of America.

Your report wisely avoids trying to justify the President's budget and tax policies, but I think it is important that we try to understand what is really happening in the U.S. economy and how the President's policies are affecting the economic well-being of all Americans.

Foreign governments, as pointed out in the Financial Services Committee yesterday, are buying GSEs—Government-sponsored entities—instead of Treasury notes. In fact, they now hold a third of our debt. What they are buying now, a third of it is now GSEs, and I am concerned. Is that a warning sign that we are getting near the edge, that foreign governments may not continue to buy our debt at the rate that is needed to sustain our spending?

I am also concerned, since this is a shift that I have never seen before—possibly it has happened before, but I am not aware of it—where GSEs have become a major holding of our debt, and that, as you know, is a Government-private sponsorship that is moving to the private away from Government. What is the ramification, if any, on our economy?

I welcome you today. I congratulate you on your appointments. Some very good people have come out of the positions that you hold and have continued to lead and play important roles in our Government. I thank you for your service today and your service and commitment to our Government. Thank you.

Vice Chairman Bennett. Thank you very much. We will now hear from our panelists. Which one goes first?

Dr. Slaughter. I believe I shall.

Vice Chairman Bennett. Okay. Dr. Slaughter, and then we will hear from Dr. Baicker.

JOINT STATEMENT OF DR. MATTHEW SLAUGHTER AND DR. KATHERINE BAICKER, MEMBERS, COUNCIL OF ECONOMIC ADVISERS

Dr. Slaughter. Thank you. Vice Chairman Bennett and other members of the Joint Economic Committee, we are very pleased to testify today about the 2006 Economic Report of the President. The report reviews the state of the economy and the economic outlook, and it discusses a number of economic policy issues of continuing importance. Across its 11 chapters, the report highlights how economics can inform the design of better public policy and reviews Administration initiatives.

The performance of the U.S. economy continues to be strong. In 2005, the Nation's real GDP grew 3.5 percent for the year, above the historical average. Key components of demand that accounted for growth in 2004—consumer spending, business investment in equipment and software, and exports—continued to do so in 2005. Employment increased by about 2 million payroll jobs for the year, and the unemployment rate dropped to 4.7 percent last month, well below the averages of recent decades. Real disposable personal income increased, and real household net worth reached an all-time high. This growth comes on top of an already strong expansion, the foundation of which has been exceptionally rapid productivity growth. The Administration's forecast, consistent with consensus private forecasts, shows the economic expansion continuing for the foreseeable future.

Increases in investment spurred by the dividends and capital gains tax relief enacted in 2003 have played an important role in the strengthening of our economy. Since the Jobs and Growth bill became law, capital investment has increased by 25 percent, contributing to sustained job growth and directly benefiting workers in the broader economy. It is essential that this tax relief be extended.

American productivity growth, and thus competitiveness, in the 21st century will rely upon American ingenuity, entrepreneurship, and labor force talent. The President's American Competitiveness Initiative aims to support these forces. Promoting a flexible and skilled workforce through improved access to high-quality primary, secondary, and post-secondary education, through policies that attract the world's best and brightest to our shores, and through investment in research and development and the continuing education and retraining of our mobile labor force will help ensure that the United States remains a leader in this rapidly changing world economy.

But maintaining this leadership will also require a continued commitment to competition in and flexibility of U.S. product, capital, and labor markets that help transform innovations into the new products and processes in the marketplace that ultimately support rising incomes for workers and their families. Innovation alone is not sufficient to guarantee rising prosperity. It also requires the dynamism of the marketplace, for which America is uniquely positioned.

This continuing strength and competitiveness of the American economy in the global marketplace depends upon policies that open international markets to U.S. goods and that promote growth and investment at home. The performance of the U.S. economy depends on an effective financial services sector and on a tax system that promotes domestic growth and international competitiveness.

Further opening of foreign markets to U.S. goods would yield great rewards for Americans. Over the past 70 years, policymakers across political parties have consistently recognized the importance of international commerce and have achieved major trade liberalization both here and abroad. The net payoff to America from these achievements has been substantial.

The Administration's policies will make even greater gains possible. Support of the agricultural sector can be provided in ways that are less distortionary. We must work to eliminate further barriers to trade, especially in services, and to further open markets in global, regional, and bilateral negotiations. Americans will reap the greatest benefits from this trade when intellectual property rights are well defined and well enforced. The Administration continues to enforce vigorously the laws that protect the rights of American intellectual property owners.

Dr. Baicker. The continued expansion of energy markets and diversification of energy sources can further increase our resilience to energy supply disruptions. Hurricanes Katrina and Rita demonstrated that competitive markets play a central role in allocating scarce energy resources, especially during times of natural disaster or national emergency. Policies that build on economic incentives and that spur our development of alternative fuel sources can further reduce U.S. vulnerability to energy disruptions and dependence on foreign oil, encourage energy efficiency, and protect the environment.

Even as living standards rise, Americans are increasingly concerned about their retirement security and health care costs. Most working-age Americans are, in fact, on track to save as much as most retirees, but there are a number of risks to the retirement preparations of Americans. People today are living longer and can face higher health care costs in retirement than members of previous generations. In addition, both defined-benefit pension plans and Social Security suffer from fundamental financial problems that expose not just retirees but all U.S. taxpayers to risk of substantial losses. The Administration is focused on addressing these problems and protecting the Nation's retirement security.

Rising health care costs are of concern to all Americans, young and old. All Americans deserve access to reliable, affordable, high-quality, high-value health care. Health care in the United States is second to none, but it can be better. Both public and private health care spending have grown much more rapidly than general inflation or wages, straining consumers, employers, and Government budgets. The cost of finding new health insurance locks some workers into their current jobs if they or someone in their family is ill or in less-than-perfect health. Frivolous lawsuits can raise health care costs for everyone. Perverse tax and insurance incentives have led to inefficient use of our health care resources.

Promoting a stronger role for consumers can help create a health care system that is more affordable, more transparent, more portable, and more efficient. Health savings accounts should be strengthened by allowing people to contribute enough to them to pay for all of their out-of-pocket expenditures tax free. Individual purchasers should have the same tax advantages as those who get insurance from their employers. We need to ensure that patients and their doctors have the information they need to use this control to get the health care that is best for them and that electronic health records are widely used to reduce costs and to improve the quality of medical treatment.

The report provides an analytical backdrop for the President's agenda, which includes restraining Government spending, making tax relief permanent, making health care more affordable and accessible, creating an economic environment that encourages innovation and entrepreneurship, continuing to open markets to American goods and services, and reducing America's dependence on foreign oil by diversifying our energy supply. These policies will help maintain the economy's momentum, foster job creation, and ensure that America remains a leader in the global economy.

Thank you all for this opportunity to discuss the 2006 Economic Report of the President, and we would be happy to answer any questions you might have.

[The prepared joint statement of Dr. Slaughter and Dr. Baicker appears in the Submissions for the Record on page 29.]

Vice Chairman Bennett. Thank you very much. We appreciate your testimony and the hard work that went into the creation of the report. You have touched on a number of issues that I find fascinating, and let me just explore a few of them with you.

The Samuelson column and the comments you have made demonstrate how changed this economy is from the one that I grew up in and, indeed, the one that many people thought was normal. "Normal" meant you graduated from high school or college, and you got a job. You went to work at Sears & Roebuck as a stock boy, and then you became a salesman on the floor, and then you became a standpoint manager, and if you were really good, you got to be an assistant store manager, and at the end of your career, you had been a store manager, and you got your pension and a gold watch, and life was good.

If you graduated and went to work at Ford or Delphi or one of the giant companies, the unions negotiated on your behalf. Your wages were not only stable, but they rose with virtually every negotiation in both real terms as well as with respect to inflation. Your job may not have been all that stimulating, but you stayed on the manufacturing line, you did a good job, you were there for 40 years, and you retired with or without the gold watch but with a pension and lifetime health benefits.

That world is gone, and it is never coming back, however much we in the Congress might want to legislate its return. The world in which we now live is a world of intense competition, and the emphasis is on the word "world," a world of intense competition, and those who meet the competitive challenge thrive, and those who do not are almost ruthlessly left behind.

I just came back, a few weeks ago, from a trip to the Far East, and we went to China, and the Chinese are very concerned about losing jobs to Vietnam, and, interestingly enough, the Chinese are worried about intellectual property rights because as their economy matures, and they begin to invent things of their own, they get very upset when somebody in some other country steals their patents without protecting their intellectual property rights. It was very interesting to hear Chinese officials say, we have to have tough international intellectual property right regulations, to which we could only say, hooray, we are glad you finally got the message.

When we did go to Vietnam, the people in Vietnam said, "Do not look to China as the place to go; look to us." And in both cases they said, "We do not want an economy built on cheap labor. We are making sure that our economy is built on technological breakthroughs and high quality." That is not the image you get reading the op-ed pages of the New York Times, but that is the image that you get when you get out into the world.

I think Samuelson is exactly right: People are doing better than they have ever done before, and they are more uneasy and feel more threatened than they ever have before; and I am not sure his analysis that that is due to competition is the right one, but that is certainly probably the place to start. However much we might want to not live in such a competitive world, the fact is we are there, and there is nothing we can do about it except accept it, compete, and be the ones that survive.

I wish I had brought it with me. Again, a recent piece pointed out that Europe is almost in a death spiral and that the average European, within 15 to 20 years, will be half as wealthy as the average American because they are not competitive, they have tried to hang onto the model that I have described as the past as their view of the future, and the net result has been to say that Europe is dropping out of the global competition, and the countries that will survive and thrive in the future will be the United States, China, and India, and I am not so sure that China will, given their population problems and the demographic challenges they have.

[The Washington Post editorial entitled, "The End of Europe," appears in the Submissions for the Record on page 23.]

They were talking to us about the difficulties of what they call the "one-two-four pyramid." They will have one worker, because of their one-child program, who will have to support two parents and four grandparents, and they have no safety net of the kind that we take for granted in that society. So the parents are looking to their child to support them, but the grandparents are still alive, and the economic burden of the one-two-four pyramid in China is something we can be grateful we do not face.

All right. I apologize. I am making a speech here, and I should be asking a question, so let me do the standard senatorial thing. What do you think?

Dr. Slaughter. I believe the answer is yes. I will offer a few reactions to that, if I may, Senator. You raise an excellent set of points.

There is a famous labor economist named Richard Freeman who refers to the change in the nature of the global economy in the past 15 years. He has coined the phrase "the great doubling." If you take the populations of China and India and the former Soviet Union and many eastern European countries, that is about half of the world's population, and if we go back even just 15 years, that set of countries economically was effectively sort of on the moon. They were very isolated and not part of the global economic system.

So one of the things that is very different today from the past when we think about global integration, if we go back, say, 10 to 15 years ago in the United States, there was a lot of discussion about the implications and ramifications of the North American Free Trade Agreement and extending our free trade agreement with Canada, to include Mexico. Candidly, Mexico is sort of rounding error when you are trying to get a hold on the number of people effectively that are now part of the population with the great doubling that we have experienced.

So that is something that is qualitatively different, and during that period the sense of unease that Robert Samuelson has talked about, he is correct. If you look at public opinion surveys on people, how they view the nature of their labor market attachment, for about 15 years now throughout the United States and also in many other countries you see rising self-reports of worker uncertainty and worker unease. That speaks to the fact that the nature of labor market attachment for people, it just does not depend on their earnings; it depends on the reliability of those earnings. There are many dimensions of labor force attachment that people think about.

In the United States, as I alluded to in my comments, we have been enjoying this productivity acceleration that started in 1995 and that has continued even further since the year 2000, which is wonderful from the standpoint of average living standards in the United States because productivity growth is the only sustainable foundation for rising average living standards for America.

One of the notable features about this productivity acceleration, especially since the year 2000, has been the critical role played by what economists call "total factor productivity growth," not the growth of capital per worker but sort of the organization and the innovations that combine workers with their capital in terms of what products firms are going to make and how they are going to make it. There is now substantial evidence from academic research, from the business community research, that the force of competition, especially international competition, is an important spur to productivity growth for firms and, therefore, for countries as a whole, and that is just based on a lot of empirical studies of lots of industries around the world. One example that I will give is retail trade.

So one of the important industries that has contributed to the productivity growth in the United States in the past several years has been the retail trade sector. The United States has had a very different experience from many continental European countries like you cite. We have had a lot of innovations in retail trade that have been implemented thanks to competition and flexible capital and labor markets in the United States.

So Wal-Mart, Costco, Target, those types of firms, have been able to establish and expand new types of retailing services in the United States, very different from in Europe where they have made a different set of choices, where there are much more qualitative and quantitative restrictions on land use, labor market use, and capital market turnover that have inhibited the ability of retailers to replicate the kind of performance we have seen in the United States.

So I broadly agree with what Robert Samuelson is talking about, that the forces of competition are very important for contributing to rising living standards in the United States, but that competition has certain dimensions to it, and, again, one of them is thinking about what is the distribution of the overall productivity gains and the sense of certainty or uncertainty that that imparts to different segments of the workforce.

Dr. Baicker. To build on what Dr. Slaughter discussed about the uncertainties that workers face in the modern economy, technology is evolving much more quickly, and the labor market is changing much more quickly than it had in the past, as you said, so it is especially important that we provide the support that workers need to move from shrinking sectors of the economy to growing sectors of the economy, whether those changes are generated by trade or internal development of new technologies, or by changing tastes in the marketplace.

Any source of displacement for workers necessitates that they get additional training and that they have the support that they need to get that training and income support during the time when they are transitioning between jobs. That is an important component to ensure that everyone in the economy can benefit from overall economic growth.

To build on that as well, you mentioned retirement security of workers who expect a lifetime pension, and one of the important supports for retirement security is that pension promises are kept. Through the defined-benefit pension system, workers were promised a stream of income in their retirement. It is important that we make sure the incentives are in place and the regulatory oversight is in place that those promises to those workers are kept to them so they can feel more secure about their retirement security as they move from job to job.

Vice Chairman Bennett. Thank you. I will not monopolize. I have got a lot of reactions to what you have had to say, but just one quick one. As we go into this new world, I think we need to get the mentality that pensions and health care are no longer tied to the employer but to the employee so that the employee who accrues pension benefits working for his first job takes those with him to his second job and this third and his fourth and his fifth and so on.

It is now very clear that people will normally and routinely in their lifetimes have 10 jobs at 10 different places and sometimes change fields entirely. A veterinarian may end up as a stockbroker or vice versa. If you can accumulate and bring with you your pension benefits, which is what the 401(K) program is supposed to do, and do the same thing with health care, you own your health care benefit rather than your employer so there is no concern about a preexisting condition because it is your plan, and you take it with you and ultimately control it.

We are not used to thinking like that. We are so tied to the old paradigm—we keep trying to keep the old paradigm alive because it worked for so many years—that we are actually putting ourselves ultimately in the position of jeopardizing what has to be done for our children and our grandchildren. Mrs. Maloney?

Representative Maloney. Thank you so much for your statement, all of you. It gives all of us a great deal to think about.

I would like to go back to one of the areas that I mentioned in my opening statement, and that is the growing divide between the haves and the have-nots in this country. Last fall, we had a Democratic forum on the economy where one economist, Alan Blinder, gave some very interesting testimony on this topic, and he argued that there had been a long-term trend toward greater inequality interrupted for a short while in the late 1990s. He did not use this particular chart, but I think it illustrates how we are all on the wrong track on this particular issue.

The blue bars show the usual weekly earnings of full-time wage and salary workers at different points in the earnings distribution between 1995 and 2000, a time of great economic growth, and the red bars show the same thing between 2000 and 2005. You see that during the Clinton years, the divide between the poorest people and the richest people was just a little over one percentage point, where now the divide between the poorest and the richest is now a clear six points. That is a growing inequality that I find disturbing.

[The bar chart entitled, "The Bush Economy: The Distribution of Earnings Has Become More Unequal," appears in the Submissions for the Record on page 28.]

Professor Blinder went on to argue that it was market forces, rather than Government policy, that is the major source of earnings inequality. That is what he argued. I just want to understand what is different about these market forces in the 1990s compared with now.

Do you agree with him that it is market forces, not Government policies, that lead to this inequality? If so, what is different now than before? Some people argue that inequality is present because we have cut some spending on domestic programs. He argued that that was not the point. He said it was market forces causing this. Could you elaborate and further explain your take on this to me and to others?

Dr. Slaughter. Sure. I will offer some initial comments on that and turn it over to Dr. Baicker.

I broadly agree with Dr. Blinder's assessment of rising income inequality in the United States.

Representative Maloney. Do you agree that it is market forces, not Government policy?

Dr. Slaughter. Yes.

Representative Maloney. I am sorry. I have to hand it back to him and read your statements in the published record. I am sorry. I have to go vote, first responsibility. We have got to vote. Okay.

Vice Chairman Bennett. We are going to have a lot of fun without anybody from the House to monitor us.

Representative Maloney. I do not think you need to be monitored. I wish I was here to hear what you have to say, quite frankly.

Vice Chairman Bennett. Thank you.

Representative Maloney. I want to add to what you have to say, and this is just an observation. I am going to miss a vote on this. I am amazed at New York's economy after 9/11. I just thought we would never recover because of the devastation. We blew out so many jobs and I have to tell you that practically everyone I meet tells me they lost their job. Yet our economy has rebounded, so it must have rebounded with new jobs, which illustrates what you are saying—this tremendous, dynamic change. It is really amazing, practically everyone I talk to tells me they lost their job. How can unemployment be worse than the rest of the country? But it is still not that bad in New York even when everybody I talk to says they lost their job. It is amazing. I would like to hear your comments on that, too.

Vice Chairman Bennett. Okay. Go back to the chart and comment on it.

Dr. Slaughter. Sure.

Vice Chairman Bennett. I think that is a legitimate issue she has raised.

Dr. Slaughter. Absolutely. They definitely are. So there are two features of that chart that I will highlight and expand on. One is that on most measures income equality in the United States across skills has been rising since the late 1970s, so the red bars there are more reflective of what the U.S. economy has been experiencing since, as I said, the late 1970s.

So one of the features of the U.S. economy that has been quite different in the past generation from previous generations is the distribution of gains. It has not been the rising tide lifting all boats. There has been something going on, and this, again, is in pretax earnings. There are some changes in the nature of supply and demand in the U.S. labor market that have been raising the returns to skills, in particular. There are other dimensions of income inequality that have been rising as well. What economists call "within-group inequality" has been increasing as well.

But if you focus on the returns to skills and different parts of the income distribution that are shown in that figure, the late 1990s that are shown there are actually the exception rather than the rule for how the U.S. labor market has been performing for quite some time. That is one fact I will highlight.

The other is that one of the striking features is that this is not a uniquely U.S. phenomenon. Most other countries around the world over the same time period of the past generation have also been experiencing rising income inequality. So the U.K. and many continental European countries; there sometimes the inequality has been manifested more in rising unemployment for less-skilled workers, even countries where you might think opposite trends would be expected, so middle-income countries like Mexico. Even today we see in China and India substantial evidence of rising income inequality as well.

A substantial amount of academic research has looked at this question, and the preponderance of evidence and conclusions from researchers has been that the main force driving up the returns to skills and contributing to the rising inequality has, again, been technology innovations that tend to favor the demand for skills.

So it sort of comes back to some of the issues we were talking about before, which is that we have got these technology innovations that firms are implementing that raise the need for more-skilled workers and, as the figure shows, raise the returns to more-skilled workers, and that speaks to the broad policy challenge of how do we try to ensure that as many Americans as possible have the kinds of skills that firms are increasingly demanding in the workplace.

Dr. Baicker. To elaborate on those points, the returns to education have been going up over time, and it is especially important, then, to ensure that all children have access to high-quality education through primary and secondary school and that people have the financial resources to continue their education beyond secondary school, such as through the expansion of grants to community colleges that disproportionately train people in growth industries. So ensuring access to those educational institutions is particularly important in the modern economy.

One other point I would like to make is that those bars would look a little bit different if you took out the full income of those different groups. So the earned income tax credit has been an important component of increasing the resources available to people at the low end of the income distribution. It has been a very successful program in both giving people income stability and the resources that they need and also in promoting participation in the labor force.

So while the point that income inequality has been rising is well taken and true, it is important to also consider the total bundle of resources available to people across the income distribution.

Vice Chairman Bennett. Thank you. Is there any parallel with the fact that from 1995 to 2000—the recession started in 2000, or the downturn started in 2000, the last quarter—those were five years of expansion and growth. The recession hit in 2001. How can 2000 be 11.1 and minus 2.1? You have got 2000 up there twice. Oh, this is fourth quarter to fourth quarter. Okay. Well, then that shows that the recession started in the fourth quarter of 2000 with the minus 2.1.

Does that impact the visual message coming off the chart, the fact that you have got five years of expansion and three years of the recession and the slow recovery? The recovery really did not begin to take hold until 2003, so is that a factor here, or is that just coincidence?

Dr. Baicker. That is a very important point, and I thank you for making it. It highlights the fact that a growing economy is a prerequisite for everyone in the economy to do better, and so policies that encourage economic growth will help people at all points in the income distribution.

Dr. Slaughter. That is right. I believe, if I remember the statistics correctly, by the peak that is in around 2000, the aggregate unemployment rate in the United States briefly dipped below 4 percent to about 3.9 percent. So the strength in the labor market overall is a force that does tend to help pull up the incomes of everyone, including those at the lower end.

Vice Chairman Bennett. Yes. Okay. But your overall conversation says that the real source of the income gap is a skill gap. Is that an acceptable statement, or is that too simplistic?

Dr. Baicker. It is an important component.

Vice Chairman Bennett. Okay. It is an important component. That is an economist's way of saying, you are not quite right, Senator. How big a component is it? You are an economist; put a number on it. Is the skill gap 50 percent of the problem, 70 percent of the problem?

Dr. Slaughter. Again, there has been this ongoing secular increase in demand for more-skilled workers relative to less-skilled workers. I think if you took a look at the body of research evidence here, the majority of that shift in demand for skills gets attributed to the technology innovations that favor skilled workers.

Other forces that have been looked at that seem to have played some role but a much smaller role include freer international trade and immigration inflows also. So some dimensions of greater international commerce and global engagement have played a role, it appears, in shifting demand in the United States towards more-skilled workers, but it played a relatively small role compared to these technology innovations.

Vice Chairman Bennett. So we have got a skill gap, we have got the impact of international trade, we have got the impact of technology, and we have got the question of whether we are in a growth period or a recessionary period, and all of those play into it. Okay.

Dr. Slaughter. Correct.

Vice Chairman Bennett. Okay. Mrs. Maloney raised another issue that I would like to explore with you. She talked about the savings rate. We now have a negative savings rate. As I have looked at that, we had a savings rate in the United States that was fairly stable and then started to tip downward in the 1980s and has continued downward on a very even trajectory since the 1980s to the point that it finally turned negative. It did not turn down and flatten out; it just started down in the 1980s and has kept going down in the 1980s.

So this is not a phenomenon of the last five years or the last 10 years; it is the last quarter century that we have been dealing with a falling savings rate. Talk about that. Tell me why that is the case.

Dr. Slaughter. So the decline in personal household savings rates that you mention has been another long-term feature of the U.S. economy. The report discusses that trend and looks at some of the possible reasons behind it.

One of the reasons that has been contributing to it, especially in recent years, that the report talks about is it kind of looks at the overall financial picture of households and points out that one of the positive features of productivity growth and the aggregate income gains over time has been rising household wealth. So net worth of households in terms of the assets they own minus the liabilities such as home mortgages; that has been rising, especially in recent years, with increases in equity prices and, more recently, home prices.

Vice Chairman Bennett. Have the two gone in lockstep, the savings down and the housing, over 25 years?

Dr. Slaughter. Not as much over 25 years, in part, I think, because the increases in household net worth have been more noticeable in recent years. A lot of research has shown that when households have increases in their wealth, they tend to take some of that wealth in terms of higher consumption, and so the report looks at some analysis that says, given what we know about the propensity of households to increase their consumption when they have more wealth, especially in recent years as household net worth has increased quite well, that explains some of the decline of the overall national personal savings rate.

The other broad feature of savings I would mention is, as Mrs. Maloney had correctly pointed out, when we think about savings for the United States in a global context, an important source of savings for the U.S. economy overall to finance investment of firms in recent years has been foreign savings. So we have domestic savings, which consists of savings by households, there is savings by the Government, there is savings by companies, and then to the extent that we have open borders, we also can use some of the savings of the rest of the world.

So the economic report talks in detail about how our current account deficit reflects the fact that on net, in recent years, the United States has been using some foreign savings to finance the investment by our companies.

Vice Chairman Bennett. That brings up the other subject that she mentioned in her opening statement about foreign investors buying paper from the GSEs. Do you want to comment on the comment that she made in that regard?

Dr. Slaughter. Sure. The data are correct. I do not know the exact details offhand, but GSEs are one of the assets that foreign private investors and public investors have been purchasing, but it speaks to the point that when we look at the range of assets that the rest of the world is purchasing from the United States in recent years, it is a pretty broad portfolio, actually. So the range of assets that are tracked in our statistics that we have in the United States include Treasury securities, and they include the GSE bonds. They also include corporate bonds, corporate equities, bank loans, and another major component of that investment is foreign direct investment, so companies with an ownership statement.

When we look at the data that are collected by the Treasury Department and also by the Bureau of Economic Analysis, the distribution of all of the assets on net that are owned by the rest of the world is pretty evenly distributed actually across those different classes of assets.

So foreign investors, both public and private, are thinking about what is the right mix of assets to own, and over time I think it is reasonable to expect there to be some evolution in the composition of the net foreign debt position of the United States.

Vice Chairman Bennett. So they are not necessarily targeting GSEs as a preferred investment; they are simply diversifying their investments and say we can do a little of this and a little of that.

Dr. Slaughter. I think that is right. On net, when you look at, again, the total stock of U.S. assets that are owned by the rest of the world, again, I do not have the exact statistics in front of me, but it is distributed pretty smoothly across those different asset classes. There is no one class, for example, that I listed that constitutes over 50 percent of the total assets that are owned.

Vice Chairman Bennett. There is not a disparate preference for GSE over Treasury?

Dr. Slaughter. I would have to look at the changes over time in recent years. Offhand, sir, I do not know the exact changes in the distribution of Treasury securities versus GSEs. I would need to look at those data in particular. I just do not have them handy.

Vice Chairman Bennett. It is my impression that there is not, that the appetite for Treasuries remains as strong as it has ever been.

Dr. Slaughter. That very well may be.

Vice Chairman Bennett. But I cannot prove it, so I will not claim it.

Dr. Slaughter. We need the statistics.

Vice Chairman Bennett. Okay. I am sure someone would raise the issue of the trade deficit. Every time we had Chairman Greenspan before us, he would say that the trade deficit in the short-term is not a problem and in the long-term is unsustainable, so you got a headline either way, depending on how you felt about it. Talk to us about the trade deficit, short-term and long-term——

Dr. Slaughter. Absolutely.

Chairman Bennett [continuing]. And what we can do about it.

Dr. Slaughter. Sure. The report has substantial discussion on the trade deficit. The facts as we know is that the trade deficit has been rising, so the recent data for 2005, the trade deficit for the United States with the rest of the world in goods and services came in at about $726 billion. A better metric is the share of GDP. It is a share of 5.8 percent of GDP.

Vice Chairman Bennett. What is the breakdown between goods and services?

Dr. Slaughter. We actually run a surplus with the rest of the world in services.

Vice Chairman Bennett. That was my sense because many times the newspapers focus on the goods trade deficit and say the sky is falling, and they do not understand that we are recovering some of that with services.

Dr. Slaughter. That is correct, sir. So for 2005, our trade surplus in services with the rest of the world was a little over $56 billion. That increased from the previous year, and it comes back to some of the issues you raised earlier. There is more change in the global economy, and part of that means a lot more activities that used to not be tradable now can be traded across borders, like business-processing services that we hear a lot of anecdotes about recently. That increases the possibility for U.S. companies, which tend to be quite good at a lot of service activities, which reflects the fact that over 80 percent of jobs in the U.S. economy are in the service sector. That raises the potential for more export opportunities for U.S.-based companies. So we run a bigger trade deficit in goods, then, that leads to the total trade deficit.

So the rise in the trade deficit that has been ongoing is definitely a source of concern, and thinking about the underlying causes and possible transitions going forward is very important, I think. We know that some of the features of the strength of the U.S. economy in recent years account for the rising trade deficit. One, in particular, is the fact that we have had much faster economic growth that we have been discussing than have most of our major trading partners.

So about two-thirds of our trade is still with other high-income advanced countries, such as Japan, Germany, and France, and they have been growing at much slower rates than has the United States, which means our faster growth rates and faster income growth tend to mean we are importing a rising amount of their goods and services compared to how much of our exports they are taking in with their income growth. That said, some of the forces that account for the increases in the trade deficit are more worrisome, and you correctly point out that the ongoing decline in personal household savings is one of those.

Going forward, then, we can think about different market-based and policy-based adjustments in the rest of the world and in the United States that would contribute to a moderation in the global imbalances that we see in the world today. In the United States, raising national savings relative to investment would be changes that would contribute to an amelioration of the trade deficit, so that would be savings by households perhaps. Again, that is a difficult issue, given that we have seen household savings falling for some time. One of the broad motivations for the tax reform panel was to think about putting in place a different set of incentives that might stimulate savings.

For the rest of the world, I think policy challenges include things like trying to undertake policy reforms that would stimulate faster economic growth that would contribute to more exports from the United States going to those countries if they were enjoying faster growth.

Vice Chairman Bennett. Well, let us look into our crystal ball and say Europe is not going to grow. Japan, aging economy, shrinking population. They do not encourage immigration. India and China, yes, they are growing at dramatic rates, but they are still not major sources for American exports.

Dr. Slaughter. Right.

Vice Chairman Bennett. How do you turn this around?

Dr. Slaughter. That is an excellent question to which I do not have the perfect crystal ball.

Vice Chairman Bennett. All right. What happens if we do not?

Dr. Slaughter. I would say two things. One is you are correct to point out that both China and India have been growing quite quickly. Of our major trading partners, our exports to China have been growing faster than any other country, over 20 percent per year in the past five years.

So one of the broad forces that we can hope for is faster economic growth and productivity growth, in particular, in China and India that will raise average incomes there and allow them to have the earning power to purchase more goods and services from the United States.

For Europe and Japan, you are absolutely correct, sir, that the growth challenges there are, at some level, daunting, given the underlying demographics that are going to limit the population and labor force growth and given that, again, in recent years, at least, they have not enjoyed the kind of productivity performance that the United States' economy has. In the near term, at least, there are signs of strengthening both business and consumer sentiment in Japan and in Germany, in particular. So for those two countries, which are two of our largest trading partners, if capital investment and productivity growth could strengthen, those would be forces that would lead to greater trade between the United States and those countries.

Going out, then, it will remain to be seen what other sources of growth there might be abroad and then what sorts of adjustments, again, both from a policy standpoint and from a market-based standpoint, of what firms and households choose to do around the world to see the distribution of U.S. trade and the total amount of U.S. trade with the rest of the world.

Vice Chairman Bennett. You have not answered my question about looking out. Say that things do not change dramatically. Okay. Europe gets a little stronger here and there, but over the next 30 years, things do not change, and the trade deficit just continues to grow every year, not every year, but the trend line continues to go up every year for the next 30 years. What does that mean to us at that point? Is there a day of reckoning out there, or can we go on like this indefinitely?

Dr. Slaughter. Again, that is an excellent question. As the report talks about, the companion of the trade deficit in goods and services that we run is this surplus in trade in assets. So another way to think about the question going forward is to what extent will the rest of the world continue to be willing to purchase more and more U.S. assets. To the extent that there is a shift in demand away from U.S. assets towards other countries' assets, either from private actors or public actors, that will be a force that will slow the rate of growth, if not start to bring down the global imbalances that we see today. What we would see in the marketplace, in part, might be a change in the market prices of currencies and also of interest rates as well.

But, again, one of the broad puzzles, I think, that we are not quite sure about how it will play out, is that the imbalances that we have seen arise in recent years are qualitatively different from the ones we have seen in previous decades and generations in part because many countries around the world have relaxed policy restrictions on the flows of capital across borders, and so we are now in an environment with a much greater degree of capital mobility across borders than we had in earlier times, and the underlying economics.

We know, kind of like trade in goods and services, that when we liberalize, there should be imbalances across borders, and so one of the challenges for policymakers, for researchers, for the business community going forward is trying to ascertain to what extent now this sort of new environment with greater capital mobility, what degree of imbalances might be sustainable.

Vice Chairman Bennett. You are not drawing a doomsday scenario. You are basically describing a readjustment and a soft landing. As long as the U.S. economy remains strong, we do not worry about the trade deficit?

Dr. Slaughter. No. We continue to worry about the trade deficit, absolutely.

Vice Chairman Bennett. But you have not given me, and I do not think there is, any prescription of what to do about it. As long as we remain stronger than other people, and our economy is growing faster, we are going to run a trade deficit. We do not want to slow us down just for the sake of statistically getting rid of the trade deficit.

Dr. Slaughter. Correct.

Vice Chairman Bennett. But what is the problem? What will be the consequence, long-term, as these adjustments occur? Will the U.S. economy slow down? Will there be greater income imbalance? What will be the consequences?

Dr. Slaughter. That is the excellent and correct question to ask. Again, it is going to be a mix of changes in the United States and changes in the rest of the world in terms of the balance of the United States on net having much higher investment than the pool of national savings, and the converse holds in many of our many trading partners like Japan and Germany. So those countries, for example, have seen sharp declines in their investment rates in recent years relative to their savings.

So, again, I could foresee a number of different scenarios in which there is greater capital investment in countries like Japan and Germany, as I talked about, related to their savings, which would mean that they would run smaller trade surpluses. In the United States, then, some mix of greater national savings related to our investment would be the offsetting change. Again, how quickly that happens and the kind and extent of adjustment of prices of currencies and interest rates depends; there is just a number of different scenarios that one could envision there.

It is hoped for that the adjustment would not be sudden and dramatic, the kind of hard landing that you are referring to. Instead, it is hoped for that, given market flexibility that we have been discussing, that the adjustment would be more gradual over a longer period of time.

Vice Chairman Bennett. Well, we have been here an hour, and I have taken up almost all of it with my questions and your answers, which, for me, is just great, but it looks as if our House colleagues will not be returning, and I have run out of things to ask in their behalf. So thank you very much for being here, and the Committee is adjourned.

Dr. Slaughter. Thank you.

Dr. Baicker. Thank you.

[Whereupon, at 11:37 a.m., the Committee was adjourned.]

Submissions for the Record

CONGRESS OF THE UNITED STATES

JOINT ECONOMIC COMMITTEE

CHAIRMAN JIM SAXTON

PRESS RELEASE

For Immediate Release
February 16, 2006

Press Release #109-59
Contact: Christopher Frenze
Executive Director
(202) 225-3923

OPENING STATEMENT OF CHAIRMAN JIM SAXTON

ECONOMIC REPORT OF THE PRESIDENT

WASHINGTON, D.C. – I am pleased to welcome Dr. Katherine Baicker and Dr. Matthew Slaughter of the President's Council of Economic Advisers before the Committee this morning. The subject of today's hearing is the *Economic Report of the President*. I would also like to note that the Joint Economic Committee and the Council of Economic Advisers share a common history, and we value our long-standing relationship with the Council.

As the *Economic Report of the President* states, U.S. economic performance has been very strong in recent years. Economic growth has been healthy, the unemployment rate has been falling and is now 4.7 percent, core inflation has been contained, and long-term interest rates remain relatively low. Since May of 2003, payroll employment has increased by 4.7 million jobs. It is worth noting that tax policy and Federal Reserve policy have made important contributions to the economic expansion in recent years.

The tax incentives contained in the 2003 tax bill are among the key reasons for the strong pace of economic growth in recent years. Before 2003, the expansion had been undermined by persistent weakness in business investment. This weakness in investment was the legacy of the many bad investments made before the bursting of the stock market and technology bubbles in the first quarter of 2000. This drag on the economy was overcome by the investment incentives contained in the 2003 tax bill.

Once investment rebounded, the pace of economic growth picked-up sharply. By 2004, the economy was growing at a 4.2 percent rate. Battered by hurricanes and oil price increases, the economy was still able to expand at a rate of 3.5 percent in 2005. Although GDP growth slowed temporarily in the fourth quarter of 2005, the Council, the Federal Reserve, and the Blue Chip consensus forecasts all project continued healthy economic growth through 2006.

The recent historical record shows that the tax incentives in the 2003 Act have worked as designed to restore investment and boost the economy. These tax incentives should be made permanent to sustain investment, economic expansion, and employment growth in the future. The biases against saving and investment ingrained in the tax code should not be permitted to undermine economic growth later in this decade.

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PREPARED STATEMENT OF SENATOR ROBERT F. BENNETT, VICE CHAIRMAN

Today, the Committee will hear testimony from two members of the President's Council of Economic Advisors relative to the recently released Economic Report of the President. As members of the Committee are aware, the President has nominated Dr. Edward P. Lazear of Stanford University to serve as Chairman of the Council of Economic Advisors. When confirmed by the Senate, Dr. Lazear will replace Dr. Ben Bernanke who was recently confirmed as the new Chairman of the Board of Governors of the Federal Reserve. We are pleased, however, to welcome the Council's two other members, Dr. Katherine Baicker and Dr. Matthew J. Slaughter to the Committee.

As we examine the Economic Report of the President, we do so against the backdrop of a strong and growing economy. The economy has created two million new jobs over the past twelve months and more than 4.7 million new jobs since August 2003. Core inflation remains relatively contained. Interest rates remain historically low despite recent increases by the Federal Reserve.

This does not mean that our economy does not face significant challenges in the future. We are faced with high energy prices and ever increasing competition in an increasingly global economy. Additionally, we face serious long term fiscal challenges as a result of promises made in entitlement programs and the demographic reality of an aging population.

It is imperative that Congress and the Administration work together to meet these and other challenges head on. We must work to reign in entitlement spending. We must work together to improve our educational system. We must improve our competitiveness in the global economy. And we must reform a tax system that is overly complex and highly inefficient if we hope to compete effectively in the future.

I believe this is of particular importance and I look forward to hearing our witnesses describe how that system can best be replaced—yes replaced—not simply altered. The time has come to start with a clean sheet of paper and the novel concept that the purpose of the tax system is to raise money to run the government and not to engineer society. We need a system built on three straightforward principles—it must be simple, it must be efficient, and it must be competitive.

Again, welcome to the Committee. We look forward to your testimony.

[From the Washington Post, June 15, 2005]

THE END OF EUROPE

(By Robert J. Samuelson)

Europe as we know it is slowly going out of business. Since French and Dutch voters rejected the proposed constitution of the European Union, we've heard countless theories as to why: the unreality of trying to forge 25 E.U. countries into a United States of Europe; fear of ceding excessive power to Brussels, the E.U. capital; and an irrational backlash against globalization. Whatever their truth, these theories miss a larger reality: Unless Europe reverses two trends—low birthrates and meager economic growth—it faces a bleak future of rising domestic discontent and falling global power. Actually, thatfuture has already arrived.

Ever since 1498, after Vasco da Gama rounded the Cape of Good Hope and opened trade to the Ear East, Europe has shaped global history, for good and ill. It settled North and South America, invented modern science, led the Industrial Revolution, oversaw the slave trade, created huge colonial empires, and unleashed the world's two most destructive wars. This pivotal Europe is now vanishing—and not merely because it's overshadowed by Asia and the United States.

It's hard to be a great power if your population is shriveling. Europe's birthrates have dropped well below the replacement rate of 2.1 children for each woman of childbearing age. For Western Europe as a whole, the rate is 1.5. It's 1.4 in Germany and 1.3 in Italy. In a century—if these rates continue—there won't be many Germans in Germany or Italians in Italy. Even assuming some increase in birthrates and continued immigration, Western Europe's population grows dramatically grayer, projects the U.S. CensusBureau. Now about one-sixth of the population is 65 and older. By 2030 that would be one-fourth, and by 2050 almost one-third.

No one knows how well modern economies will perform with so many elderly people, heavily dependent on government benefits (read: higher taxes). But Europe's economy is already faltering. In the 1970s annual growth for the 12 countries now using the euro averaged almost 3 percent; from 2001 to 2004 the annual average was 1.2 percent. In 1974 those countries had unemployment of 2.4 percent; in 2004 the rate was 8.9 percent. Wherever they look, Western Europeans feel their way of life threatened. One solution to low birthrates is higher immigration. But many Europeans don't like the immigrants they have—often Muslim from North Africa—and don't want more. One way to revive economic growth would be to reduce social benefits, taxes and regulations. But that would imperil Europe's "social model," which supposedly blends capitalism's efficiency and socialism's compassion.

Consider some contrasts with the United States, as reported by the Organization for Economic Cooperation and Development. With high unemployment benefits, almost half of Western Europe's jobless have been out of work a year or more; the U.S. figure is about 12 percent. Or take early retirement. In 2003 about 60 percent of Americans ages 55 to 64 had jobs. The comparable figures for France, Italy and Germany were 37 percent, 30 percent and 39 percent. The truth is that Europeans like early retirement, high jobless benefits and long vacations.

The trouble is that so much benevolence requires a strong economy, while the sources of all this benevolence—high taxes, stiff regulations—weaken the economy. With aging populations, the contradictions will only thicken. Indeed, some scholarly research suggests that high old-age benefits partly explain low birthrates. With the state paying for old age, who needs children as caregivers? High taxes may also deter young couples from assuming the added costs of children.

You can raise two objections to this sort of analysis. First, other countries are also aging and face problems similar to Europe's. True. But the aging is more pronounced in Europe and a few other nations (Japan, for instance), precisely because birthrates are so low. The U.S. birthrate, for example, is 2.1; even removing births to Hispanic Americans, it's about 1.9, reports Nicholas Eberstadt of the American Enterprise Institute. Second, Europeans could do something about their predicament. Also, true—they could, but they're not. A few countries (Britain, Ireland, the Netherlands) have acted, and there are differences between Eastern and Western Europe. But in general Europe is immobilized by its problems. This is the classic dilemma of democracy: Too many people benefit from the status quo to change it; but the status quo isn't sustainable. Even modest efforts in France and Germany to curb social benefits have triggered backlashes. Many Europeans——maybe most—live in a state of delusion. Believing things should continue as before, they see almost any change as menacing. In reality, the new E.U. constitution wasn't radical; neither adoption nor rejection would much alter everyday life. But it symbolized change and thereby became a lightning rod for many sources of discontent (over immigration in Holland, poor economic growth in France).

All this is bad for Europe—and the United States. A weak European economy is one reason that the world economy is shaky and so dependent on American growth. Preoccupied with divisions at home, Europe is history's has-been. It isn't a strong American ally, not simply because it disagrees with some U.S. policies but also because it doesn't want to make the commitments required of a strong ally. Unwilling to address their genuine problems, Europeans become more reflexively critical of America. This gives the impression that they're active on the world stage, even as they're quietly acquiescing in their own decline.

[From the Washington Post, Feb. 16, 2006]

THE FEARS UNDER OUR PROSPERITY

(By Robert J. Samuelson)

A puzzle of our time is why the economy has become increasingly stable while individual industries have become increasingly unstable. The continuing turmoil at General Motors and Ford simply reflects this more pervasive industrial instability—also in airlines, telecommunications, pharmaceuticals and the mass media, among others. Hardly a week passes without layoffs from some major company, which is "downsizing," "restructuring" or "outsourcing." And yet, the broader economy has undeniably become more stable. Since the early 1980s, we've had only two recessions, lasting a combined year and four months and involving peak unemployment of 7.8 percent. By contrast, from 1969 to 1982, we had four recessions lasting altogether about four years and having unemployment as high as 10.8 percent.

A cottage industry of economists is cranking out studies on these questions. One intriguing theory—completely counterintuitive—is that the greater overall stability stems in part from the increased instability of individual industries. You would, of course, expect the opposite: As individual industries became less stable, so would the larger economy.

But the reality may be more complex. Different industries may go through cycles that are disconnected from each other, argue economists Diego Comin and Thomas Philippon of New York University. All don't rise and fall simultaneously. To simplify slightly: Housing, autos and farming might strengthen, while computers, airlines and chemicals weaken.

Assuming there's something to this theory—which seems a good bet—it helps explain the riddle of why there's so much anxiety amid so much prosperity. As Americans stock up on BlackBerrys and flat-panel TVs, it's hard to deny the affluence. But people also look to their employers for a sense of confidence about the future—and here doubts have multiplied, because more companies and industries seem assailed by menacing forces. We can all identify the usual suspects. Globalization. Deregulation. Greater domestic competition. In a series of papers, Comin, Philippon and various colleagues have shown that, for most businesses, sales, profits and employment have all become more volatile in recent decades. They bounce around more from year to year, suggesting greater industry instability. Competitive pressures have dramatically intensified. One telling statistic: In 1980 a firm in the top fifth of its industry had about a 1-in-10 chance of losing that position within a five-year period; by 1998 the odds had increased to 1 in 4. Feeling threatened, corporate managers have altered pay and employment practices. In 1994, economists Peter Gottschalk of Boston College and Robert Moffitt of Johns Hopkins University showed that annual wage gains also had begun to bounce around more in the 1980s (in technical lingo, there was more variation around the average). Now, Comin and Erica Groshen of the Federal Reserve Bank of New York and Bess Rabin of Watson Wyatt Worldwide have connected these erratic wage increases to firms' fluctuating fortunes. In good years, companies enlarge the pot for wage and salaries, says Groshen; in bad years, the pot grows less or shrinks. About four-fifths of big U.S. firms also resort more to bonuses, personal incentives and stock options, Hewitt Associatesreports.

The same sort of cost-conscious behavior also leads to more layoffs, even among career workers. In 1983, 58 percent of men ages 45 to 49 had been with their current employer 10 years or more, reports the Bureau of Labor Statistics. By 2004, the comparable figure was 48 percent. Little wonder that we have rising job insecurity, despite lower average unemployment.

Not by accident do many of these trends begin, or strengthen, in the 1980s. From 1980 to 1983, the Federal Reserve crushed inflation, which fell from 12.5 percent to 3.8 percent. Inflation dulls competition. Sloppy managers can simply raise prices. Because most companies are rapidly increasing prices, customers have a harder time discriminating. Inflation also comes to dominate the business cycle. It overwhelms other influences. Once inflation declined, competition—based on prices, new products and technologies—intensified. Differences among sectors became more pronounced. So we return to the original puzzle: Why does an economy of greater stability have industries of lesser stability? The answer is competition. An intensely competitive economy enhances overall stability by holding down inflation (which is itself destabilizing) and spreading economic disruptions throughout the business cycle (rather than letting them accumulate for periodic, massive downturns). But the solution to one problem creates other, though smaller, problems. Except during unsustainable booms, say, the late 1990s, even good times are punctuated with insecurities, disappointments, job losses, broken promises and shattered expectations. What may be good for us as a society may hurt many of us as individuals. The unending challenge is to find the necessary social protections that help the most vulnerable without frustrating desirable, if sometimes painful, change.

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CHAD STONE
STAFF DIRECTOR

Opening Statement
Senator Jack Reed
Joint Economic Committee Hearing
February 16, 2006

Thank you, Chairman Saxton. I want to welcome Dr. Baicker and Dr. Slaughter from the President's Council of Economic Advisers, and thank them for testifying here today.

This year's Economic Report of the President is an interesting collection of chapters on various economic issues. I have to commend the President's council members for finding a silver lining for every dark cloud over the economy. Indeed, the Wall Street Journal noted this week that the President's report struck "a more optimistic tone than many economists" and observed that "the U.S.'s rock-bottom personal-saving rate and record trade deficit aren't major worries" for the White House.

There is another curious disconnect between the analysis in the report and the President's policy priorities. The report does analyze many key aspects of the U.S. economy, but it reveals little about how the President's policies would actually help average families or bring down the deficit.

The centerpiece of the President's message to Congress is the benefits of making his tax breaks for the wealthiest permanent, yet there is no analysis in the report to justify the claim that taxes are too high and are hurting the economy. In fact, the chapter on taxes shows something that has been true for a long time—the United States has a relatively low tax burden compared with other developed countries.

The report tells us why energy prices are high, but we see no proposal from the President to bring relief to the majority of American households who find their budgets squeezed by rising energy costs on the one hand, and stagnation in their take-home pay on the other.

The President's report extols the benefits of trade, but the focus is on the long run. While the report acknowledges that 'any job loss involves hardship, and any job change can involve challenge,' the President has no meaningful plan to address the problems of those who are hurt by trade.

A whole chapter is devoted to the large U.S. international payments imbalance and low national saving rate, including an acknowledgement of federal government dissaving

- more -

as the federal budget balance went from a surplus equivalent to 2.4 percent of GDP in 2000 to a deficit equivalent to 3.6 percent of GDP in 2004. But President Bush's FY 2007 budget proposals would increase the size of the deficit rather than reduce it.

The one area where the President's policies do reflect the Administration's philosophies is health care. The Administration seems to believe that Americans have too much health care coverage, so they plan to cut Medicare spending and also move toward making consumers finance care below a catastrophic, high-deductible limit.

The President's budget slashes Medicare spending by $36 billion over the next five years by cutting funding for hospitals and other providers, inflicting pain on the nation's elderly without solving the problem of the growing cost of health care. Similarly, the President's "consumer-driven" health care proposals would do little to reduce the number of uninsured, lower costs, or improve the quality of coverage. If the chaos surrounding the Administration's Medicare prescription drug plan is any indication of how the President's health care proposals will play out, I think the public should be very concerned about this approach.

Unfortunately, middle- and lower-income families are paying the price for the President's tax cuts for the wealthiest, as programs that help ordinary Americans cope with economic or health insecurity have become candidates for budget cutting.

I look forward to our discussion of this report and the economic outlook.

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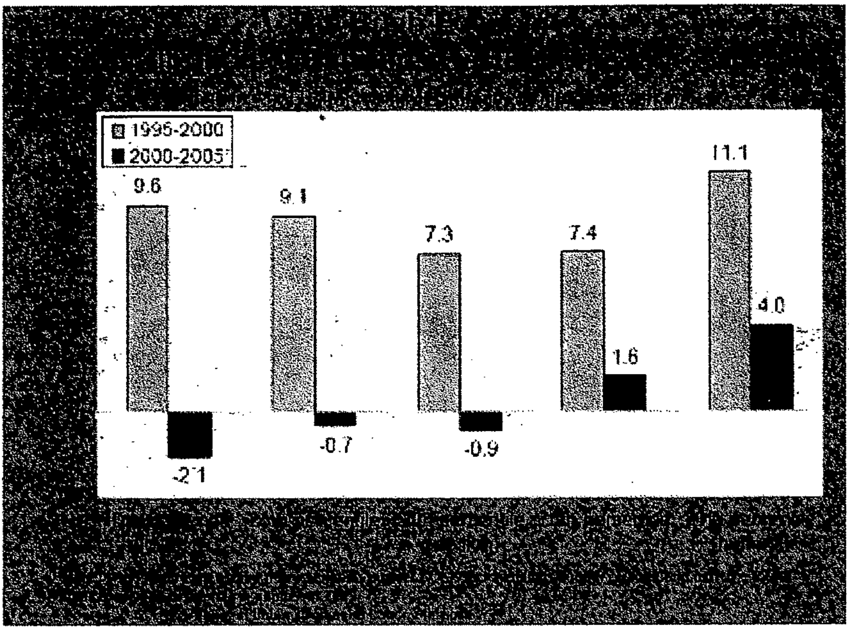
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PREPARED JOINT STATEMENT OF DR. MATTHEW SLAUGHTER AND DR. KATHERINE BAICKER, MEMBERS, COUNCIL OF ECONOMIC ADVISERS

Chairman Saxton, Vice-Chairman Bennett, Ranking Member Reed, and other members of the Joint Economic Committee, we are pleased to testify today about the 2006 Economic Report of the President. The Report reviews the state of the economy and the economic outlook, and discusses a number of economic policy issues of continuing importance. Across its 11 chapters, the Report highlights how economics can inform the design of better public policy and reviews Administration initiatives.

The performance of the U.S. economy continues to be strong. In 2005, the Nation's real GDP grew 3.5 percent for the year, above the historical average. Key components of demand that accounted for growth in 2004—consumer spending, business investment in equipment and software, and exports—continued to do so in 2005. Employment increased by almost 2 million payroll jobs over the year, and the unemployment rate dropped to 4.7 percent last month, well below the averages of recent decades. Real disposable personal income increased, and real household net worth reached an all-time high. This growth comes on top of an already strong expansion, the foundation of which has been exceptionally rapid productivity growth. The Administration's forecast, consistent with consensus private forecasts, shows the economic expansion continuing for the foreseeable future.

Increases in investment spurred by the dividends and capital gains tax relief enacted in 2003 have played an important role in the strengthening of our economy. Since the Jobs and Growth bill became law, capital investment has increased by 25 percent, contributing to sustained job growth and directly benefiting workers. It is essential that this tax relief be extended.

American productivity growth and thus competitiveness in the 21st century will rely upon American ingenuity, entrepreneurship, and labor-force talent. The President's American Competitiveness Initiative aims to support these forces. Promoting a flexible and skilled workforce—through improved access to high-quality primary, secondary, and post-secondary education, through policies that attract the world's best and brightest to our shores, and through investment in R&D and the continuing education and re-training of our mobile workforce—will help ensure that the United States remains a leader in this rapidly changing world economy.

But maintaining this leadership will also require a continued commitment to competition in and flexibility of U.S. product, capital, and labor markets that help transform innovations into the new products and processes in the marketplace that ultimately support rising incomes for workers and their families. Innovation alone is not sufficient to guarantee rising prosperity. It also requires the dynamism of the marketplace for which America is uniquely positioned.

This continuing strength and competitiveness of the American economy in the global marketplace depends upon policies that open international markets to U.S. goods, and that promote growth and investment at home. The performance of the U.S. economy depends on an effective financial-services sector and on a tax system that promotes domestic growth and international competitiveness. Further opening foreign markets to U.S. goods would yield great rewards for Americans. Over the past 70 years, policymakers across political parties have consistently recognized the importance of international commerce, and have achieved major trade liberalization both here and abroad. The net payoff to America from these achievements has been substantial.

The Administration's policies will make even greater gains possible. Support of the agricultural sector can be provided in ways that are less distortionary. We must work to eliminate further barriers to trade, especially in services, and to further open markets in global, regional, and bilateral negotiations. Americans will reap the greatest benefits from this trade when intellectual property rights are well-defined and well-enforced. The Administration continues to enforce vigorously the laws that protect the rights of American intellectual-property owners.

The continued expansion of energy markets and diversification of energy sources can further increase our resilience to energy-supply disruptions. Hurricanes Katrina and Rita demonstrated that competitive markets play a central role in allocating scarce energy resources, especially during times of natural disaster or national emergency. Policies that build on economic incentives and that spur our development of alternate fuel sources can reduce U.S. vulnerability to energy disruptions and reliance on foreign oil, encourage energy efficiency, and protect the environment.

Even as living standards rise, Americans are increasingly concerned about their retirement security and health care costs. Most working-age Americans are in fact on track to have more retirement wealth than most current retirees. There are, however, a number of risks to the retirement preparations of Americans. People today are living longer and could face higher health-care costs in retirement than members of previous generations. In addition, both defined benefit pensions and Social Security suffer from fundamental financial problems that expose not just retirees but all U.S. taxpayers to risk of substantial losses. The Administration is focused on addressing these problems and protecting the Nation's retirement security.

Rising health care costs are of concern to all Americans, young and old. All Americans deserve access to reliable, affordable, high-quality, high-value health care. Health care in the United States is second to none, but it can be better. Both public and private health care spending have grown much more rapidly than general inflation or wages, straining consumers, employers, and government budgets. The cost of finding new health insurance locks some workers into their current jobs if they or someone in their family is chronically ill. Frivolous lawsuits raise health care costs for everyone. Perverse tax and insurance incentives have led to inefficient use of health care resources.

Promoting a stronger role for consumers can help create a health care system that is more affordable, transparent, portable, and efficient. Health Savings Accounts should be strengthened by allowing people to contribute enough to them to pay for all of their out of pocket expenditures tax free. Individual purchasers should have the same tax advantages as those who get insurance from their employers. We need to ensure that patients and their doctors have the information that they need to use this control to get the health care that is best for them, and that electronic health records are widely used to reduce costs and improve the quality of medical treatment.

The Report provides an analytical backdrop for the President's agenda, which includes restraining government spending; making tax relief permanent; making health care more affordable and accessible; creating an economic environment that encourages innovation and entrepreneurship; continuing to open markets to American goods and services; and reducing America's dependence on foreign oil by diversifying our energy supply. These policies will help maintain the economy's momentum, foster job creation; and ensure that America remains a leader of the global economy.

We will briefly outline for you the highlights of the Report. Chapter 1, The Year in Review and the Years Ahead, reviews the economic developments of 2005 and discusses the Administration's forecast for the years ahead. The expansion of the U.S. economy continued for the fourth consecutive year in 2005, with strong growth in real GDP. Most components of demand that accounted for growth in 2004—consumer spending, business investment in equipment and software, and exports—continued to do so in 2005. Labor markets continued to strengthen, with almost 2 million new jobs created in 2005 and a year-end unemployment rate of 4.9 percent. Productivity growth remained well above its historical average. Overall inflation rose substantially at mid-year, but came down by year-end as it reflected the movement of energy prices, while core inflation (which excludes food and energy prices) has remained in the moderate 2-percent range. The Administration's forecast, consistent with consensus private forecasts, shows the economic expansion continuing for the foreseeable future.

Chapter 2, Skills for the U.S. Workforce, discusses the economics of education, immigration, and job training. Promoting a flexible and skilled labor force—through improved access to high quality primary, secondary, and post-secondary education, through policies that attract the world's best and brightest to our shores, and through investment in the continuing education and training of our mobile workforce—will ensure that the United States remains a competitive leader in this rapidly changing world economy.

Chapter 3, Saving for Retirement, addresses the concern that Americans have been preparing inadequately for retirement. Most working-age Americans are in fact on track to have more retirement wealth than most current retirees. There are, however, a number of risks to the retirement preparations of Americans. People today are living longer and could face higher health-care costs in retirement than members of previous generations. In addition, both defined benefit pensions and Social Security suffer from fundamental financial problems that expose not just retirees but all U.S. taxpayers to risk of substantial losses. The Administration is focused on addressing these problems and protecting the Nation's retirement security.

Chapter 4, Improving Incentives in Health Care Spending, reviews the causes and consequences of health care spending growth and discusses how the President's consumer-driven proposals can improve the health care system. Growth in spending on health care has been much more rapid than general inflation, straining consumers, employers, and government budgets. Perverse tax and insurance incentives have led to inefficient levels and composition of spending on health care. Promoting a stronger role for consumers is a promising strategy for improving health care value and affordability.

Chapter 5, The U.S. Tax System in International Perspective, examines U.S. tax system choices in the context of other countries. These choices matter because they affect living standards and economic growth. The United States has a different tax structure from most other advanced economies, raising more of our revenue through a tax on personal income instead of consumption. While the U.S. system has been significantly improved in recent years, it could benefit greatly from additional reforms, particularly those focused on the taxation of capital income.

Chapter 6, The U.S. Capital Account Surplus, discusses the enormous number of trade and financial transactions the U.S. has with other countries. In 2004, the United States ran a current account deficit of $668 billion—meaning that the United States imported more goods and services than it exported, and that foreign investors purchased more U.S. assets than U.S. investors purchased in foreign assets. The size and persistence of U.S. net capital inflows reflect a number of U.S. economic strengths, as well as some shortcomings. Greater global balance of capital flows can be promoted by higher domestic savings, better growth and investment opportunities in Europe and Japan, and greater exchange rate flexibility and financial sector reforms in Asia.

Chapter 7, The History and Future of International Trade, notes that while economic research and historical evidence show that the benefits of trade outweigh the costs, trade liberalization has always generated concerns in the United States and throughout the world. Over the past 70 years, policymakers across political parties have consistently recognized the importance of international commerce, and have achieved major trade liberalization both here and abroad. The net payoff to America from these achievements has been substantial. The Administration is working to eliminate further barriers to trade, especially in services, and to further open markets in global, regional, and bilateral negotiations.

Chapter 8, The U.S. Agricultural Sector, examines the effects of agricultural support payments and trade policy on domestic prices, the wellbeing of the agricultural sector, and of the economy overall. In 2005, the Federal Government spent approximately $20 billion on agricultural support payments, but most farmers do not benefit from these subsidies. In addition, the United States maintains barriers to the import of some commodities, and these barriers raise the domestic prices of these commodities relative to world prices. Support to agriculture can be provided in many forms that are potentially less market-distorting.

Chapter 9, The U.S. Financial Services Sector, explores what financial services do for an economy, how financial development relates to economic performance, and how financial services can be effectively regulated. The U.S. financial services sector improves economic performance by addressing informational problems and facilitating innovation. An effective financial regulatory system appropriately balances the costs and benefits of public regulation.

Chapter 10, The Role of Intellectual Property in the Economy, notes that intellectual property rights create incentives for investment in research, development, and innovation. Well-defined and enforced intellectual property rights are an important element of the American economy and can contribute to the economic growth of all countries. The Administration continues to enforcevigorously the laws that protect the rights of American intellectual property owners.

Chapter 11, Recent Developments in Energy, discusses crude oil, refined petroleum products, natural gas, and electricity markets. Increased scarcity and rising prices over time will encourage conservation, increase incentives for exploration, and stimulate the development of new, energy efficient technologies and alternative energy sources. In the near term, unexpected disruptions to energy supply and distribution networks may continue to affect consumers and businesses. Hurricanes Katrina and Rita demonstrated that competitive markets play a central role in allocating scarce energy resources, especially during times of natural disaster or national emergency. The continued expansion of energy markets through regional and global trade can further increase our resilience to energy supply disruptions. Policies that build on economic incentives can reduce U.S. vulnerability to energy disruptions, encourage energy efficiency, and protect the environment.

Thank you for this opportunity to discuss the 2006 Economic Report of the President. We would be happy to answer any questions you might have.

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ENERGY AND THE IRANIAN ECONOMY

HEARING

BEFORE THE

JOINT ECONOMIC COMMITTEE
CONGRESS OF THE UNITED STATES

ONE HUNDRED NINTH CONGRESS

SECOND SESSION

JULY 25, 2006

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SUBMISSIONS FOR THE RECORD

ENERGY AND THE IRANIAN ECONOMY

TUESDAY, JULY 25, 2006

CONGRESS OF THE UNITED STATES,
JOINT ECONOMIC COMMITTEE,
Washington, DC.

The Committee met, pursuant to notice, at 10 a.m., in room 210, Cannon House Office Building, Hon. Jim Saxton (Chairman of the Committee) presiding.

Representatives present: Saxton, English, Hinchey, Sanchez, and Cummings.

Senators present: Reed.

Staff present: Chris Frenze, Ted Boll, Colleen Healy, Katie Jones, Chad Stone, and Kasia Murray.

OPENING STATEMENT OF HON. JIM SAXTON, CHAIRMAN, A U.S. REPRESENTATIVE FROM NEW JERSEY

Representative Saxton. Good morning. It is a pleasure to welcome Mr. Simons, and the members of the second panel of witnesses before the Committee today. Given the course of events in the Middle East, this hearing on energy and the Iranian economy is very timely. Iran is a country with immense wealth in the form of oil and gas reserves. Iran has the third largest oil reserves and the second largest national gas reserves in the world.

Unfortunately, despite the country's great economic potential, the government of Iran has adopted policies that have undermined the country's economic development and standard of living. Despite Iran's huge oil and gas reserves, the Iranian regime is intent on extending its nuclear program, supposedly for peaceful purposes. However, the regime's deception regarding the nuclear program, its aggressive promotion of terrorism, and its President's recent statements concerning Israel obviously constitute a grave threat to world peace.

The facts before us today concerning Iran's large energy reserves undercut assertions by the Iranian regime that the nuclear program is needed for peaceful nuclear power generation.

Iran's leaders have also sought to intimidate oil-consuming nations by threatening to cut off Iranian oil. However, Iranian oil exports generate a high percentage of Iranian export earnings and finance a significant portion of government spending. In short, the Iranian Government and economy are highly dependent on oil exports and threats to cut off these oil exports do not seem credible.

The Iranian economy labors under a heavy burden of government mismanagement, cronyism and corruption, facilitated by government-affiliated foundations and enterprises. The Iranian people pay a high price for the failures of the regime's economic policies, but the prospects for reform of these policies are bleak in the near term.

In view of the Iranian regime's aggressive behavior, the feasibility of sanctions against the regime must be considered. Iran's reliance on imported gasoline is one potential pressure point. However, the effectiveness of sanctions would depend on the willingness of a much broader group of nations acting in concert with the United States to contain Iran's threats. The coming weeks and months will reveal whether a broader attempt to impose sanctions will be tried and produce positive results.

At this point I would like to yield to Senator Reed for any comments he may have.

[The prepared statement of Representative Saxton appears in the Submissions for the Record on page 36.]

OPENING STATEMENT OF HON. JACK REED, RANKING MINORITY, A U.S. SENATOR FROM RHODE ISLAND

Senator Reed. Thank you very much, Mr. Chairman. I think this is a very timely and important hearing and I commend you for calling it. As we monitor diplomatic developments surrounding the nuclear standoff with Iran and as the current conflict between Israel and Hezbollah continues to destabilize the region, this hearing on energy and the Iranian economy is very important and very timely.

Iran has recently enjoyed strong economic growth primarily due to high oil prices. Despite some progress in reforming certain aspects of the economy, the Iranian economy continues to suffer some significant structural weaknesses. First, its heavy reliance on oil revenues makes it extremely vulnerable to oil price shocks. Second, entrenched political interests impede substantive economic reform. Last, the country continues to rank poorly on various indicators of foreign investment risk.

Such vulnerabilities lead some observers to conclude that the United States and its allies may have some leverage primarily through sanctions, possibly backed up by the threat of military action, in convincing Iran to abandon any nuclear weapons ambitions. However, oil prices are expected to remain high at least through 2007, and with the global oil market Iran will always find alternative customers in countries that are willing to violate sanctions to advance their own interest.

Even if Iranian oil exports were to slow somewhat, the higher prices that result would at least temporarily cushion the revenue impact. Iran's vast energy reserves promise that the country will remain attractive to foreign investors.

Russia and China recently signed on with the United States and its European partners in seeking a United Nations Security Council resolution ordering Iran to freeze its nuclear program or face possible sanctions.

To be truly effective on their own, sanctions must target the oil exports that are central to the Iranian economy. Given tight oil supplies, however, it is highly unlikely that all six negotiating partners would ultimately agree to such comprehensive economic sanctions. In fact, a decade's worth of experience with the Iran-Libya

Sanctions Act, or ILSA, which was implemented during a period when oil was relatively cheap and plentiful, suggests our allies' reluctance to further rattle the global oil market. Further, both Russia and China have indicated that they will not support military action against Iran.

The experience with the United States sanctions against Iran suggests that a unilateral approach simply will not work. U.S. sanctions have not prevented Iran from developing what International Atomic Energy Agency inspectors believe to be a potential military dimension to its clandestine nuclear program or from continuing to sponsor terrorist organizations such as Hezbollah and Hamas.

Some analysts believe that U.S. sanctions have done more to isolate the United States than to isolate Iran. Rather than taking a unilateral approach, the United States must continue to work with the United Nations community. If universal comprehensive economic sanctions are not feasible, we must focus on a more effective mix of targeted sanctions that our negotiating partners can agree to. Targeted sanctions may not cripple the Iranian economy to the point where it is financially incapable of developing a nuclear weapon; however, coupled with concerted diplomatic efforts, the right mix of sanctions has the potential to convince Iran to abandon any nuclear weapons ambitions it may harbor.

I look forward to the testimony of our witnesses here today. In addition to hearing about the state of the Iranian economy and energy sector, I hope to discuss ways in which sanctions could be effectively applied, preferably as part of a multilateral diplomatic effort.

Thank you very much, Mr. Chairman.

[The prepared statement of Senator Reed appears in the Submissions for the Record on page 41.]

Representative Saxton. Thank you, Senator Reed.

I am very pleased to be able to welcome the Honorable Paul E. Simons, Deputy Assistant Secretary for Energy, Sanctions and Commodities at the U.S. State Department's Bureau of Economic and Business Affairs. Mr. Simons, thank you for being with us.

STATEMENT OF HON. PAUL E. SIMONS, DEPUTY ASSISTANT SECRETARY FOR ECONOMIC AND BUSINESS AFFAIRS, DEPARTMENT OF STATE

Mr. Simons. Thank you, Mr. Chairman, Members of the Committee. Thank you for your initiative in calling this hearing on this important issue. Let me also congratulate the staff for the preparation of an excellent Committee report on Iranian energy that I think helped us get prepared for the hearing this morning.

Iran, as you have noted in your report and as we have noted in our written testimony, does play a significant role in international oil and gas, but Iran is also a country whose policies and actions have long been cause for deep concern to the United States and our international partners. Given its pursuit of weapons of mass destruction and missile delivery system, its place as the leading state-sponsor of terrorism, its support for violent opposition to the Middle East peace, its unhelpful role in Iraq, and its oppression of its own citizens, as well as its abysmal human rights record, Iran does pose, as Under Secretary of State Burns recently said, a profound threat to U.S. interests.

Iran's concerted effort to develop a nuclear weapons capability has become the focus of particular concern not only for the United States, but also for the broader international community, as reflected in the resolution adopted in February by the International Atomic Energy Agency Board of Governors and in the March statement by the U.N. Security Council.

On June 6th, the governments of the United States, the United Kingdom, France, Russia, China and Germany, referred to as the P5+1 countries, offered Iran a set of far-reaching proposals that presented that country with a clear choice between two paths.

One path would lead to important benefits for the Iranian people if Iran suspends all its enrichment-related and reprocessing activities and enters into negotiations on the basis of the P5+1 offer. Secretary Rice has made clear that the United States would be willing to join the negotiations if Iran fully and verifiably suspends its enrichment program.

However, if Iran chooses the other path and continues on its current course, it will face greater international isolation and strong U.N. Security Council action.

Iran has failed to take the steps needed to allow negotiations to begin, specifically the suspension of all its enrichment-related and reprocessing activities. Absent such a positive, concrete response from the Iranian government, we and our international partners really have no other choice but to return to the Security Council to adopt a resolution that would make that suspension mandatory.

Let me turn now briefly to the issue of energy. And I would ask that my full statement be admitted to the record, and I will make some brief comments.

On the energy issue, as you have noted in your opening statement and in the report, Iran is the world's second-largest holder of natural gas reserves, and it ranks second or third in conventional oil reserves. It does have a current oil production capacity of just over 4 million barrels a day, making it OPEC's second-largest oil producer and its second-largest oil exporter, at about 2.6 million barrels per day.

What is striking, though, and as you have noted in your report—and a view that is endorsed as well by the State Department—is that Iran is not as prominent a player in the international oil and gas scene as its geological potential would suggest. So despite its huge gas reserves, Iran basically has a very limited gas export potential at present.

It also hasn't really moved very intensively toward developing a liquefied natural gas export capability, and as we note in our statement, this contrasts with the situation in Qatar, Iran's small neighbor just across the Gulf which has moved very aggressively, has attracted massive foreign investment, and is very actively developing LNG and other gas projects with the assistance of the international investment community.

Iran has expressed its intention to expand its production of both oil and gas. There have been various notional targets put out, but its efforts to attract foreign investment through buy-back arrangements—which are explained in some detail in your report—which were initiated in 1995, have met with only limited success. Foreign investment in this sector does appear to be slowing. There are a combination of factors. Certainly one factor is a strong perception of heightened political and financial risk due to Iran's own behavior.

In addition to the discouraging impacts of Iran's problematic policies, its pursuit of nuclear weapons has raised the possibility of international sanctions, which several of the Members have noted here. And as a result, international companies have found it difficult to reach agreement with Iranian negotiators on terms that would essentially offset this high level of political risk.

Iranian oil refining capacity is also inadequate to meet demands. There has been inadequate investment in the downstream sector. So this is also an issue.

Let me just conclude briefly with a couple of remarks about the nuclear side. The P5+1 package that I mentioned earlier in my statement, and which was put forward in May, reaffirms Iran's right to nuclear energy for peaceful purposes in conformity with Iran's obligations under the Non-Proliferation Treaty, the NPT. And both the President and the Secretary have made that point quite clear. We are not seeking to deny peaceful nuclear energy to the Iranians.

However, Iran's long history of deception and noncompliance with its NPT commitments and its IAEA safeguard obligations have created something of a loss of confidence in Iran's intentions. So, as the President has said, civilian nuclear energy is a legitimate desire. We do believe the Iranian people should enjoy the benefits of a truly peaceful program to use nuclear reactors to generate electric power. As the President noted, America does support the Iranian people's right to develop nuclear energy peacefully, but with proper international safeguards. This is the important point.

Let me conclude by stating that with its enormous natural resource endowments and its very talented people, Iran really ought to be among the more prosperous countries in the world. I think this point is also reinforced in the Committee report. But counterproductive economic policies, mismanagement, corruption, and misguided goals, such as the dangerous request for nuclear weaponry, have in fact dimmed Iran's economic prospects.

Iran's economic problems reflect in some ways its negative political culture with all the problematic manifestations which were outlined earlier in my statement. But as President Bush recently noted, Americans do admire the rich history, the vibrant culture of Iran, and its many contributions to civilization. The President recently said that the people of Iran, the people everywhere, also want and deserve an opportunity to determine their own future, an economy that rewards their intelligence and talents, and a society that allows them to pursue their dreams. Thus far, these dreams have been sadly thwarted.

Thank you, Mr. Chairman.

[The prepared statement of Mr. Simons appears in the Submissions for the Record on page 43.]

Representative Saxton. Thank you, Mr. Simons.

Let me get right to the matter that is of concern to us. You said in your testimony that Iran is richly endowed with the second or third largest oil reserves and the second-largest natural gas reserves, and that this becomes an extremely important economic factor to that country.

As a matter of fact, Iran's revenues from oil exports were about $47 billion in 2004 and 2005, and that its oil therefore accounts for about 80 percent of Iran's export revenues. In addition, the central government's revenue is accounted for by oil exports to the extent of about 50 or 60 percent, according to indications that we have, and oil and gas exports amount to about 20 percent of GDP.

With oil supplying such a high percentage of revenue to support the Iranian government's budget and military spending, how credible do you think are their threats to cut off the oil supply?

Mr. Simons. Clearly I think you have outlined the importance of oil and energy to the Iranian economy and to the Iranian economic engine. I don't think I can really speculate here in an open session about the motivations behind a potential unilateral shutoff of oil by Iran. There has been extensive press speculation on this.

Perhaps we could have a closed session where we could get into a little bit more detail.

But I would just like to make a couple of points here. First, Iran is an important contributor to global energy stability, and it does export about 2½ million barrels a day. We do have capabilities in place to handle a potential shutoff of these flows were that to occur. So the United States and other members of the global energy community are certainly prepared if the situation goes that way.

But beyond that, I really wouldn't want to speculate in this setting behind the possibility that Iran might take a unilateral step in this direction.

Representative Saxton. I appreciate that, but I guess maybe these facts kind of speak for themselves: $47 billion in 2004 and 2005 in exports, which amounts to 80 percent of Iranian exports, not just oil exports, but all exports. And the central government depends on these oil exports for something like 50 or 60 percent of its resources, and that oil and gas exports amount to about 20 percent of GDP.

That means that exporting oil is a critical factor in the Iranian economy, and the reason that I emphasize this point is that every time the Iranian leadership rattles its oil drum, the price goes up here at the pump. Perhaps that is not a necessary reaction.

So, I just wanted to make this point. Wouldn't Iran's economy and government be crippled without the revenues produced by oil exports?

Mr. Simons. Once again, there is no question that oil and gas are the centerpiece of the Iranian economy and that were there to be some type of interruption in Iranian oil production, there would be a significant impact on the Iranian economy.

As I mentioned, the impact on global oil economy could be accommodated by various measures that we could put into place. But certainly for the Iranians, there would be a significant impact.

Representative Saxton. Thank you. I think one would conclude that this is a very strong suggestion that Iran's threats to cut off oil exports from time to time are mostly, if not entirely, empty in my view.

I think this is an extremely important point, because in the past they have been able to affect Western economies by issuing threats from time to time. When we understand the nature of and importance of petroleum exports to their country, it appears to me at least that Western investors and Western business people and Western governments have not put it in the right context to the extent that we might have.

With its immense and undeveloped resources in oil and natural gas, do you believe there is a compelling need for Iran to develop nuclear power and a nuclear power industry for peaceful energy production?

Mr. Simons. Mr. Chairman, I think the Committee has done good work laying out the scope of potential that Iran has were they to fully develop their oil and natural gas reserves. As Secretary Rice recently pointed out, we fundamentally don't understand why Iran has to have a civilian nuclear power capability. From an economic standpoint they would be able to develop—they could develop, on the electricity side, sufficient gas power generation to meet their needs.

However, as the Secretary also pointed out, nuclear power is part of an energy strategy for many countries that seek to decrease their exclusive dependence on hydrocarbons. So, we have been pursuing in this country a diversification strategy where we look to different elements of the technology basket to meet portions of our electricity needs, and many other countries around the world do this. So, I think what we have really been stressing is that in order for this civilian nuclear program to be acceptable, it has to contain the proliferation risk, and this is really what our focus has been.

Both the Secretary and the President have noted that we are not seeking to deny the Iranians access to civilian nuclear technology, or not necessarily either to particularly second-guess how they define their desirable mix in terms of how they define their energy security. So it is an option that is out there and we just want to make sure it is made available in ways that protect global nonproliferation concerns.

Representative Saxton. Let me turn for just a couple of minutes to the issue of potential economic sanctions which, incidentally, Senator Reed and I both agree have to be international and multifaceted in nature. The economic incentives offered Iran from refraining from uranium enrichment are quite substantial, as I believe you mentioned in your testimony. Can you comment on them and why Iran has not accepted them?

Mr. Simons. My understanding, Mr. Chairman, is that the Iranians have indicated that they will respond later in August to the package that has been put forward. As I mentioned in my opening statement, we do think they have a fairly stark choice in front of them. They can choose a path of cooperation, which would create a series of incentives for them to work with the international community to develop a civilian nuclear capability, if they so choose, and to afford them these rights which are part of their membership in the NPT.

So these are options that are out there that fulfill some of their economic and political aspirations and some of the aspirations of their people in terms of putting Iran on the global stage.

On the other hand, if they choose the other route, we do feel that we have a group of countries, probably for the first time in many years, a strong multilateral coalition that would take this issue to the Security Council and seek to more actively deny Iran some of those same options.

Representative Saxton. Does the fact that Iran imports refined gasoline create a vulnerability that could be used to pressure the regime?

Mr. Simons. I think you have pointed out in your statement, Mr. Chairman, and in your report that Iran does import something on the order of 170,000 barrels a day of gasoline. Over the last couple of months there have been some internal discussions inside Iran of ways in which they could reduce that dependency by initiating conservation measures, and by boosting local refined product capability.

But for the time being, I think the point you make is basically correct: Iran is an extensive exporter of crude petroleum and imports a large chunk of its refined products. Again, in open session, I wouldn't want to get into a detailed discussion of how these tradeoffs might play when one takes a look at sanctions options, but perhaps, again, we could discuss that in a closed session.

Representative Saxton. Let me just ask one final question; then we will go to Mr. Hinchey. How vulnerable is Iran to the loss of other products, specifically agricultural products, and what other economic pressure points or vulnerability might Iran have?

Mr. Simons. If I could ask you to clarify; loss of access on the import side or export?

Representative Saxton. Import.

Mr. Simons. Well, Iran is a significant agricultural importer. U.S. law and policy exempts agricultural products, certain kinds of agricultural products, from our sanctions regime; so we are able to export certain types of agricultural products to Iran and to other countries that are under sanctions.

So, generally speaking, again, I wouldn't want to speak for the Congress, but in terms of the sanctions world, the trend has been to focus our attention away from the food side and the medicine side of the equation. That has generally been the focus of the Administration, as well as successive Congresses.

Representative Saxton. Other than gasoline, are there other elements of the economy of Iran that would be affected by sanctions—or could be?

Mr. Simons. Well, it all depends on what you decide to target. I think the scope is rather large, but as I think Senator Reed mentioned when he was here, we have found that sanctions that are applied multilaterally and that are targeted not at the broader population, but more at the portions of the regime that are responsible for the undesirable behavior tend to be more effective.

So, I think when you take a look at some of these broader-brush types of sanctions options, you do have to keep in mind what type of impact that you might have, and I think you want to make sure when you design these programs that the impact is focused in on the group whose behavior you want to affect.

Representative Saxton. I apologize to Mr. Hinchey. Every time you give an answer it raises another question in my mind.

Many of the businesses, particularly which are involved in import, export, and development of energy, and perhaps even nuclear pursuits, are very closely related to the government, aren't they? They are not businesses as we think of them; they are either owned by or very closely associated with or controlled by the regime. Is that right? Those are the elements of the economy that we would want to perhaps target.

Mr. Simons. Well, again, I would prefer to get into the details of any kind of targeting discussion in another session.

Representative Saxton. Just being able to ask the question makes the point.

Mr. Simons. One way to look at it would be to focus on government-owned companies in the energy sector; but another way of looking at it, which is the way the Administration has focused initially, has been taking a look at those companies that are directly participating in Iran's weapons of mass destruction-related activities and trying to pinpoint those companies and to shut down their operations and their ability to function.

So I think there is a subset of these government-owned companies that are more directly related to the nonproliferation stream that has been our initial focus, and we have an Executive order and we have designated certain companies under that Executive order for sanctions.

Representative Saxton. Thank you very much, Mr. Simons.

Mr. Hinchey, please feel free to take as much time as you need.

Representative Hinchey. Well, thank you very much, Mr. Chairman. I appreciate your holding this hearing and giving us this opportunity to learn more about what the State Department in this particular case is doing in this situation. I very much appreciate your testimony and your response to our Chairman's questions, Mr. Simons. Thank very much for being here.

The Middle East is of course, as we know, the most volatile and dangerous part of the world and Iran is one of the most significant countries in the Middle East, even if you were to just limit that to the possession of huge amounts of oil and natural gas. But they are significant for other reasons, including a very large population and a very strong country, even considering the context in which they operate.

The sanctions that were imposed by the United States, even though those sanctions have not really been carried out, I believe date back to the 1980s. Am I mistaken about that, or can you give us the exact date?

Mr. Simons. Well, the principal set of U.S. unilateral sanctions were put into place in 1995 and 1997.

Representative Hinchey. Aren't there sanctions that go back, however, to the 1980s? Weren't there some actions taken back in the 1980s at the same time that Iran Contra was of great controversy here?

Mr. Simons. There were some financial-related sanctions, some asset freezes, but the broad prohibitions on U.S. business involvement in Iran actually date to the Clinton administration.

Representative Hinchey. What took place back in the early 1980s, specifically? Can you tell us what happened?

Mr. Simons. Going back to November 1979, President Carter issued an Executive Order freezing Iranian assets and banning imports from Iran, in response to the takeover of the U.S. Embassy in Tehran. In April 1980, the President banned all commerce and travel between the United States and Iran, because of the continuing hostage crisis. However, these measures were subsequently lifted pursuant to the Algiers Accords, under which the U.S. hostages were freed. In January 1984, Iran was designated a state-sponsor of terrorism, which resulted in the application of specific statutory restrictions incident to that status. In October 1987, most imports from Iran were prohibited because of its support for terrorism. Broader prohibitions, including on U.S. exports and investment, were imposed in 1995.

Representative Hinchey. The relationship that Iran has with other countries is seemingly much more normal. They have good relations with China, with Russia, and with a number of European countries, if not most or all of the European countries, particularly mainland Europe. So it would seem that any attempt that we might take to impose some economic problems on that country by initiating sanctions would have a good deal of difficulty in succeeding, given the fact that other countries are very likely to step in and increase their economic relationships with Iran. Don't you believe that that is the case?

Mr. Simons. I think we are really in a fundamentally different situation than we were back in the 1990s. When we imposed the unilateral sanctions back in the mid-nineties the United States was seeking to move ahead the Middle East peace process, and I believe, Congressman, you played a role in that. If I am not mistaken, we had some contact on this back in the nineties. I think you came out to Israel when I was out there. So you are very familiar with the issue.

Iran was a major obstacle to forward movement in the peace process and also we saw a number of demonstrations of Iranian support for international terrorism that were very troublesome, and this is what led the Clinton administration to impose at that point the unilateral sanctions. I would agree with you, at that point, many of our partners around the world were not choosing to go this route and were pursuing greater economic ties with Iran.

But what has happened in the last couple of years and I think what represents something of a sea change is that today in 2006, we have been able to mobilize a fairly robust international partnership and coalition of countries that are prepared to take a tough look at Iran and that have been speaking with one voice to the Iranians and that culminated in the package that was put forward at the end of May, and the two choices that I outlined earlier.

And the difference this time around is that we do have the international community speaking with one voice on Iran, probably for the first time in many, many years, and we have been able to work this diplomacy effectively. I think it is one of the signature achievements of this Administration that for the first time we have been able to have a common multilateral definition of the Iranian problem and of a possible solution.

Representative Hinchey. I think it is true that anyone who thinks about it would much prefer that the Iranians, and a great many other people, other countries around the world, were not developing nuclear weapons; because the more nuclear weapons there are in the world, the more likelihood is that one of them is going to go off someplace and cause some serious problems, including the possibility of one going off here in the United States.

So it is pretty evident that most people are concerned about the proliferation of nuclear weapons, and I think in a country like Iran that makes some sense. But in terms of the way in which we are dealing with Iran and the imposition of sanctions—and those sanctions which were imposed during the 1990s have never really taken place. Nothing really has ever been done to implement those sanctions; is that correct?

Mr. Simons. No, I don't think that is correct. Certainly, U.S. businesses are not active in Iran currently and have not been active for the past decade. We would also argue from the Administration's perspective that there has been a lot less involvement by the rest of the world than there otherwise would have been if we had not gone down this road.

So, a lot of the conclusions I think that the Committee report came to in terms of the rather slow development of the Iranian oil and gas sector, there were many reasons for this; and certainly you can't put the entire monkey on the back of sanctions, but the sanctions regime played some role in slowing the development of Iran's oil and gas sector.

Representative Hinchey. In the context of the discussions within the Department of State with regard to this situation, to what extent do you regard the reaction of Iran to the United States to be a result of the President's inclusion of Iran in the so-called axis of evil with Iraq and then having attacked Iraq?

Mr. Simons. I think the President's statement stands for itself and is an accurate description of the threats that Iran does pose, which I outlined as well in my opening statement. So this Administration and previous Administrations have had very, very significant concerns with Iranian behavior. This is really what motivated the Clinton administration to put in place the sanctions back in the nineties. So there has been a history of U.S. Executive Branch as well as congressional concern with a wide range of Iranian behaviors: the terrorism issue, human rights, peace process, and now the proliferation issue.

So I think the President's statement was quite consistent with policies that have been adopted before and after.

Representative Hinchey. When did Iran sign the Nuclear Non-Proliferation Treaty?

Mr. Simons. I am sorry, I don't have the exact date that they signed, but they have been a member for many years.

Representative Hinchey. Are we aware of significant violations of the NPT by Iran?

Mr. Simons. I think what we are trying to do here is to construct a set of incentives that would oblige Iran to carry out its civilian nuclear responsibilities in ways that are consistent with the NPT and that would draw the International Atomic Energy Agency into a supervisory role to ensure that Iran does abide by its NPT obligations.

Representative Hinchey. Thank very much, Mr. Simons. Thank you, Mr. Chairman.

Representative Saxton. Mr. English.

Representative English. Thank you, Mr. Chairman.

Mr. Simons, we have seen an international effort to engage Iran that has included, I think, a powerful set of economic incentives that have been offered to Iran to refrain from uranium enrichment. I guess, looking at this, I have seen very little evidence that Iran has responded to those incentives.

Do we have any reason to believe that Iran would respond differently to other economic incentives, including sanctions, and can you detail for us any change in Iranian behavior that have resulted so far from the sanctions that have been included in ILSA?

Mr. Simons. Thank you, Congressman English. I believe that the discussion of sanctions and the fact that the international community has stood with a united front over the last 6 months in keeping a sanctions option available has had a lot of impact and has affected thinking around the world, including in Iran.

I think it is a little difficult to point to any specific evidence of this, but certainly going back to Mr. Hinchey's observation, we had a situation for the past decade in which European countries were pursuing economic engagement with Iran and not really availing themselves of a sanctions option. Now the sanctions option is very much front and center as the consequence of Iran choosing not to cooperate with the international community.

So I do think that that has had a significant impact on thinking. I think it has to some extent—and the Secretary has made this observation as well—it has affected the political risk calculus of businesses and banks that might otherwise be thinking of expanding or continuing their involvement with Iran.

We have seen some evidence of a slowdown in investment, we have seen Iran's credit rating being downgraded, for example, in the OECD, and we have seen some other evidence that by stoking up the level of political risk and by not offering economic incentives to offset that political risk, that Iran already, even before sanctions are imposed, is becoming a less desirable place to do business. So I do think that having the sanctions option in full view has been very important.

You raised a second question about ILSA, and in this regard the Administration did send a midterm report up to Congress last year in which we detailed what we believed to have been the impact of ILSA in terms of investment. And here too, as I mentioned earlier, we do believe that ILSA has played some role in terms of slowing the pace of investment in Iran's oil and gas sector.

Representative English. In other words, you are suggesting that ILSA has had an effect on the international business community's interactions with Iran. Have you seen any change of behavior on Iran's part, either at the government level, or has this had any impact on economic players below the government level, within the country and its economy?

Mr. Simons. I think I might defer to some of our following witnesses who might follow this a little more carefully. But I would just note that in looking at some of the Iranian government statements that have been made since the sanctions option has been out there, the Iranian government appears to have been making a lot of efforts to suggest that all is well on the investment front and has been seeking out opportunities to present a normal face, a kind of positive face in terms of investment. And I think the fact that they are engaging in that type of campaign suggests perhaps that all is not so well.

Representative English. I appreciate that, Mr. Simons. I realize the questions I have raised here are very difficult because this is a very difficult area of policy, but I am grateful to the Administration for pursuing the aggressive course it has and the diplomacy it has in dealing with the thorny issue of Iranian enrichment. And I am grateful to you, Mr. Chairman, for giving us an opportunity in this hearing to fine-tune how we approach engaging Iran and encouraging them to play a more active and positive role in the international community.

So I thank you and I yield my time.

Representative Saxton. Thank you very much, Mr. English. I move now to Ms. Sanchez.

Representative Sanchez. Thank you, Mr. Chairman, and thank you, Mr. Simons, for testifying before us.

Do you really believe that—what do you think the real impact would be, if we do have a stand-off and we are not able to come to an agreement with respect to the enrichment issue in Iran, if the world powers got together and say we are going to have sanctions against this country?

First of all, do you really believe places like China and Russia would actually follow that, or their business interests would follow that? And, second, what would be the impact if there was leakage in particular from—let's say from those two areas?

Mr. Simons. Thank you, Congresswoman Sanchez. It is a little difficult for me to get into a speculative realm here. I would just note, though, that China, Russia and other countries did stand up with us in the IEAE votes; two very important IEAE votes over the past 6 months they stood with us and the rest the international community in terms of insisting that Iran meet its commitments. And the Secretary and Under Secretary Burns have made it their highest priority to work with this P5+1 group that I described in my opening statement, and it is one of the highest priorities for this Administration's diplomacy.

So I do think that the fact that we have assigned this priority and that we have been able to speak with one voice to this point is a very important achievement.

Representative Sanchez. With respect to China and the fact that if you take a look at what it has been doing in the last few years and having long-term contracts for energy availability, have you seen them have any interaction with respect to Iran in that situation?

Mr. Simons. That is a good question. I actually was in Beijing last week for some discussions on energy issues, and there is no question that China faces daunting challenges meeting its future energy requirements, given the projections of explosive economic growth. You can just see it all around.

They are looking abroad, they are launching upstream investment activities in many parts of the world. But at the same time, as former Deputy Secretary Zoellick pointed out in a speech that he gave, we are seeking to work with the Chinese to develop a responsible stakeholder role for China whereby they would take a close look at the political and security consequences of their energy policies.

Representative Sanchez. That sounds nice, but my question was have you seen any contract, any deals going on with Iran with respect to securing energy for the future, from China?

Mr. Simons. I think many countries around the world, China, India, others, are engaging in discussions——

Representative Sanchez. But we haven't seen anything.

Mr. Simons [continuing]. Discussions. Let me continue for a minute. As with many of these discussions, they go on for many years. And as the Chairman has pointed out, Iran is the second-largest holder of gas reserves, second-largest, third-largest oil reserves in the country. So you will not be able to shut off this process of discussion that goes on and of keeping doors open, and so our job in the Executive Branch is to ensure that some of these other factors that you point out are brought to the attention of the Chinese authorities and other authorities.

Representative Sanchez. I am going to cut you short because you are running through my time on answering—of giving me answers to questions I didn't ask.

With respect to any economic reforms, have you seen any going on in the economy for Iran? I ask that from the whole sense that there are a lot of people that believe that the most moderate people in that region would be the Iranians, the people—I am not talking about who controls the government.

Have you seen—what type of economic reforms, if any, have you seen in that country? And the second question with respect to the rise of price in gas, in getting that money back into the economy, what has the government or the Iranians done with those moneys? Has it gone to military spending; has it gone into infrastructure building; what have you seen?

Mr. Simons. As to your first question, we have not seen much evidence of economic reform, but countries that receive surges of oil income rarely have the incentives to undertake economic reform, so it is not unexpected that the Iranians would not push ahead on reforms.

With respect to the use of funds, some of the petroleum reserves go back into the general budget and they finance a variety of development expenditures, security expenditures, everything that would go into a general purpose budget. So there has been some focus, additional focus on development issues, because there has been a budgetary surplus as a result of the oil revenues. This is consistent with revenues that would come from tax or other sources.

Representative Saxton. Thank you very much.

Mr. Cummings.

Representative Cummings. Thank you very much, Mr. Chairman. Iran said that it will respond on August 22nd to the incentives being offered by the United States and our allies to entice it to give up its nuclear weapons program. If Iran responds by withdrawing from the Nuclear Non-Proliferation Treaty, what leverage would be available to the United States and/or the United Nations to try to slow the Iranian nuclear program, particularly if countries like Russia and China remain opposed to sanctions and to other measures that they consider to be provocative?

Mr. Simons. Thank you, Congressman. I am afraid that question is a little bit out of my area of expertise, which tends to be more on the oil and energy side. But I would just note that we have given the Iranians a choice of paths that they can follow, and it has been fairly clearly enunciated, and we do have all the major powers of the world aligning themselves, the P5+1, in the direction of a path of cooperation which would enable the Iranians to access civilian nuclear technology, admittedly under safeguards.

But this is something that the Iranians will need to take, obviously, a close look at. But these are the choices that are ahead.

So either they can pursue the path or they can pursue the path of isolation. On July 12, the Permanent Members of the U.N. Security Council, plus Germany (the P5+1), noting that Iran had given no indication that it was ready to engage seriously on the substance of the proposals presented on June 6, agreed to seek a Security Council Resolution that would make mandatory Iran's suspension of all uranium enrichment and reprocessing activities. The P5+1 also agreed that should Iran fail to comply with such a Resolution, we would work for the adoption of measures under Article 41 of Chapter VII of the U.N. Charter, which provides for sanctions.

Representative Cummings. I appreciate that. Particularly as the United States has virtually no contact with Iran now and has imposed unilateral sanctions since the 1980s, could additional sanctions even be imposed against Iran if they were not fully supported by the U.N. and by countries like Russia and China?

Mr. Simons. I think you make a good point, Congressman Cummings, in the sense that the U.S. sanctions are already quite comprehensive, so the approach the Administration has followed is to take a look at how other countries around the world could basically look at those kinds of options and could to some extent associate themselves with some of the things that we have already had on the table for some time.

Representative Cummings. Well, I mean when you consider Iran's role with regard to terrorism, have you seen any effect with regard to Iran's behavior since we have been imposing sanctions since the 1980s? Have you seen any effect on those sanctions?

Mr. Simons. As I mentioned in my opening statement, we still have very, very significant concerns with Iranian support for terrorist organizations, up until the events in the past few weeks, and clearly the Iranian supply of Hezbollah has been a huge problem. I think this is an issue we continue to work on and it is a concern. And it is a concern now that we have—I think the important factor now is that we have a broader coalition of countries that look at the issue the same way that we do, which is a significant advance over where we had been for the prior decade.

Representative Cummings. Thank you, Mr. Chairman.

Representative Saxton. Thank you, Mr. Cummings.

Mr. Simons, thank you for being with us this morning. I would like to conclude with one thought and that is that you just mentioned the events of the last few weeks, and one of the outcomes of the events of the last few weeks that has been noted is a different attitude toward Iran even among or maybe particularly among Middle Eastern governments. I am thinking of Saudi Arabia and Egypt and Morocco, of course, and Northern Africa who have, I believe, in each case failed to condemn the actions of Israel, which is unusual, against the Hezbollah, the Iranian backed Hezbollah, and I find that as a very interesting development subsequent to the actions in Israel and Lebanon.

So thank you for being with us. We appreciate it very much. Your perspectives are very valuable to us, and thank you for what you do and keep up the good work.

We are now going to move to introduce our second panel. Dr. Kenneth Katzman, a specialist in Middle Eastern Affairs, Congressional Research Service and the Library of Congress. Second, Mr. Ilan Berman, Vice President for Policy of the American Foreign Policy Council. Third, Mr. Andrew Davenport, Vice President, Conflict Securities Advisory Group, here in Washington, DC. And Mr. Jeffrey J. Schott, Senior Fellow for the Institute for International Economics.

Thank you for being with us. And why don't we start with Mr. Katzman and we will kind of move across the dais here.

Dr. Katzman, the floor is yours.

STATEMENT OF DR. KENNETH KATZMAN, SPECIALIST IN MIDDLE EASTERN AFFAIRS, CONGRESSIONAL RESEARCH SERVICE, LIBRARY OF CONGRESS

Dr. Katzman. Thank you, Mr. Chairman. Thank you for asking me to appear at today's hearing. I will summarize my remarks and request the full statement be placed in the record.

To summarize, I am going to focus today primarily on the politics of Iran's economy rather than the hard facts of Iran's economy. Iran's economy is highly resistant to reform because it is in the interests of those governing the regime to keep the economy exactly the way it is.

Iran's leaders are able to steer the proceeds or parts of the economy to provide patronage, build their constituencies, particularly among the lower classes.

Because Iran's political leaders benefit from the structure of Iran's economy, there is little chance under the current system of major structural economic reform.

What I would like to talk about is the engine of this system that the clerics run are the quasi-state, the state funded, state directed foundations called bonyads, a Persian word meaning "foundation." These are informal networks. They are controlled by key clerics or former or current government officials. They are technically not under the authority of the Ministry of Welfare and Social Security, and they do play a role in social welfare. However, their criteria are arbitrary, which in many ways explains the conclusions of the World Bank, which said that Iran's system of social welfare is inefficient and in fact many Iranians receive benefits from the system who are in fact not even below the poverty line because the bonyads, the foundations, their criteria are arbitrary and in many cases they reward with social welfare families who are politically loyal to the regime rather than hard facts of demonstration of actual economic need or poverty.

The bonyads, these foundations, actually account for about an estimated one-third of Iran's GDP, and I would argue that they distort normal market forces in Iran.

In many cases, they have these bonyads that because they are so politically well connected have cornered entire segments of the market for import or export of certain goods and have developed monopolies in some of these goods, trading in some of these goods.

Iran's economy fundamentally is a trading economy. Iran really doesn't manufacture really anything, much of anything. Except maybe carpets. It runs on trading, buying, selling, markup discount. That is Iran's economy essentially.

The most controversial allegations about these bonyads is whether or not their funds have been used, because they are not really under any ministry, as a sort of a circuitous way to generate extra funds to procure weapons of mass destruction technology and other technology.

This allegation has long surrounded the largest foundation, the Foundation for the Oppressed and Disabled, which has constantly been run by hardliners and former officials of the Revolutionary Guard, including Mohsen RafiqDust, who was the first minister of the Revolutionary Guard. It is now run by a former chief of the Revolutionary Guard, Mohammad Forouzandeh. The Foundation for the Opressed is so large it manages broad assets, 400 companies and factories, with a total estimated asset value of about $12 billion, and it is considered the largest single economic entity after the government itself.

It is active in the following sectors: Food and beverages, chemicals, shipping. The bonyads shipping company, metals, petrochemicals, construction, dams, tours, farming, horticulture, animal husbandry, tourism, transportation, hotels, two major hotels in Tehran, commercial services, financing. It produces the best selling soft drink in Iran called Zam Zam. It uses profits—it does, however, provide social welfare. It helps about 120,000 poor families and veterans of the Iran-Iraq war.

Another foundation based in Mashhad in northeastern Iran is the Shrine of Imam Reza Foundation. It uses donations from 8 billion pilgrims to the shrine—it has used that to buy up to 90 percent of the arable land in its area. The estimated value of this land could be as much as $20 billion, and it is the largest employer in Khorasan province. It runs 56 companies, including a Coca-Cola factory and two universities and is now getting into automobile manufacturing.

It is headed by Ayatollah Abbas Vaez-Tabasi, who is on the powerful Expediency Council that is headed by former President Akbar Hashemi-Rafsanjani, who lost the Presidential election in 2005. His son is married to a daughter of the Supreme Leader Ayatollah Khamenéi.

The Noor Foundation imports sugar, pharmaceuticals and construction equipment and has substantial real estate holdings. It is headed by Mohsen RafiqDust, who was the first Minister of the Revolutionary Guard and who later was head of the Foundation of the Oppressed. RafiqDust is on the Expediency Council.

The last foundation I would like to mention is the 15 Khordad Foundation. It is the bonyad, the foundation, that offered the $1 million to anyone who would kill author Salman Rushdie, and the bonyad has not—although the government has said they have no issue with Rushdie any more, the 15 Khordad Foundation has not actually rescinded that offer for the killing of Rushdie.

A few other elements of the economy, the political economy, I want to mention. The cooperatives, another sector of the economy. The most well known is the Rafsanjani Pistachio Growers Cooperative run by the cousin of Mr. Rafsanjani, again, who is chairman of the Expediency Council. The cooperative represents about 70,000 pistachio farmers and has a large estimated value of $746 million. Many believe it was Rafsanjani's wealth from the Rafsanjani cooperative that has led him to prominence and has allowed him to pay off supporters although it did not carry him to victory in the 2005 election. He still lost to Mahmoud Ahmadinejad.

The Revolutionary Guard. I have done a lot of work on the Revolutionary Guard in my career. Very loyal to the leadership. Increasingly playing an economic role. As we have seen, it is getting its tentacles into the economy, and in fact a firm owned by the Revolutionary Guard called Ghorb is being awarded a $2.3 billion a year deal to develop two phases of the large South Pars gas field, which is Iran's large natural gas project. That project was going to be awarded to Norway's Aker Kvaerner, but the Guard, using its political influence, overturned that. It was retendered and it was won by this arm of the Revolutionary Guard. Again, and certainly Ghorb is much less capable of developing the South Pars gas fields than Norway's Aker Kvaerner. So this is another way of how the Guard and the regime have basically captured, cornered large parts of the economy.

The implications for reform are clear. There is a big debate in Iran over reform because the conservatives are very divided. I will conclude with that. Ahmadinejad really represents the lower class. He believes in state control of the economy, that the state should drive employment. Other conservatives such as Rafsanjani, they represent the bazaaris, the traders. They are really almost in many ways pure capitalists. They want very few restrictions. They want to be able to trade in and out freely and mark up their goods. They don't want state control of the economy. And they don't want really foreign investment in the economy because if foreign investment comes in the investor from a multinational company will probably make a better product than they do or do a better job than they do and will displace their monopoly. So the bazaaris want to keep out foreign investment.

So in many ways, considering sanctions on investing in Iran outside the energy sector may not necessarily be unpopular in major segments of the Iranian leadership because, as I said, the bazaaris don't want this investment anyway because it will hurt them.

So in summary, I see very little prospects for political reform. I think the structure of the system is the way it is. It allows the clerics to build patronage to control their supporters, to keep people loyal. And I think the system serves that interest, and repeated efforts to reform have been thwarted.

Thank you.

[The prepared statement of Mr. Katzman appears in the Submissions for the Record on page 45.]

Representative Saxton. Thank you very much, Mr. Katzman, for those important perspectives. We appreciate it.

Mr. Berman.

STATEMENT OF ILAN BERMAN, VICE PRESIDENT FOR POLICY, AMERICAN FOREIGN POLICY COUNCIL

Mr. Berman. Thank you very much, Mr. Chairman. Dr. Katzman spoke about the Islamic Republic's political economy and I would like to talk about economic avenues that are available for the United States and its allies in confronting Iran. Let me focus my oral remarks on three vulnerabilities or, if you will, points of entry into the Iranian economy by which we can exert pressure. And I do this in order of escalating effectiveness, at least in my opinion.

The first is foreign direct investment. Iran today produces 3.9 million barrels of oil a day, and exports 60 percent of that, approximately 2.5 million. In order to maintain this level of production, it requires approximately $1 billion of FDI, foreign direct investment, annually. In order to increase that capacity, Iran requires approximately $1.5 billion. In context, though, this is not a lot of money. Iran has signed contracts worth dozens of billions of dollars with foreign powers over the past several years.

China alone has signed at least two massive exploration and development deals with Iran worth a cumulative $100 billion over 25 years since 2004.

As a result of this trend, Iran is no longer an economic pariah the way it was in the mid to late 1990s. It now has very vibrant economic ties with a number of foreign countries. And Iran has amassed huge amounts of money as a result of the high price of oil. The average cited in the Iranian press is that Iran has approximately $50 billion in hard currency reserves as of March of 2006, the end of the Iranian calendar year.

What does this mean? This means that legislation such as the Iran-Libya Sanctions Act which we have in force and is coming up for renewal next week, even if there are a political will to implement it more fully, will not be able to alter Iranian behavior by itself. There is simply too much hard currency that the regime could tap into and there are too many foreign factors who are invested who would act. Iran will find a billion dollars, or a billion and a half, somewhere. What the United States can do is try to complicate where Iran gets its foreign direct investment from, and force them to draw from their hard foreign currency reserves. I would argue that is a worthwhile effort, because if Iran has less money available for its nuclear program, for terrorism, or for interference in Iraq, that is an aggregate benefit for American foreign policy. However, this is not by itself a solution to the nuclear issue. We should not rely just on curbing FDI.

The second weakness is the economic hierarchy that exists in Iran today. The vast majority of regime wealth is concentrated in a small number of people. For example, as Dr. Katzman alluded to, the extended family of former Iranian President Ali Akbar Hashemi Rafsanjani virtually controls copper mining, pistachio trade, and a number of profitable export and import businesses. And parallel to that you have the bonyads, the regime's sprawling charitable foundations. They are largely unregulated, accountable only to Iran's Supreme Leader. And they account for 20 percent or more of Iranian national GDP, and as much as two-thirds of the country's non-oil GDP.

So there is a substantial financial base that can be targeted which has very deep ties to the regime. Targeted financial measures that restrict the ability of these individuals and organizations to access international markets and curtail their ability to engage in international commerce are likely to have an immediate and pronounced effect on regime decisionmaking. This is a large domestic constituency and there is likely to be a lot of domestic pressure exerted on the Iranian government if these people can no longer live in the manner to which they have become accustomed.

But the most solid point of entry, in my opinion, is commodities. Iran maintains a socialist energy sector. Gasoline is sold for pennies on the dollar. It costs approximately 40 cents to buy a gallon of gas in Tehran today. Iran consumes 64.5 million liters of gasoline a year and it imports close to 40 percent of that. More importantly, it does not have the equivalent of a strategic gas reserve. There have been studies out of Iran that suggest Iran only has a 45-day supply of gasoline "in country," after which there will be shortages at the pump in a very destabilizing manner.

So on this issue, it is my opinion that economic pressure can work. We are already beginning to see this. Sanctions have not yet been applied in any way, but leading parliamentarians in Iran have already told the government it needs to spend an extra $5 billion this year alone to maintain its established policy of deep subsidies and avoid rationing. It is quite clear that this international climate is creating additional fiscal requirements for the regime to maintain state subsidies, and we can exploit that. That is a point of entry for us.

But none of this is occurring in a vacuum. Iran is already making very substantial economic countermoves.

First, Iran has carried out large scale transfers of financial assets from Europe to institutions in China and Southeast Asia, where the belief is they will be less likely to be exposed if sanctions are applied.

Second, the regime has begun the initiation of a large scale privatization of government funds, transferring to offshore accounts, transferring into private hands, selling off gold reserves, things like that.

And most importantly, and I think this needs to be emphasized, the regime about a month ago passed a new budget which goes into effect over the next several months which calls for a halt to imports of refined petroleum projects and gasoline rationing beginning this fall.

These are all efforts to minimize economic vulnerabilities on the part of the Islamic Republic, and they are an attempt by Iranian leadership to deny the West the ability to influence Iranian behavior, specifically on the nuclear issue.

Therefore, and I say this advisedly, the sanctions track that we are currently pursuing at the United Nations is likely to be ineffective. First of all, we have a problem with timing. The delays that we have experienced so far—and are likely to experience moving forward—allow the regime time to make these economic countermoves that will make sanctions, when they are applied, likely to be less effective than they are today.

And the second is a problem with scope. There is a need to appease the stragglers in our economic coalition: The Russians and the Chinese have made no secret of the fact that they are very hesitant to apply economic sanctions. Therefore, any measures that emerge as a result of the U.N. track will need to be tailored to make sure that they don't warrant a Chinese or a Russian veto. It means they are going to be narrow in scope.

My conclusion here is that, unfortunately, the way the Administration is currently pursuing economic policy toward Iran will virtually guarantee that sanctions will fail. In my opinion, what the Administration needs to do, and needs to do in short order, is to create a "coalition of the willing" with which it can go outside the confines of the U.N. and focus on those measures that will be most effective in changing Iranian behavior.

I say all of this advisedly because it is not guaranteed at all that sanctions will work. In fact, the political will of the regime to acquire a nuclear capability is very strong and historically, sanctions are not an isolated event. They tend to have a very strong positive correlation with escalation to the use of force. But I think sanctions are a step that should be attempted because if we don't, and we acquiesce to the current U.N. track, this will make other options, chief among them the eventual use of force, either by us or another country, all the more likely.

Right now, we still have the ability to attempt to use economic pressure on Iran to slow down and to curb Iran's atomic ambitions. A year from now, it is not at all clear that we will have that opportunity.

Thank you.

[The prepared statement of Mr. Berman appears in the Submissions for the Record on page 50.]

Representative Saxton. Thank you very much, Mr. Berman. We move now to Mr. Davenport.

STATEMENT OF DR. ANDREW DAVENPORT, VICE PRESIDENT, CONFLICT SECURITIES ADVISORY GROUP, INC.

Dr. Davenport. Mr. Chairman, thank you for the privilege of appearing before this Committee. I would like to speak first about the central role that Iran's oil and gas industries play in supporting all facets of Iran's government and then focus my time on the company specific dimensions of that equation. I will also touch on the impact of U.S. policy on corporate decisionmaking regarding the pursuit of these business opportunities.

In our view, three central issues define Iran's oil industry today. First, it is clear that Iran's oil exports play a key role in underwriting that country's government. As oil prices increase, Tehran experiences economic windfalls that have a direct impact on the government's discretionary spending across the board.

Second, despite the lucrative nature of Iran's oil exports, its energy industry as a whole has distinct weaknesses that have prevented it from reaching its full potential. Iran's oil industry is state controlled, aging, inefficient and in need of significant upgrades that only foreign companies with their access to large-scale capital and advanced equipment technology are capable of providing. These upgrades and foreign investments are essential for Iran to cushion the blow of increasing domestic oil consumption and aging oil fields that, together, are putting downward pressure on the country's oil exports.

Third, the country's gasoline related expenditures have put added strain on Iran's budget. Despite booming revenues, Iran's lack of refining capacity has forced the country to spend billions of dollars importing gasoline. Moreover, the decision by Iran's parliament to lock domestic gas prices at 2003 levels has led to billions more dollars in state subsidies.

Over the coming years, the intersection of these three industry pressures will put the Iranian government and the companies that do business there at a crossroads. With Iran almost completely dependent on its energy exports for its revenues and in desperate need of foreign investment to keep these revenues flowing, foreign companies will become even more central to the prosperity of Tehran than they are today.

The summary statistics regarding the role of oil in the Iranian economy tell the story. Iran holds an estimated 10 percent of the world's proven oil reserves. Its oil exports generate 80 to 90 percent of the country's total export earnings and 40 to 50 percent of its total government budget.

Although the state-owned National Iranian Oil Company largely runs the country's oil industry, we understand that oil export revenues are effectively funneled straight to the country's central bank. As might be expected, oil related revenues quite literally equate to discretionary funds for Tehran. Although Iran's military and nuclear spending is largely unknown, it can be reasonably expected that both are benefiting directly from recent oil windfalls.

To maintain these high revenue flows, however, not only will oil revenues need to remain high, but Iran will need to invest heavily in its existing and prospective energy projects. Most would agree that the future success of Iran's oil fields requires billions of dollars in foreign investment capital and technology in the coming years.

Our research shows that there is no shortage of corporations currently working in Iran's oil industry. In our view, even considering the outrageous pronouncements of Iran's new President, short of international sanctions, no significant number of companies will forgo the country's business opportunities. History has shown time and again that companies will do what the law allows. As long as operating in Iran is legal, the draw of a growing economy and the country's vast oil and gas resources will lure them in.

There are a few important exceptions. A number of companies have correctly identified a growing sensitivity in the U.S. investor community to business associations with Iran. The prospect of being labeled as, quote, "doing business with the enemy," unquote, the title of a 60 Minutes segment that has aired twice over the past 2 years, has influenced the behavior of some companies. For most companies, however, this calculation is still in flux.

For at least five prominent U.S. companies, Comptroller William Thompson of New York City made this calculation a good deal easier by registering public shareholder resolutions with the SEC on behalf of the city's fire and police pension funds calling for a board level review of their corporate ties to Iran and other terrorist sponsoring states.

After some wrangling, these companies made adjustments to corporate policies and in certain cases renounced any future business ties to Iran whatsoever.

The impact of corporate reputational concerns and market forces, however, should not only be measured by whether or not a company chooses to exit completely from Iran. One positive development stimulated by these concerns and increased attention to this issue from investors, the government and the media in the U.S. has been a new sensitivity to the structure of their corporate ties to Iran.

Some non-U.S. companies have begun to self-police their operations at standards above and beyond the requirements of their national laws to protect their reputations from potential Iran-related harm. For example, companies are substituting equipment and technology to minimize dual use concerns and in some cases posing questions regarding certain local partners. In fact, our firm is witnessing corporations insisting on certain contract terms with Iran rather than vice versa.

While this may be short of what some policymakers prefer, it demonstrates an innovative market oriented reaction that has a high likelihood of reducing the security risks that these corporate ties can represent. In our view, this increased security consciousness, when it occurs voluntarily, should be viewed as a good thing.

Given recent events and the importance of foreign companies to the Iranian economy, one might ask: What role does U.S. policy play in the considerations of these companies operating in Iran? For a long time, the answer for non-U.S. companies has been very little. President Clinton's 1995 Executive Order banned U.S. involvement in Iran's energy sector, but had little to no impact on foreign companies.

Congress then passed the 1996 Iran-Libya Sanctions Act, or ILSA, which sought to sanction non-U.S. companies investing more than $20 million annually in Iran's oil and gas industries by restricting their access to the U.S. economy. ILSA, however, was never enforced. Soon after the act was passed, several large companies, including France's Total and Russia's Gazprom, violated its provisions and following an official review went unpunished. These early precedents cleared the way for other companies to do the same and, today, there are over 20 companies in technical violation of ILSA.

With U.S. sanctions policy toward Iran remaining fairly consistent since the mid-1990s, one might further ask: What has changed over the past few years causing changes to corporate behavior that we have been witnessing?

Our findings demonstrate that after September 11th the stigma associated with corporate ties to terrorist sponsoring states increased significantly. This stigma reverberated in the local and national press. State and municipal governments began analyzing how their retirement and other public investment funds were invested in these companies. Grassroots attention to state sponsors of terrorism raised substantially the reputational risk of these corporate ties.

This grassroots movement continues today. For example, in Missouri, an investment trust just recently became the first public fund in the country to institute a policy that, after careful review, screens out certain companies with business in Iran and other terrorist sponsoring states. A so-called terror free mutual fund, the Abacus Bull Moose Growth Fund, has likewise been created in response to market demand. As a result of this trend, some companies are rightfully seeking to safeguard their corporate operations from these types of associations. To be clear, this is market oriented cause and effect.

According to our Global Security Risk Monitor online research product, over 300 public companies have carried out business with Iran during the past 3 years.

As stated, short of strong multilateral sanctions, there will continue to be companies looking to enter the Iranian market or expand their corporate presence. As reputational risk increases, so too will corporate self-policing. Such new corporate governance guidelines and due diligence measures will not be lost on the state-owned companies that will have to learn to be responsive to the reputational burden that they bring to each of their prospective and existing business partners.

Thank you.

[The prepared statement of Dr. Davenport appears in the Submissions for the Record on page 54.]

Representative Saxton. Thank you very much, Dr. Davenport.

Mr. Schott.

STATEMENT OF DR. JEFFREY J. SCHOTT, SENIOR FELLOW, INSTITUTE FOR INTERNATIONAL ECONOMICS

Dr. Schott. Thank you very much, Mr. Chairman. I appreciate the opportunity to testify before this Committee.

My testimony today draws on my personal experience as a U.S. Government official involved in the formulation and implementation of sanctions policy back in the late 1970s and early 1980s and since then also as a researcher who has spent 25 years documenting the use of economic sanctions around the world with my colleagues Gary Hufbauer and Kimberly Elliott. We have probably produced the most extensive study of the use of economic sanctions, analyzing where they can be successful and their limitations. I hope that that analysis will help the Committee in its deliberations and the Congress as it pursues legislation in the coming weeks.

There has already been very extensive discussion of Iran and sanctions and petrodollars. The questions that were raised by you and the other Members of the Committee in the first panel were very insightful, and I will try not to duplicate that discussion.

But there is an important point to bear in mind. Iran now pockets about an extra $30 billion of oil export revenues annually compared to a decade ago. And these oil profits, as has been said in this panel, fuel the Iranian economy. They also finance Iranian investment in weapons development and support for terrorism.

What is good news for the ayatollahs is not good news for the United States. We are paying for these developments and not just at the pump. Petrodollars make Iran more capable of pursuing its nuclear ambitions and funding Hezbollah and other terrorist organizations and, importantly, it makes Iran more immune to U.S. economic coercion. I have some differences with comments that have been made about the effectiveness of expanded sanctions, in part because I have concerns about the viability of stronger multilateral support for our initiatives.

We have had sanctions for several decades, as Mr. Hinchey implied in his question in the opening panel. Fortunately, one only has to look back 22 years to the bombing of the Marine Corps barracks in Lebanon and the sad fact that our Marines had to return to Lebanon for the first time in 22 years just the past week or so to help the evacuation of U.S. citizens.

That led to sanctions against Iran for the first time since the hostage crisis of 1979 to 1981; it put Iran on the list of state sponsors of terrorism where it belongs and where it has remained for the past 22 years. We have had extensive unilateral sanctions. We have had very modest international support for those sanctions. And as a result, we have not achieved the very ambitious, difficult objectives that our sanctions policy has sought.

Now the question is, what more can be done? I think that question makes this hearing very timely, very important. But there is no easy answer to the questions that you have raised this morning.

In the interest of time, I will just note that in terms of our past sanctions policy I have appended to my statement a chronology of key events in the decades long sanctions efforts. If you read that, it will be troubling, because it goes back over many events that now resonate in the headlines of the newspapers that we read everyday. It is like Yogi Berra said, it's like deja vu all over again. The same problems confronting U.S. policy two decades ago now dominate the headlines.

Funding of terrorists in Lebanon. Testing North Korean missiles and Iran's pursuit of nuclear weapons. Economic sanctions have not blunted Iran's foreign adventurism in these two decades although they have undoubtedly inhibited the task and made it more costly to pursue.

Now the Congress is considering the extension or expansion of the ILSA sanctions against Iran. I think that law should be extended, renewed as is. But we should be careful to assess what can be done through the use of sanctions.

Can sanctions stop Iran from eventually developing a nuclear weapon? I don't think so. We have let the cat out of the bag in our reactions to developments in India and Pakistan. I fear any Iranian government would follow similar nuclear ambitions because—for them—the issue is one of nationalism. Even if the ayatollahs were not in power, leaders in Iran would feel that nuclear weapons will bring them regional dominance and that, just like with India and Pakistan, the West will accept their accession to the nuclear club without significant retribution.

Nonetheless, history shows that targeted sanctions can push back that day of reckoning. India, Pakistan and North Korea have all been subject to very extensive sanctions and some multilateral measures. The sanctions did not prevent proliferation but collective denial by Western powers of key ingredients of the bomb maker's art—the reprocessing technology, centrifuges and the like—substantially slowed the process.

I have studied a lot of sanctions, and I know that there are lots of ways you get around sanctions. Sanctions will not prevent a determined and a well financed country from eventually crossing the nuclear threshold. Even the tightest sanction regime can be evaded with sufficient incentive.

Saddam Hussein showed that during his reign when billions of dollars were smuggled into Iraq, sometimes with the complicity of Iran. Land borders are porous, especially in the Middle East, and sea and air freight are difficult to monitor effectively without intense military operations. With Iran's petrodollar bonanza, it will be able, over time, to procure the necessary material and technology to achieve its nuclear ambitions. This is a sad reflection and we ought to be planning how to deal with this.

The comments that were raised earlier that we should ratchet up the sanctions cause me some concerns, because this is not the same situation we had back in the 1990s when ILSA entered into force. Given tight global supplies, Iran has greater leverage to counter sanctions from major oil consuming nations and it can counter sanctions in several ways. One is by cutting back its level of oil exports. It doesn't have to cut them off. It can just reduce a bit. It can do non-oil related measures by racheting up tensions in the Middle East, as it is now doing in Lebanon, and it can also do the same in Iraq and perhaps they are doing it at the same time.

Few producing nations have the spare capacity to offset potential Iranian cutbacks, so prices would likely rise sharply. Now, as you implied, Mr. Chairman, and Mr. Simons implied in his answer to you, you could utilize release from the Strategic Petroleum Reserve. It is not an automatic process, especially if you want an internationally coordinated action using the IEA's emergency sharing plan. I sat on the governing board of the IEA as part of the U.S. delegation trying to do that in 1980, 1981, and it was a difficult process. We ended up doing nothing. The crisis was over before there was international agreement to take action. Prices went up and then they went down as a result of the global recession.

That may be a satisfactory response, but in the short term certainly Iran will sell less and earn more. For that reason, there are a lot of politicians who find it hard to stomach the idea of more comprehensive sanctions, because of its short-term impact on prices, and because it would undoubtedly trigger at least in the short term a global recession.

Europe, China, and Japan have similar concerns and are likely only to follow a very modest path of sanctions escalation. Russia will be even more ambivalent and so will China. The Russians have gained a lot from the oil price spikes that have already been generated by Mideast tensions. They are one of the world's major oil producers and indeed they increased their production over the last decade, and they also want to continue to cultivate Tehran as its best foothold in the Middle East. I would be very wary of thinking we will get strong support in multilateral actions from the Russians.

So what should we do? Let me conclude with a brief commentary. I think the most immediate and obvious task is continued denial of critical components for Iran's nuclear industry. The policy already receives support from major powers, but there is a lot of leakage that comes in from second tier powers and we ought to be concentrating our diplomacy on getting those states to try to join in the broader sanctions effort.

Other targeted sanctions against Iran's ruling class should also be considered. I think these are more for annoyance—measures such as travel restrictions and overseas asset freezes—but Dr. Katzman perhaps can comment more on the impact that they would have on domestic Iranian politics.

But the strategy of limited sanctions accompanied by coordinated diplomacy is not going to achieve the result of denying Iran eventually its objectives. It will only delay the process. Hopefully, over time, that delay will mellow Tehran's nuclear ambitions. This is less than a satisfying result, but effectively what we can achieve given current conditions in world energy markets.

Thank you very much, sir.

[The prepared statement of Dr. Schott appears in the Submissions for the Record on page 58.]

Representative Saxton. Thank you very much, Dr. Schott. That was a very good statement and we appreciate it very much. You each heard Dr. Schott, other panelists, obviously heard Dr. Schott talk about the effectiveness or potential effects of sanctions. Within the context of what Dr. Schott had to say, Mr. Davenport and Mr. Berman and Mr. Katzman, would you just kind of respond and give us your thoughts relative to the context within which Dr. Schott put the subject?

Dr. Davenport. I will do my best. I would have to say that from our perspective, we spend a lot of our time, the company that I represent, researching which companies from around the world are doing business in Iran and what they are doing there and hence the focus of my testimony on the importance of those companies to the country's economy. And I think it has been supported really in the testimony of some of the other witnesses that, at present and for the future, the Iranian oil economy is going to be highly dependent on the investments of foreign companies. That is really how they are going to keep up their current level of revenues and how they are going to keep producing more and more oil in order to compensate for currently aging oil fields and their increasing domestic consumption. As long as that is happening, I think you are going to see Iran's economy, short of oil prices falling, continuing along apace even with U.S. sanctions in place.

So I believe that what would affect Iran's economy most substantially would be international sanctions, if they were to occur, or a severe drop in the price of oil. I think these vulnerabilities show increasingly as Iran ramps up its budget and gets rather spendy with the current oil-related revenues that they are experiencing. I believe they have a budget deficit currently, even given the enormous windfalls that they are experiencing from today's oil prices. So I think either oil prices fall or international sanctions are put into place and those are the two biggest things that I see having a negative impact or significant impact on Iran's current economic situation.

Representative Saxton. Thank you.

Mr. Berman.

Mr. Berman. Thank you very much. I tend to agree about 50 percent with Mr. Schott, and let me explain why. He is exactly right in terms of goals. Economic sanctions cannot change the calculus of the Iranian leadership. It is very clear that Iranian officials have made a strategic choice in favor of nuclear possession, and they also have made clear that they are willing to stomach very painful economic measures inflicted upon them from the international community in order to achieve their goals, in order to perpetuate policy. But let me draw in something that hasn't been mentioned so far yet today.

The goal of sanctions should not be to stop the nuclear program. If that is the goal, then we have already failed. We have failed before we started. The goal, rather, should be to impress upon the Iranian people, the 85 to 90 percent of the Iranian people that are disenfranchised from the government, that their ruling regime's goals have concrete economic consequences, because the one thing that is very important here is the degree to which economic measures are not done in isolation. They have a diplomatic component. The most important component here is in order to accentuate the effectiveness of sanctions is to deny the regime the ability to rally the people around the flag, and that means that any economic measures have to be coupled with very robust public diplomacy that talks about the concrete consequences of their regime's adventurism.

The second point is on Iranian oil power, and about what can Iran do. Is it likely to expect an oil trade disruption? I think there are a couple of factors that mitigate strongly against that. The Iranian regime has blustered very publicly that it will reduce the flow of oil from the Persian Gulf. That they will cutoff the flow of oil from the Strait of Hormuz. And they have the capability to do that, certainly, but it is useful to remember here that Iran is dependent on less than savory countries, which are its primary customer base for energy. And it is very clear that if Iran is no longer on the table, countries like China and countries like India will waste no time in finding other, more stable suppliers.

The second point is that if Iran begins fiddling with the "oil tap," this will do something that so far American strategy has not been able to: to galvanize an international consensus about the need for a fundamental change in Iran. Many countries that are very dependent on Iran for oil will simply not stomach someone tinkering with a passageway through which two-fifths of the world's oil trade passes. I think the goal of their bluster is to have us self-censor, to have us think about what the costs are. But it is a very far cry for them to be able to do that. In fact, I think they understand that doing so in a very robust fashion might actually be regime threatening.

Representative Saxton. Mr. Katzman.

Dr. Katzman. My view is that Iran is single mindedly determined to achieve a nuclear capability and they will not be deterred by economic measures. In the Iranian view of Iranian strategists all across the spectrum, the reformists, the hardliners, every type of hardliners, Iran has been humiliated by outside powers throughout its history. It has been criss-crossed by every invader imaginable. The only way to reverse this sense of vulnerability is to achieve a nuclear capability, in which case they would no longer be vulnerable in their perceptions to this type of manipulation, in their view, by outside powers. I believe they can endure substantial economic privation.

Remember, Iran I think—I believe there is a perception in Washington, popularly here in America, that the Tehran elites are Iran. That is not Iran. Iran is rural villages, very poor. It is not a rich country. It is not a really well educated country. In Tehran there are very well educated elites who would be quite harmed and quite injured by economic privation. But the vast majority of Iranians are used to economic privation their entire lives, and I don't personally believe that any sanction will deter them from this course of pursuit.

Thank you.

Representative Saxton. Thank you.

Mr. Hinchey.

Representative Hinchey. Thank you, Mr. Chairman. Gentlemen, I want to thank you very much. I think your insight today that you provided us is very valuable and I wish the entire number of the Members of the House of Representatives could have been here to hear you. I think it would have been very beneficial.

Have any of you been to Iran recently? Not recently. Any of you been to Iran at all? I think that is a major problem, and I don't say that in any way to diminish what you just said. I think what you just said is very, very valuable and I don't mean to diminish it at all. But I just ask that question inquisitively because there is very little contact between our countries, any real, any meaningful contact between our countries, and the situation has gotten worse over the course of the last 25, now almost 30 years.

Mr. Schott, you said that a lot of people, politicians particularly, have a difficult time stomaching sanctions. I think that is right. I have a hard time rationalizing when you look—when you look back on the history of our involvement with this country, it seems to have been deplorably unsuccessful, and it is because the relationship has been a very aggressive one and the aggression has been primarily from our side. I can remember, you know, when I was a very, very young man watching television news programs over the weekend where the Shah of Iran was the principal guest and at that time Iran was a major ally and close friend of the United States through the Shah. But the Shah, over time, became less and less popular within his own country and when that happened back in the Carter administration, we reacted in a favorable way toward the Shah and an unfavorable way to the people who opposed him, and that was really the beginning of the decline of this relationship.

And it is an unfortunate situation, because I think that the people who are making policy could very much benefit from the insights that you provide. I don't know what kinds of opportunity you have to talk to this Administration or particularly to the State Department. I hope it is—I hope that you do have the opportunity because I think that there could be a great benefit from that kind of interaction.

But I would just like to ask you ask one question basically. The approach that we have taken to Iran has been very unsuccessful, seems to me completely unsuccessful. The likelihood of the situation improving under the present set of circumstances I think is remote. The response of the Iranian people to the actions that we have taken with regard to their country has been very reactionary. They have increasingly elected more and more reactionary leaders who are increasingly hostile to the United States and to other countries, particularly Israel. So the circumstances that prevail today are worse than they were 10 years ago, substantially worse than they were 30 years ago.

Everything that we have done has made the situation worse. Well, I don't know about everything, but most of the things that we have done has made the situation worse. What is it that we should be doing to make the situation better?

I think it was Mr. Berman who said he didn't have an opportunity to talk about diplomacy in his opening remarks. Seems to me that that is exactly the problem we all have. None of us have had an opportunity to talk very much about diplomacy, let alone to engage in a serious diplomatic initiative with this very significant country. So I would appreciate anything that you might care to respond to that. Dr. Katzman, if you would like to begin.

Dr. Katzman. Well, I would just begin by saying there has been engagements and actually in the last 4 years there has been substantially more engagement with Iran than ever before. Actually in 2003 for the first time the two countries acknowledged that they were conducting an open dialog. During the Clinton administration there had been talk about what the conditions might be for entering a dialog with Iran. But the last 4 years we have actually had a dialog with Iran, starting with Afghanistan, and Iran was extremely helpful in putting together the Karzai Government at the Bonn conference in late 2001. And then there were talks with Iran on Iraq and how Iran might be helpful.

Representative Hinchey. What you have just said is absolutely true. Iran was very helpful with regard to Afghanistan and that was very important to us because Afghanistan was the appropriate focus of our attention at that particular moment. What strikes me as—what is difficult for me to understand is why we allowed our relationship to deteriorate with them after they had been so helpful to us in Afghanistan. I was in Afghanistan in December of 2001. I had a chance to see what was going on there. I understand the kind of things that Iran and other countries did working closely with us. Why then did the President say, for example, in his speech just a couple of months later, a month later, that Iran was part of the axis of evil?

Dr. Katzman. Well, the Iranians point to that as something that bothers them greatly. But I would also say the dialog was suspended in May of 2003 when al-Qaeda activists who were in Iran were responsible for the bombing of a big housing complex in Riyadh, Saudi Arabia. Sayf al-Adel and bin Laden were believed to be in Iran possibly under Iranian protection there.

Representative Hinchey. You take a big jump in time between 2001 to 2003. The curious question is what did we allow to happen or what did happen in that intervening period that caused the situation to deteriorate, sir?

Dr. Katzman. There were—what I understand is there was consideration of building on the Afghan initiative, the Iraq initiative. But there was a sense that Iran was still doing things we found objectionable such as the nuclear. Remember in 2002, late 2002, the evolution of the major nuclear sites was unveiled. So while Iran may have been helpful on Afghanistan and Iraq, we had this other track happening where it suddenly became apparent that Iran was much more advanced in its nuclear program than we had previously thought, and that might have factored in to why this dialog was not built on.

Mr. Berman. A couple of points. You made the case that our approach has been spectacularly unsuccessful. I would argue that in fact we haven't had much of an approach at all for the last 8 years, 10 years. What you have actually had in Washington is two competing camps. One thought that we could do business with the Iranian government. On the other side, you have people that said this is a government that is unreformable and we simply can't talk to them. And the result of that clash, predictably, has been policy inertia. I think that it has actually affected some of the things that this Administration has done. The legacy is still there.

So I would say that your point is well taken, but I think it might not be because we have tried everything at our disposal. It might be because we are butting heads with ourselves.

The second point: You made reference to the election of Ahmadinejad, and I think the more appropriate term here is selection. What is important to remember is that there were two Presidential run-offs, one in June and one in July. But 3 months before that, in March, the Iranian government's vetting authority excluded more than a thousand potential candidates for President. The eight that remained, who participated in the first round, might have talked a different talk, but they all walked the same walk. None of them were going to pursue policies that were going to be threatening to the Islamic Republic. And in the final stage in the run-off between former President Rafsranjami and Ahmadinejad, it is important to understand why the latter won. He won on a campaign that was populist. It was against corruption, basically pointing to his people and saying, "These people have robbed you, the Iranian people, of your deserved wealth. Stick with me and I will make it better." He hasn't, and this is where there is an opportunity for the United States. Ahmadinejad for the last year has had the opportunity to pursue very populist policies. And he has done some of that tinkering on the margins of agrarian reform, etc. But what he hasn't done is reconstruct, as he promised to do, the relationship between the government and the people in terms of trickle-down economics, if you will.

That is an opportunity for the United States, because if Iranians substantively are still economically disenfranchised from the government. But that doesn't mean they will be in the future. If the Iranian regime begins implementing some of these policies, you will see a fracturing of that base of Iranians that right now does not see any economic opportunity for them in the perpetuation of the Islamic Republic. But so far, this hasn't happened.

Dr. Davenport. I will have to defer to some extent to other witnesses here since the company that I represent is impartial and doesn't take policy positions on the research we perform.

But what I would like to say is whether or not you would agree with the current track of the Government here with respect to Iran, what we are witnessing in the private sector is a number of Americans at the local level, and most notably in the investment community taking, matters to some extent into their own hands via a form of what has been called, in the past, socially responsible investing, also termed values-based investing, based on their own opinions of what is going on in the world. In some cases, where American policy and regulatory regimes can't reach, these investors are taking actions with respect to U.S. and foreign companies doing business in Iran, taking a look at exactly what they are doing there and deciding for themselves whether or not they want a part of it. And in some cases, they are screening out these companies altogether. And I think that is becoming an element in the international dynamic as that community grows.

Dr. Schott. As in the first panel, Mr. Hinchey, you have put your finger on the key question: Is U.S. policy making things better or moving us toward meeting U.S. objectives, or is it making things worse? And I strongly disagree with some of the commentary on this panel that we haven't had a policy. We have had a very clear policy dealing with a very difficult and volatile situation.

The policy started, as you rightly mentioned, back in the 1970s when we played Iranian politics the wrong way, ended up in the hostage crisis, and we used economic sanctions very intensively and ultimately somewhat successfully to provide bargaining chips to get our people home after 440 days.

But that created a sense of tension and animosity that carried over. Clearly, the Iranians had the capability to export their adventurism, and they did so, and that led to the sanctions regime starting in 1984.

That was manageable. We followed a policy of containment as opposed to a policy of military response. And given the situation in the Middle East, given the lack of strong multilateral support back in the 1980s and the 1990s, and even today, it probably was the best of a bad set of options to follow.

Any containment policy is going to have tensions among domestic groups. There is going to be cheating. There is going to be those who say, well, we have military means, let's use them, though it is hard to figure out what the next step will be after you begin a military response, even if it is a limited bombing raid.

And so the policy of containment in the 1980s—and essentially that has been the policy under ILSA, to limit the growth of the Iranian industry—has been successful. Iran still produces about the same amount of oil, but it hasn't been able to take further advantage of its natural resources.

We now have a much more difficult international environment in which to pursue our policy. The global oil supply demand balance is very tight, and that has contributed to the financial windfall that the Iranians now benefit from that gives them a lot more margin of flexibility for pursuing domestic and international policies.

It also, as I said in my statement, ends up constraining the impact of economic coercion against them. That is why I think we have to continue a policy of containment. I think we can try to sharpen it in some areas, the narrowly targeted areas of componentry and technology useful for the nuclear industry, so that we lengthen the period of time, and hopefully the global environment both economically and politically will allow us to begin to work more closely with the future Iranian government, as the policy dialog began to improve a few years ago, as Dr. Katzman said.

But sanctions are not going to be a magic bullet to solve our problems. There is a wide range of problems in the Middle East related to economics and politics that pull against a coordinated international action and I don't think we are going to see that from the Russians, the Chinese, or the Japanese in the future. They will help us a little, but you will get the type of bland statements you got out of St. Petersburg 2 weeks ago.

Representative Saxton. Thank you very much.

Mr. Hinchey, thank you for hanging in here with us.

Representative Hinchey. I thank you, Mr. Chairman, for holding this hearing, and thank these gentlemen. The insight that you all provided I find very, very valuable.

If I could just ask one last brief question, Mr. Chairman.

Representative Saxton. If it is very brief.

Representative Hinchey. Could you supply me a list of those 20 companies that violated the ILSA?

Dr. Davenport. I will do my best. I will be in touch with your office and talk with my guys.

Representative Saxton. In wrapping up here, we started this discussion a couple of hours ago to focus on the economics of the oil industry and Iran and what we can do to influence policy there, and perhaps it was a natural thing that we didn't focus on the ideology that is driving all of this. It just seems to me that a mention of that at this point might be worthwhile. It is obviously an ideology which the regime is intent on spreading. From my point of view, much of what is going on in Iraq today has directly to do with this. Much of what is going on in Syria today has a lot to do with this. Much of what is going on in Lebanon and northern Israel today is directly influenced by the policies of the Iranian regime and the other parts of the world as well.

The second thing I would just like to point out is, as I briefly mentioned earlier, it seems to me that there is a new or different attitude being expressed by various governments in the Middle East, including and perhaps not limited to Saudi Arabia and Egypt and Oman and Qatar and Bahrain and other countries that are less than anxious to be influenced by this ideology. And that perhaps as much as anything else that I have heard here today should be viewed by us and our Government as an opportunity to build with our friends, with moderate Middle Eastern countries, if you will, to try to counteract what we have been here talking about for the last 2 hours or so.

So thank you for sharing these perspectives with us. I think it has been extremely helpful to those of us who have attended today.

[Whereupon, at 12:05 p.m., the Committee was adjourned.]

Submissions for the Record

CONGRESS OF THE UNITED STATES

JOINT ECONOMIC COMMITTEE

CHAIRMAN JIM SAXTON

PRESS RELEASE

For Immediate Release
July 25, 2006

Press Release #109-86
Contact: Christopher Frenze
Executive Director
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OPENING STATEMENT OF CHAIRMAN JIM SAXTON

ENERGY AND THE IRANIAN ECONOMY

It is a pleasure to welcome Mr. Simons and the members of our second panel of witnesses before the Committee today. Given the course of events in the Middle East, this hearing on energy and the Iranian economy is very timely.

Iran is a country with immense wealth in the form of oil and gas reserves. Iran has the third largest oil reserves and second largest natural gas reserves in the world. Unfortunately, despite the country's great economic potential, the government of Iran has adopted policies that have undermined the country's economic development and standard of living.

Despite Iran's huge reserves of oil and gas, the Iranian regime is intent on extending its nuclear program, supposedly for peaceful purposes. However, the regime's deception regarding its nuclear program, its aggressive promotion of terrorism, and its president's recent statements concerning Israel, obviously constitute a grave threat to world peace. The facts before us today concerning Iran's large energy reserves undercut assertions by the Iranian regime that its nuclear program is needed for peaceful nuclear power generation.

Iranian leaders have also sought to intimidate oil consuming nations by threatening to cut off Iranian oil exports. However, Iranian oil exports generate a high percentage of Iranian export earnings and finance a significant portion of government spending. In short, the Iranian government and economy are highly dependent on oil exports, and threats to cut off these oil exports are not very credible.

The Iranian economy labors under a heavy burden of government mismanagement, cronyism, and corruption facilitated by government affiliated foundations and enterprises. The Iranian people pay a high price for the failures of the regime's economic policies, but the prospects for reform of these policies are bleak in the near term.

In view of the Iranian regime's aggressive behavior, the feasibility of sanctions against the regime must be considered. Iran's reliance on imported gasoline is one potential pressure point. However, the effectiveness of sanctions would depend on the willingness of a much broader group of nations acting in concert with the United States to contain Iran's threats. The coming weeks and months will reveal whether a broader attempt to impose sanctions will be tried and produce positive results.

JOINT ECONOMIC COMMITTEE

JIM SAXTON, CHAIRMAN

RESEARCH REPORT #109-31
March 2006

IRAN'S OIL AND GAS WEALTH

INTRODUCTION

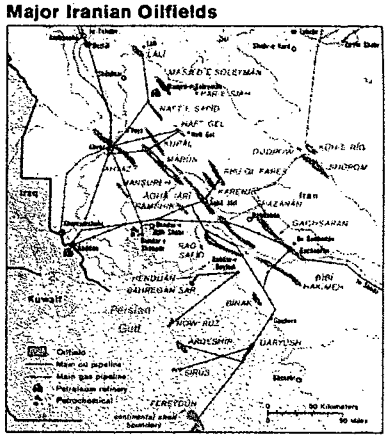
Iran's vast oil and gas resources undermine the Iranian regime's claim that its nuclear program is needed for domestic energy generation. Iran holds the world's third largest known oil reserves, 132.5 billion barrels, and second largest natural gas reserves, 971 trillion cubic feet, representing 10 and 16 percent, respectively, of the totals.[1] However, support for terrorism and economic mismanagement by the government have damaged oil and gas development in Iran. Specific impediments to development of these natural resources include:

- Membership in the OPEC cartel;
- Restrictive contracting practices;
- Threatening policies that provoke U.S. trade and investment sanctions; and
- State control of domestic energy prices.

IRAN'S OIL RESOURCES

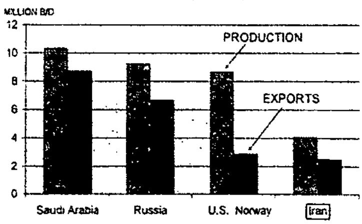
The map shows the largest of Iran's 40 producing oil fields (27 on- and 13 offshore), which, in terms of sulfur content and gravity, hold mostly mid-grade crude oil similar to that found in Saudi Arabia, Iraq, and Kuwait. Iranian crude generally sells for slightly less than the weighted average price of the OPEC "basket" of eleven crude oil grades.[2]

Major Iranian Oilfields



Only Saudi Arabia and Canada hold larger oil reserves than Iran, whereby most oil in Canada is in the form of oil sand and far more costly to extract. In oil production and exports Iran ranks fourth in the world; it produced 4.2 million barrels of oil per day (b/d) and exported 2.7 million b/d in 2005.

Figure 1 CRUDE OIL PRODUCTION, EXPORTS TOP FOUR COUNTRIES

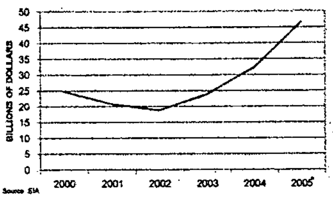


Source: EIA, 2004 Data.

[1] "Worldwide Look at Reserves and Production," *Oil & Gas Journal*, 103, 47 (12/19/2005): 24.
[2] Information supplied by the Energy Information Administration (EIA). African crude, for example, is lighter and hence more expensive. Since June 2005, the basket includes additional heavy crude oil grades, lowering the average price. EIA's "OPEC Revenues Fact Sheet" and "Country Analysis Briefs," are the sources for this report, unless otherwise noted.

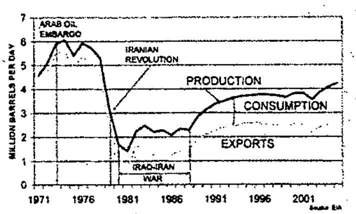
OPEC. Iran is a founding member of the Organization of the Petroleum Exporting Countries (OPEC) and participates in the cartel's restrictive output practices to drive up the price of oil on the world market. As the oil price has surged, Iran's net oil export revenue has reached record (nominal) levels, nearly doubling from $23.7 billion in 2003 to $46.6 billion in 2005.

Figure 2 IRAN'S NET OIL EXPORT REVENUE



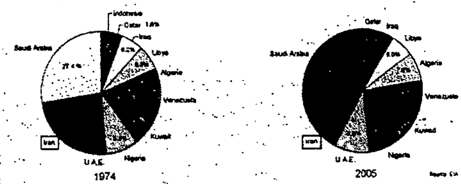
Eighty to ninety percent of Iran's export earnings come from oil. Boosted by oil, Iran's real GDP grew 4.8 percent in 2004 and 5.6 percent in 2005. But, Iran's rate of oil production and its share of OPEC's oil output are much lower than they were prior to the Iranian revolution and the subsequent war with Iraq. Oil production did increase after the war but is only now approaching the level of 35 years ago. Iran's share of OPEC production was 12.5 percent in 2005 compared to 19.8 percent in 1974.

Fig. 3 IRAN'S CRUDE OIL PRODUCTION & EXPORTS



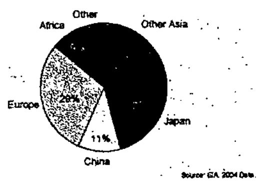
Lagging oil exports. Iran's oil consumption has been increasing substantially and claims 36 percent of production while its oil exports remain barely at half the peak rate of 1974. As Iran's oil production and exports declined, OPEC—whose output slightly exceeds its peak rate in the 1970's—reduced the output quota it assigns to Iran. Since 1990, OPEC has kept the quota at a rate between 3 and just over 4 million b/d. Iran thus accounts for a much smaller share of OPEC oil exports than it once did. Figure 3 compares the cartel members' relative shares of net oil export revenue in 1974 and in 2005. The EIA's estimate of 2005 OPEC revenue is $473 billion.

Figure 4 OPEC REVENUE SHARES



Fifty-six percent of Iran's oil exports are to Asia and 29 percent to Europe. Japan and the People's Republic of China (PRC) together buy over one-third of Iran's oil exports. The U.S. buys no oil from Iran (other than specially licensed swaps for Caspian oil).

Figure 5 IRAN'S OIL EXPORT DESTINATIONS



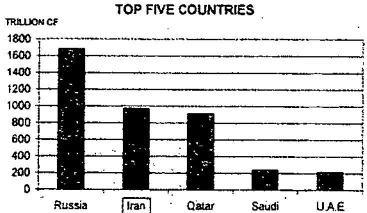
By comparison, 64 percent of all Mid-East oil exports are shipped to Asia, 16 percent to Europe, and 13 percent to the U.S.[3]

[3] Inter-area movements 2004, BP Statistical Review of World Energy, June 2005.

IRAN'S GAS RESOURCES

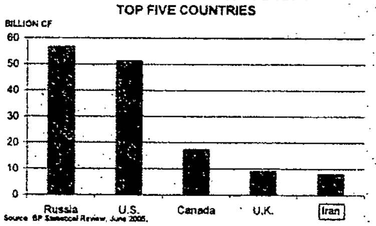
Only Russia holds more natural gas than Iran, and only one other country, Qatar, holds nearly as much gas as Iran, as Figure 6 shows. But, 62 percent of its natural gas reserves have not yet been developed.

Figure 6 NATURAL GAS RESERVES TOP FIVE COUNTRIES



Iran ranks only fifth in the world in natural gas production and produces far less gas than Russia, not only in absolute terms but also in proportion to its reserves.

Figure 7 NATURAL GAS PRODUCTION PER DAY TOP FIVE COUNTRIES



OPEC's output quotas do not extend to natural gas, and Iran's gas production has more than doubled in the last ten years, albeit from a low base. The South Pars gas field in the Persian Gulf is part of the largest natural gas deposit in the world and is shared by Iran and Qatar (whose portion is called the "North Field"). Developing South Pars is Iran's single largest energy project, which already has attracted more than $15 billion in investments and has 18 active of 28 planned development phases.

<u>Minimal gas exports</u>. Natural gas now accounts for close to half of Iran's total energy consumption; its consumption of gas ranks fifth in the world. Iran imports natural gas from Turkmenistan via a pipeline built in 1997 and exports gas to Turkey, its only gas export customer. A natural gas pipeline to Turkey was completed in 2002, but there is a dispute between the two countries over price and purchase volume. Iran may be a net importer of gas.[4] It has signed multiple agreements with other potential gas customers, including Armenia, India, Pakistan, the PRC, and European countries, but concrete progress appears slow. In order to export natural gas on a large scale, Iran needs to build additional pipelines far beyond its borders and/or construct liquefied natural gas (LNG) facilities, of which it has none at this time. The potential for LNG exports has caused internal debate in Iran over the priorities of competing uses for natural gas.[5] Meanwhile, other Persian Gulf countries have moved ahead of Iran in positioning themselves for LNG exports.

CONFLICTING PRIORITIES

<u>Buy-back contracts</u>. Iran's restrictive petroleum law was loosened recently but remains a hindrance to foreign investment.[6] Along with Saudi Arabia, Iraq, and Kuwait, Iran is one of the Persian Gulf's "Big Four" oil nations enjoying the highest well flow rates and the lowest unit cost in the world, less than $2 per barrel.[7] However, investments in the billions of dollars are a prerequisite to

[4] The BP Statistical Review shows Iran's natural gas consumption exceeding production in 2004, 8.4 versus 8.2 billion cubic feet per day (bcfd).
[5] Gas can be used for domestic consumption, export, and re-injection into oil fields to raise underground pressure; see "Gas Use at Issue in Iran as Oil Production Sags," by Judy Clark, *OGJ*, 103, 18 (5/ 9/ 2005): 34.
[6] International Petroleum Encyclopedia 2005, PennWell Corp., p.149.
[7] Thomas R. Stauffer, "The Economic Cost of Oil and Gas Production: A Generalized Methodology," *The OPEC Review* 28, 2 (June 1999): 192.

production. Iran imposes so-called buy-back contracts on investors that compensate them through allocations of oil production on a relatively short-term, profit limiting basis. Oil field operations must be turned over to the National Iranian Oil Company (NIOC) when the contracts expire.

U.S. Sanctions. Since 1995, in response to Iran's support of terrorists and pursuit of nuclear technology, the U.S. has banned investment in and trade with Iran by executive order. In addition, the Iran-Libya Sanctions Act (ILSA) subjects foreign companies to sanctions, if they invest more than $20 million in Iran's energy sector. While a key waiver in the case of the South Pars gas field was granted, ILSA is believed to have limited Iran's oil production capabilities.[8] Also, most LNG plants use technology developed by U.S. companies, which could hinder Iran's progress in this field.

Large imports of gasoline. Domestically, Iran sets low prices for oil products and natural gas. A gallon of gasoline sells for less than 40¢. Low prices and an increase in population since 1980 from 40 to 68 million people have pushed Iran's gasoline consumption beyond its refining capacity. Motor gasoline consumption has increased by nearly 13 percent annually from 2000 to 2004, resulting in an estimated 170,000 b/d of gasoline imports last year. On a net basis, Iran's gasoline imports rank second in the world. Its import bill for gasoline is running at $3 to $4 billion per year. An estimated 25 percent of Iran's gasoline imports come from Persian Gulf countries, 15 percent from India, and the remainder from a variety of sources, including France, Turkey, Singapore, the Netherlands, and the PRC. Iran is a net exporter of refined products in total, based on shipments of residual fuel oil.

Diverse pursuits. Iran wants to raise its oil production to 5 million b/d by 2010; it has aspirations to expand the Caspian oil and gas trade and has made outsized claims for a stake in offshore fields. It wants to increase refining capacity from 1.47 to as much as 2.2 million b/d by 2008. It plans to convert 1.5 million motor vehicles to compressed natural gas (CNG) and install 700 CNG filling stations by the 2009 to 2011 timeframe.[9] It has announced new projects in exploration, pipelines, LNG, and petrochemicals. Well known are its nuclear ambitions. But, prospects in the Caspian Sea seem far off. Major producing oil fields are in decline—the rate of recovery in existing fields is 8 to 11 percentage points less than the world average—and there are doubts the country can even sustain its current production.[10] Iran is mired in slow-moving negotiations with an array of foreign companies, and it has drawn the ire of the world over its nuclear program.

CONCLUSION

Iran has an enormous energy output gap: the reserve-to-production ratio of, say, Russia for natural gas applied to Iran would yield 33 bcfd of gas production and for crude oil would yield 20 million b/d of Iranian oil production—4 and 4.8 times, respectively, its current rates of output. Iran is centrally located between European and Asian energy markets and is courted by eager buyers of oil and gas. Yet the regime insists on aggressive politics, pursues threatening nuclear technology, manipulates the international oil price through OPEC, and drives a wedge between energy demand and supply at home by limiting consumer prices while impeding foreign investment. Iran does not need nuclear energy; it needs to reconnect with the world, realign its disjointed priorities, and develop its vast oil and natural gas resources.

[8] See CRS Reports RS20871, "The Iran-Libya Sanctions Act (ILSA)," 4/19/2005, and RL32048, "Iran: U.S. Concerns and Policy Responses," 1/20/2006, by Kenneth Katzman. In 2001, the ILSA was extended to August 2006.

[9] Petroleum Encyclopedia, p. 149.

[10] Iran's crude oil output fell slightly in December 2005 and January 2006, as did OPEC's, according to Platt's *Oilgram News*, 84, 30 (2/14/2006).

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CHAD STONE
STAFF DIRECTOR

Opening Statement
Senator Jack Reed
Joint Economic Committee Hearing
July 25, 2006

Thank you, Chairman Saxton. I want to welcome both panels of experts and thank them all for testifying here today.

As we monitor the diplomatic developments surrounding the nuclear standoff with Iran—and as the current conflict between Israel and Hezbollah continues to destabilize the region—this hearing on energy and the Iranian economy is indeed timely.

Iran has recently enjoyed strong economic growth—primarily due to high oil prices. Despite some progress in reforming certain aspects of its economy, the Iranian economy continues to suffer from significant structural weaknesses. First, its heavy reliance on oil revenues makes it extremely vulnerable to oil price shocks. Second, entrenched political interests impede substantive economic reform. Lastly, the country continues to rank poorly on various indicators of foreign investment risk.

Such vulnerabilities lead some observers to conclude that the United States and its allies may have some leverage—primarily through sanctions, possibly backed up by the threat of military action—in convincing Iran to abandon any nuclear weapons ambitions.

However, oil prices are expected to remain high at least through 2007 and with a global oil market Iran will always find alternative customers in countries that are willing to violate sanctions to advance their own interests. Even if Iranian oil exports were to slow somewhat, the higher prices that resulted would, at least temporarily, cushion the revenue impact. And Iran's vast energy reserves promise that the country will remain attractive to foreign investors.

Russia and China recently signed on with the U.S. and its European partners in seeking a United Nations Security Council resolution ordering Iran to freeze its nuclear program, or face possible sanctions. To be truly effective on their own, sanctions must target the oil exports that are central to the Iranian economy. Given tight oil supplies, however, it is highly unlikely that all six negotiating partners would ultimately agree to such comprehensive economic sanctions. In fact, a decade's worth of experience with the Iran Libya Sanctions Act or "ILSA"—which was implemented during a period when oil was relatively cheap and plentiful—suggests our allies' reluctance to further rattle the global oil market. Further, both Russia and China have indicated they will not support military action against Iran.

The experience with U.S. sanctions against Iran suggests that a unilateral approach simply will not work. U.S. sanctions have not prevented Iran from developing what International Atomic Energy Agency (IAEA) inspectors believe to be a potential military dimension to its clandestine nuclear program, or from continuing to sponsor terrorist organizations such as Hezbollah and Hamas. Some analysts believe that U.S. sanctions have done more to isolate the United States than to isolate Iran.

Rather than taking a unilateral approach, the U.S. must continue to work with the U.N. community. If universal, comprehensive economic sanctions are not feasible, we must focus on a more effective mix of targeted sanctions that our negotiating partners can agree to. Targeted sanctions may not cripple the Iranian economy to the point where it is financially incapable of developing a nuclear weapon. However, coupled with concerted diplomatic efforts, the right mix of sanctions has the potential to convince Iran to abandon any nuclear weapons ambitions it may harbor.

I look forward to the testimony of our witnesses here today. In addition to hearing about the state of the Iranian economy and its energy sector, I hope to discuss ways in which sanctions could be effectively applied, preferably as part of a multilateral diplomatic effort involving the U.N. and the IAEA.

PREPARED STATEMENT OF HON. PAUL SIMONS, DEPUTY ASSISTANT SECRETARY FOR ECONOMIC AND BUSINESS AFFAIRS, DEPARTMENT OF STATE

Mr. Chairman, distinguished Committee members, I am pleased to be here today to testify on "Energy and the Iranian Economy."

Iran is an important country from a number of perspectives, and has a particularly significant place in the international oil and gas domain. But Iran is also a country whose policies and actions have long been cause for deep concern. Given its pursuit of weapons of mass destruction and missile delivery systems, its place as the leading state-sponsor of terrorism, its support for violent opposition to Middle East peace, its unhelpful role in Iraq, its oppression of its own citizens and abysmal human rights record, Iran poses, as Under Secretary Burns recently said, a profound threat to US interests.

Iran's concerted effort to develop a nuclear weapons capability has become the focus of particular concern, not only for the US but for the international community, as reflected in the resolution adopted in February by the International Atomic Energy Agency (IAEA) Board of Governors, and in the March statement by the United Nations Security Council (UNSC). On June 6, the governments of the US, UK, France, Russia, China, and Germany—referred to as the P5+1—offered Iran a set of far-reaching proposals that presented Iran with a clear choice between two paths: One path leads to important benefits for the Iranian people, if Iran suspends all enrichment-related and reprocessing activities and enters into negotiations on the basis of the P5+1 offer. The Secretary has made clear that the United States would be willing to join the negotiations if Iran fully and verifiably suspends its enrichment program.

If Iran chooses the other path and continues on its current course, it will face greater international isolation and strong U.N. Security Council action. Iran has failed to take the steps needed to allow negotiations to begin, specifically the suspension of all enrichment-related and reprocessing activities. Absent such a positive, concrete response from the Iranian government, we and our international partners have no other choice than to return to the U.N. Security Council to adopt a resolution which would make suspension mandatory.

THE IMPORTANCE OF ENERGY

Let me turn to energy matters. Iran is the world's second largest holder of natural gas reserves (after Russia), with an estimated 940 trillion cubic feet of gas available, and it ranks second or third (the Iranians claim 132 billion barrels) in conventional oil reserves. (While there is no doubt that Iran's oil and gas reserves are substantial, the opaque nature of the Iranian energy sector makes it difficult if not impossible to independently verify the figures it claims.) With a capacity of just over 4 million barrels per day (bpd), Iran is OPEC's second largest oil producer and second largest exporter (about 2.6 million bpd).

What is striking, however, is the fact that Iran is not as prominent a player on the international oil and gas scene as its geological potential would suggest. Despite its huge gas reserves, Iran is actually a gas importer (from Turkmenistan). At present, it exports gas only to Turkey and to the small Azerbaijani exclave of Nakhichevan, with imports and exports roughly balancing. A project for a gas pipeline to Pakistan and India has long been a subject of study and discussion, but thus far of little concrete action. Notwithstanding its central location, Iran has not developed into a hub for international oil or gas pipeline development.

LNG has also been a focus of discussion and negotiation, but at present, no LNG facilities exist and none are under construction. This contrasts with the situation in Qatar, Iran's small neighbor on the other side of the Gulf, whose North Field shares a reservoir with Iran's South Pars field. Qatar's liberal investment regime, secure political climate, and strong relationship with the US have attracted massive foreign investment and enabled Qatar to leap far ahead of Iran in developing LNG and other gas projects. At just above 4 million bpd, current oil output in Iran is significantly less than the approximately 6 million bpd Iran produced prior to the 1979 revolution; production has increased in recent years, but not by a great deal (it was about 3.8 million bpd in the mid-90s). New production has been largely offset by the natural decline (estimated at 8 to 13 percent per year) in the output of older fields, while rising consumption squeezes exports.

ENERGY POLICY

Iran has expressed its intention to expand its production of both oil and gas. Plans have been announced to increase oil production to 5 million bpd in 2010 and 8 million bpd in 2015. But Iran's efforts to attract foreign investment through "buy-back" deals, initiated in 1995 in a reversal of post-Revolution policy, have met with only limited success. Foreign investment in this sector appears to be slowing, due in part to a strong perception of heightened political and financial risk in dealing with Iran. In addition to the discouraging impact of Iran's problematic policies, including its pursuit of nuclear weapons which has raised the possibility of international sanctions, international companies have found it increasingly difficult to reach agreement with Iranian negotiators on project terms that are economically attractive. US measures and policies, including ILSA (the Iran and Libya Sanctions Act), have also contributed to the negative business and investment climate that prevails today for Iran. Foreign involvement in the oil and gas sector also remains a politically charged issue in Iran. Most current oil production in Iran comes from fields developed and operated by Iranian entities;

Iranian refining capacity is inadequate to meet the demand for most petroleum products, particularly gasoline, and the Energy Information Administration (EIA) estimates that Iran will spend more than $4 billion on product imports this year. Prices are fixed well below international market levels (gasoline costs about 9 cents per liter), which inevitably spurs demand and makes smuggling to other countries profitable. Price increases have proven politically unacceptable, and proposals for rationing are meeting opposition.

THE IRANIAN ECONOMY

There are some positive indicators in the Iranian economy: recent IMF estimates for fiscal year 2005 put GDP growth at 6 percent. Iran's foreign exchange reserves are estimated at $47 billion, excluding gold—about 10 months worth of imports at the 2005 level. The IMF also estimates a budget surplus for 2005/2006.

But despite the advantage of recent high oil prices, there are also very significant negatives in the economic picture, including high rates of inflation and unemployment. For 2005, official inflation and unemployment rates were both in the double digits at 13 percent and 11 percent respectively. Iran's stock market dropped sharply in 2005/06, losing 20 percent of its value (though the stock market is not a major factor in Iran's overall economy). The Iranian economy also remains heavily dependent on the output of a single sector, with petroleum export revenues, estimated at nearly $45 billion last year accounting for 80 to 90 percent of Iran's foreign exchange earnings and more than 10 percent of GDP. According to the EIA's January 2006 report, Iran's major customers for oil are Japan, China, South Korea, Taiwan, and Europe.

NUCLEAR PROGRAM

Iran's formerly secret efforts to develop a complete nuclear fuel cycle included uranium mining and milling, uranium conversion, gas centrifuge enrichment, laser enrichment, construction of a heavy water production plant, a heavy water reactor, and plutonium separation experiments. Iran claims it is seeking an indigenous nuclear fuel cycle, including the capability to make fissile material, for nuclear energy purposes only. Iran has also claimed that its nuclear activities will provide energy security and independence. However, Iran's limited uranium reserves would not give Iran nuclear energy independence and the costs to Iran of manufacturing fuel indigenously would far exceed the price at which fuel could be purchased on the international market. As noted, Iran also has huge reserves of natural gas, which if developed would represent a significant energy resource. If recovered, flared natural gas in Iran would be sufficient to generate over 4000 megawatts of electricity, equal to four Bushehr-capacity power plants.

Bushehr is the only power reactor under construction in Iran. Bushehr, a VVER (from the Russian acronym for water-cooled, water-moderated) 1000, 1000 megawatt light water reactor, is nearing completion. Iran still lacks the know-how and facilities to manufacture the requisite reactor fuel for Bushehr. Russia has agreed to supply fuel for this reactor, and to take back the spent fuel, but has not delivered fuel.

The August 2005 offer from the EU–3 (the UK, France, Germany)—which Iran rejected—included future European assistance to support an expanded, safe, safeguarded nuclear power program. The June 6, 2006 package of incentives offered by the P5+1 governments includes an offer to cooperate with Iran in the development of a civilian nuclear power program.

The P5+1 package reaffirms Iran's right to nuclear energy for peaceful purposes in conformity with Iran's obligations under the Nuclear Nonproliferation Treaty. The President and the Secretary have made clear that we do not seek to deny peaceful nuclear energy. However, Iran's long history of deception and noncompliance with its NPT (nonproliferation treaty) and IAEA safeguards obligations have created a loss of confidence in Iran's intentions.

As the President has said, civilian nuclear energy "is a legitimate desire. We believe the Iranian people should enjoy the benefits of a truly peaceful program to use nuclear reactors to generate electric power. So America supports the Iranian people's rights to develop nuclear energy peacefully, with proper international safeguards."

LOST OPPORTUNITIES

With its enormous natural resource endowments and talented people, Iran should be among the most prosperous countries in the world. But counterproductive economic policies, mismanagement, widespread corruption, and misguided goals such as the dangerous quest for nuclear weaponry, have dimmed Iran's economic prospects. Iran's economic problems reflect in some ways its negative political culture, with all the problematic manifestations I outlined earlier. As President Bush recently noted, Americans admire the rich history and vibrant culture of Iran, and its many contributions to civilization. "The people of Iran", the President has said, "like people everywhere, also want and deserve an opportunity to determine their own future, an economy that rewards their intelligence and talents, and a society that allows them to pursue their dreams." Thus far, those dreams have been sadly thwarted.

Prepared Statement of Dr. Kenneth Katzman, Specialist in Middle Eastern Affairs, Congressional Research Service, Library of Congress

Thank you, Mr. Chairman, for inviting me to appear at today's hearing. I request that the full statement be placed in the record, and I will summarize my remarks.

OVERVIEW OF IRAN'S POLITICAL ECONOMY

As a longtime analyst of the politics of Iran, I will primarily focus on the politics of Iran's economy. I want to preface my remarks by saying how difficult it is to obtain authoritative information on Iran's political economy. Iran is not an isolated country—it has relatively open trade with U.S. allies. However, Iran's economy is not transparent and there is no U.S. Embassy in Iran to follow Iran's economy and obtain authoritative information. The Iranian government has not, to date, allowed a CRS visit to Iran on the grounds that CRS is part of the U.S. Government.

In particular, I will discuss how key leaders and factions have gained a substantial measure of control over major segments of the Iranian economy, avoiding virtually any official transparency or accountability. Iran's leaders are able to steer the proceeds of parts of the economy to provide patronage and build their constituencies, particularly among the lower classes. Because Iran's political leaders benefit from the structure of the economy as it is, there is little chance under the current system of major, structural economic reform.

The consensus of experts is that Iran's economy has improved substantially over the past 2 years, but that is primarily the result of increased oil prices and masks underlying weaknesses that would likely be revealed were oil prices to fall significantly. Oil revenues account for about 80–90 percent of Iran's export earnings and almost 50 percent of the government budget. The IMF, the World Bank, and outside experts say that Iran has pursued only limited structural economic reform and that Iran needs to reform its financial sector and privatize state-owned industries, and further liberalize trade regulations. As is also true of other countries in the region and throughout the developing world, some reforms are blocked by powerful political interests, and others are not implemented because of fear of mass unrest. In the case of Iran, some of its economic difficulties have been caused by the ideology of the Islamic revolution of 1979, which propounded self-sufficiency and an end to Iran's dependence on and perceived manipulation by great powers.

Energy Subsidies. As one example of Iranian mismanagement of its energy sector, Iran heavily subsidizes gasoline costs to consumers. Gasoline costs only about 40 cents per gallon in Iran, and the Majles (290-seat elected parliament) has consistently rejected proposed legislation to reduce the gasoline subsidy because doing so would result in higher prices, which could spark unrest. Iran's refining capacity is sufficient to fulfill only about 60 percent of the gasoline consumption of Iranian consumers, and the remainder is purchased from nearby sources (including India and Kuwait) on the open market. As a result, Iran's government is currently spending an estimated $5 billion per year to import refined gasoline, and the funds have been derived by drawing down on Iran's foreign exchange reserve fund. It is a large increase over the amounts spent in previous years—about $1.5 billion per year. Most experts believe that Iran should eliminate the gasoline subsidy in order to reduce domestic demand, in part by encouraging use of public transportation. In addition, according to press accounts, Iran's per-vehicle gasoline consumption is relatively high because many of its vehicles are older-model and not fuel efficient.

Inefficient Social Welfare Policies. A 2003 World Bank assessment notes that the Islamic regime has pursued a "social justice" policy since it took power in 1979.[1] The official welfare effort has succeeded in reducing the proportion of the population below the poverty line from 47 percent in 1978 to 19 percent in 2003. The regime has also closed a gender gap in education (even though the regime is perceived as repressive of women), and it has instituted universal education and extensive health care coverage.

Over 7 million Iranians (about 10 percent of the population) benefit from the government's officially sanctioned social welfare network. The main official relief agencies are the Welfare Organization and the Imam Khomeini Relief Committee. They are overseen by the Ministry of Welfare and Social Security. The Imam Khomeini Relief Committee is said to assist as many as 7 million Iranians with basic foods. The Welfare Organization, as well as the Committee, provides social welfare services to women-headed households as well as other recipients. The Ministry of Welfare and Social Security has set up some 7,000 job centers for women heads of households, providing vocational training among other services. Other ministries that oversee or give out social welfare benefits are: the Ministry of Housing and Urban Development; the Ministry of Agricultural Jihad; and the Ministry of Labor and Social Affairs.

However, the government's social welfare strategy includes the provision of implicit subsidies, not only for gasoline but also for medicines, bread, and other goods. The World Bank calls these subsidies "untargeted and ineffective" and not disproportionately benefiting the poor. Much of the benefit of subsidies goes to Iranians who are middle class or even affluent. For example, the Imam Khomeini Relief Committee also provides marriage dowries, as well as education assistance to about 600,000 students, including university scholarships. These benefits do not necessarily go to Iranians who are below the poverty line. In addition, according to critics, the government is trying to eliminate poverty through handouts and charitable transfers rather than by generating employment. The Bank recommends that Iran should shift away from untargeted subsidies to more targeted subsidies that benefit the genuinely poor.

Quasi-State Foundations (*Bonyads*). Part of this inefficiency might be a result of the politics of Iran's social welfare system. As discussed below, many Iranians receive benefits not only from the "official" social welfare network but also from an informal charitable network. The core of the informal network is the quasi-official "foundations" (*bonyads*) described below. These organizations are controlled by key clerics and other former or current government officials. The *bonyads* are technically not under the authority of the Ministry of Welfare and Social Security, and therefore the *bonyads'* criteria for deciding who should receive social welfare is often arbitrary, according to many observers, explaining why some Iranians who are not truly needy receive benefits. Those needy Iranians who are not well-connected or who are perceived as unsympathetic to the regime might often not receive social welfare benefits. By contrast, the official social welfare system overseen by the Ministry of Welfare and Social Security do have clear criteria and clearly stipulated benefits, for example for unemployment compensation, old age pensions, disability pensions, survivor benefits, and medical benefits.

The *bonyads*, which are said to account for an estimated 33–40 percent of Iran's total GDP, also distort normal market forces in Iran. Some of them have existed for centuries as custodians of Shiite holy sites in Iran, and, since the 1979 revolution, have come to enjoy significant economic and political privileges. Several of the *bonyads*, the heads of which are appointed by Supreme Leader Khamene'i, control vast assets given to them by the state. Combined, they are said to employ as many as 5 million Iranians and give social welfare to perhaps several million more. These figures indicate that the *bonyads* have a large constituency and are able to build support for the regime among the working and lower classes.

Their privileges are vast, by all accounts. According to the World Bank study in 2001, the *bonyads* enjoy virtual tax exemption and customs privileges, preferential access to credit and foreign exchange, and regulatory protection from private sector competition. Using these preferences, some of the major *bonyads* have been able to carve out virtual monopolies in the import and distribution of several categories of items. Several of the *bonyads* are headed by former or current major figures of the regime, largely explaining their exemption from substantial official oversight.

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[1] World Bank Report No. 25848–IRN. Iran: Medium Term Framework for Transition. April 30, 2003.

The most controversial allegation about the *bonyads* has been whether or not their funds have been used to procure weapons of mass destruction (WMD) technology. This allegation has long surrounded the largest *bonyad,* the Foundation for the Oppressed and Disabled (discussed further below), primarily because this bonyad has been run by hardliners and former officials of the Revolutionary Guard (example, Mohsen Rafiq-Dust, a former Minister of the Revolutionary Guard). The theory underlying the allegation is that the *bonyads,* because they are not formally part of Iran's government, can operate outside official scrutiny of foreign governments, and could therefore illicitly procure equipment that might not be approved for export to Iran. During an official visit to Dubai in 1995, observers at the US consulate there told me that Foundation employees were present in significant numbers in Dubai, holding large quantities of cash which they were using to procure technology from Russian and other arms and technology brokers in the emirate. Others, however, put forward a less alarmist view of the Foundation's activities, saying that Foundation officials carry cash for the purpose of obtaining better pricing on purely civilian goods such as household appliances and paper goods.

Some sources say there might be as many as 123 different *bonyads* in Iran, but most experts focus only on the largest and best known of them. The major *bonyads* are the following:

- The Foundation for the Oppressed and Disabled (*Bonyad Mostazafin va Janbazan*). The largest and most important of the *bonyads,* it took over much of the assets of the former Shah and his associates who fled Iran after the Islamic revolution. It is headed by Mohammad Forouzandeh, the chief of staff of the Revolutionary Guard in the late 1980s and later Defense Minister. It now manages over 400 companies and factories, with a total value estimated by Iranian experts at as much as $12 billion, and it is considered the largest economic entity after the government.[2] The Foundation is active in the following sectors: food and beverages, chemicals, shipping (Bonyad Shipping Co.), metals, petrochemicals, construction materials, dams, towers, farming, horticulture, animal husbandry, tourism, transportation, hotels (including two major hotels in Tehran), commercial services, and financing. It produces the best selling soft drink in Iran, called Zam Zam. The Foundation uses the profits from these ventures to assist 120,000 families of veterans and victims of the 1980–88 Iran-Iraq war, as well as large segments of the poor.
- Martyr's Foundation (*Bonyad Shahid*). This foundation also assists families of those killed or maimed in the Iran-Iraq war. It owns several companies involved in mining, agriculture, construction, and import-export.
- The Shrine of Imam Reza Foundation. Based in Mashhad in northeastern Iran, it used donations from 8 million pilgrims to the Shrine of Imam Reza to buy up 90 percent of the arable land in its area. The estimated value of this land could be as high as $20 billion. The largest employer in Khorasan Province (Mashhad is its capital), the Foundation runs 56 companies, including a Coca-Cola factory and two universities, and it is said to have diversified also into automobile manufacturing. It is headed by Ayatollah Abbas Vaez-Tabasi, who is on the powerful Expediency Council that is headed by former President Akbar Hashemi-Rafsanjani. Vaez-Tabasi's son is married to a daughter of Supreme Leader Khamene'i.
- The Noor Foundation. It reportedly imports sugar, pharmaceuticals, and construction equipment, and has substantial real estate holdings. It is headed by Mohsen RafiqDust, the first Minister of the Revolutionary Guard and who later was head of the Foundation of the Oppressed. RafiqDust is on the Expediency Council.
- 15 Khordad Foundation. In 1989, it offered $1 million to anyone who killed Salman Rushdie, author of the Satanic Verses that Ayatollah Khomeini called blasphemous. The Foundation is named for the date in 1963 when Khomeini began revolutionary activities against the then Shah.
- Housing Foundation (*Bonyad Maskan*). This foundation was set up in the months after the February 1979 Islamic revolution to provide housing for the poor, particularly in rural areas.
- Ahl al-Bayt Foundation. Said by observers to be run by younger-generation clerics.
- Isargaran Foundation. Said to be controlled by ex-Revolutionary Guard officers, it provides services to the families of those killed or taken prisoner in the Iran-Iraq war.

The Cooperatives. The so-called "cooperatives" are another sector of the economy that have come under the control of key elites. There is a Ministry of Cooperatives that, in theory, oversees the operations of cooperatives. However, in practice, the larger cooperatives are run by allies or relatives of regime heavyweights and therefore the Ministry's oversight powers are limited.

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[2] The IMF estimated its value at $3.5 bilion in 2000.

The most well known cooperative, and which exemplifies the privileged status of these organizations, is the Rafsanjan Pistachio Growers Cooperative. It is run by the cousin of former president Akbar Hashemi-Rafsanjani, who is chairman of the powerful Expediency Council. The cooperative claims to represent over 70,000 pistachio farmers. The pistachio export industry in Iran is valued at an estimated $746 million. Rafsanjani's older brother, Ahmad, headed the Sarcheshmeh copper mine complex, although he is now retired. The control over these sectors has given Rafsanjani substantial opportunities for patronage, although obviously his wealth did not prevent his loss in the 2005 Presidential election. Some believe it was partly his wealth that caused his defeat because he is viewed as corrupt and less in tune with the interests of the lower classes than is Ahmadinejad.

The Revolutionary Guard. Some have noted that the Revolutionary Guard—the part of the armed forces that is most loyal to the clerical leadership—is playing an increasing role in the economy. President Ahmadinejad was a commander in the Guard during the 1980–88 Iran-Iraq war and his presidency is likely to only enhance the Guard's influence. Its motivations for expanding its economic role are apparently to provide rewards for senior officers, and to generate revenue to supplement the budget allocated to the Guard by the government.

The Guard has formed contracting firms to bid on government projects, using its strong political influence to win business. In one recent example, one of the firms owned by the Guard, called "Ghorb," is being awarded a $2.3 billion deal to develop two phases of Iran's large South Pars gas field. Most of the other phases have been awarded to well-known multi-national energy firms, and the work given to Ghorb had originally been awarded to Norway's Aker Kvaerner, but was retendered.[3] This suggests that the Guard exerted political influence to win the contract and take it away from what most industry experts would consider a more capable firm. Two years ago, the Guard briefly closed down the new international airport in Tehran to oust an Austrian-Turkish firm from some airport operations; those operations have now been taken over by the Guard.

THE POLITICS OF ECONOMIC REFORM

Many Iranian officials acknowledge the weaknesses of Iran's economy, and argue for reform. However, differences among Iranian leaders—in part caused by their different constituencies—undoubtedly has contributed to the relative deadlock on broad structural reform of the economy.

Some of the differences were exposed in the course of the 2005 Presidential election campaign, which resulted in the second round victory (June 24) of hardline Tehran mayor Mahmoud Ahmadinejad. He became the first non-cleric president since 1981. Ahmadinejad campaigned on a platform of redistribution of wealth to the poorer classes, rather than a growth-oriented strategy. He and his allies tend to favor an extensive state role in the economy, including state management of factories and other entities that can provide employment for the working classes. Since taking office, he has tried to implement those promises by proposing a "marriage fund" to provide monies to newly married couples, as well as increasing some pension and other social welfare payments run by the state. He also has authorized below-market rate lending and debt cancellation for farmers.[4]

As a former Revolutionary Guard officer himself, he is close to other former Guards and those who run the various *bonyads*, particularly the Foundation of the Oppressed and Disabled, and he supports their work in distributing social welfare to the poor. He does not favor eliminating the preferences that the *bonyads* enjoy because he depends on the *bonyads* to provide social payments to his core lower class base.

He is also less attracted than are other Iranian politicians to greater economic interaction with Europe and other Western countries, for example by joining the World Trade Organization[5] or reaching a free trade agreement with the EU (currently being negotiated). Ahmadinejad believes that his lower class constituents would not necessarily benefit from a more export-oriented, growth- oriented economy, and the lower classes generally do not buy European-made luxury goods that constitute a growing portion of Iran's imports.

Ahmadinejad's main competitor in the 2005 election, Rafsanjani, represented another pole in the debate over economic reform. Rafsanjani is a Khomeini disciple who has been a leading figure since the revolutionary regime was formed. As one

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[3] Kalantari, Hashem and Sally Jones. Iran Set to Award Lucrative Gas Deal to Elite Militia. *Wall Street Journal,* June 29, 2006.

[4] Diehl, Jackson. Deft Demagoguery in Iran. *Washington Post,* May 7, 2006.

[5] Iran applied to join the WTO in May 2005 when the Bush Administration dropped its nine-year-long objection to Iran's application

of Iran's richest men, Rafsanjani believes Iran would benefit from a free trade agreement with the EU that would open up big markets to increased volumes of Iranian exports.

Another large economic interest that carries substantial weight in Iran are the bazaar merchants ("the bazaaris"). The bazaaris control not only an important engine of Iran's economy—the import and export of goods, but several newspapers, including the well-known Resalat, are considered their mouthpiece. They also have the ear of Supreme Leader Ali Khamene'i, who has been supportive of the bazaaris throughout his career. The bazaaris and their allies tend to oppose a large role for the state in the economy. Like Iranian reformers, the bazaaris want increased trade with the West, because doing so would expand the market for Iranian goods. However, the bazaaris do not necessarily want a completely open trading regimen that might impinge on their privileged trading status. The bazaaris are also skeptical of increased foreign investment, because Western factories and companies might operate more efficiently than Iranian companies and compete effectively with the bazaaris. Some Iranians complain that the bazaaris try to control certain markets by acting in concert, such as jointly boycotting supplier companies to force them to make concessions.[6] Some experts refer to practices like this as "crony capitalism."

THE ENERGY SECTOR

Iran's energy sector is undoubtedly the most closely watched portion of the Iranian economy, because of the dependence of the economy on its revenues. Since the Islamic revolution, Iran's energy sector has been deteriorating primarily because of antiquated practices and equipment. Oil production fell from 6 million barrels per day (mbd) in 1974, when the Shah was in power, to about 3.9 mbd since the 1979 revolution. Of that amount, Iran exports about 2.4 mbd. Iran's proven oil reserves are about 128 billion barrels, about 10 percent of the world's total. Its natural gas reserves are even more noteworthy—about 940 trillion cubic feet, second only to those of Russia. In the mid 1990s, Iranian leaders acknowledged that halting the deterioration of the oil sector and developing the unexploited gas sector would require foreign investment by the world's major energy corporations.

To develop the energy sector, Iran has been able to work around its ideology to attract substantial foreign investment. In 1996, Iran first offered various onshore and offshore oil and gas fields to foreign investment under a "buy-back" arrangement, in which the investing firm(s) incur all development expenses and are paid back, plus given a fixed rate-of-return, from the proceeds of the field once it becomes productive. This arrangement enabled Iranian leaders to claim that they had not compromised Iran's sovereignty in allowing the foreign investment.

Iran's buy-back offer has attracted significant foreign investment, despite Congress' enactment in 1996 of the "Iran-Libya Sanctions Act" (P.L. 104–172). That law, extended for another 5 years in 2001, imposes sanctions on foreign companies that invest in Iran's energy sector. However, the Clinton and Bush Administrations have not imposed any actual sanctions on investing firms, perhaps causing foreign firms to minimize the importance of this U.S. law in considering whether or not to invest in Iran.

Since 1997, when the first foreign investments began under the buy-back plan, foreign companies have committed to at least $15 billion in foreign investment to develop about a dozen Iranian oil and gas fields. The earliest of the investments have begun production, and the more recent investments are under development and expected to begin producing oil and gas soon. Iran says that it expects these investments to increase its oil production to about 5 mbd by 2009, and 7 mbd by 2024.

Most of the natural gas produced by the new investments has been used for the domestic market or for re-injection to Iran's oil fields to boost production of oil, although it is exporting gas to Turkey through a joint pipeline. Iran is hoping to become a major gas exporter and, over the past year, Iran has signed a number of long-term (25 year) agreements with gas buyers, particularly in China and India. Iran is also in discussions with India and Pakistan for the construction of a natural gas pipeline that would link the three. The Bush Administration has publicly "expressed concern" about the pipeline, a stance consistent with U.S. policy of opposing energy routes that include Iran.

CONCLUSION

The current confluence of political interests and factions in Iran will likely prevent any substantive economic reform. The connections between the various

[6] Birch, Nicholas. In Iran, It Pays To Be a Religious Leader. Seattle Times, August 20, 2003.

bonyads, the Revolutionary Guard, and the upper reaches of the regime are too strong to permit curbing their influence in the economy. At the same time, the economic strength of the *bonyads* and the cooperatives translate into political strength for the clerics and politicians that run them. The income generated by these quasi-state economic conglomerates give the clerics substantial opportunity for patronage and keeps the Iranian public dependent on them for social welfare. On the other hand, these economic mechanisms are keeping Iran's poor fairly well sustained and, in the view of some, represent useful and necessary institutions even if they reduce the transparency of Iran's economy.

PREPARED STATEMENT OF ILAN BERMAN, VICE PRESIDENT FOR POLICY, AMERICAN FOREIGN POLICY COUNCIL

Chairman Saxton, Vice-Chairman Bennett, distinguished members of the Committee:

It is a privilege to appear before you today to discuss the subject of the Iranian economy and U.S. policy options.

There is no greater foreign policy challenge facing the United States today than the one posed by the Islamic Republic of Iran. The Iranian regime's persistent work on its nuclear program, and its intransigence in the face of international demands, has catalyzed a growing crisis that threatens international peace and security. So far, however, there has been little public discussion about the economic dimension of the current crisis, or of the financial levers available to the United States and its international partners to alter Iranian behavior.

WHAT FUELS IRANIAN INTRANSIGENCE?

More than any other factor, Iran's defiance in the current stand-off with the West over its nuclear program has been made possible by energy.

Over the past several years, the Islamic Republic has emerged as a bona fide energy superpower. Home to approximately 10 percent of world oil, Iran is the second largest exporter in the Organization of Petroleum Exporting Countries (OPEC), producing an average of 3.9 million barrels of oil per day. At the same time, Iran sits atop the world's second-largest reserves of natural gas (some 940 trillion cubic feet). As a result, Iran's economy is overwhelmingly energy-based. Today, the vast majority (80 to 90 percent) of Iran's export earnings, as well as about one half of its budget and a quarter of its gross domestic product, is derived from energy exports to the international community.[1]

In the past, this energy-dominated economy has led to wild fluctuations in Iran's financial fortunes. During the late 1990s, plummeting world oil prices left the Iranian regime nearly bankrupt.[2] Today, however, quite the opposite is true; the rising price of world oil generated by political instability associated with the War on Terror has provided Iran with a staggering fiscal windfall. As of March 2006 (the end of Iranian calendar year 1384), officials in Tehran were publicly estimating their country's hard currency reserves at some $50 billion.[3] These added resources and financial cushion can be expected to dramatically increase the Iranian regime's willingness to engage in risky regional behavior, as well as to accelerate the pace and scope of its strategic programs, in the months and years to come.

Iranian officials have attempted to solidify this economic status through a major expansion of their country's international energy profile. Over the past 2 years, Iran has signed two massive exploration and development accords, worth an estimated $100 billion over the next twenty-five years, with China alone.[4] A growing number of other nations, including France, Malaysia, japan, Canada, and Italy, are now engaged in the development of existing oil fields within the country, and this involvement is expected to increase as recent discoveries—including the Azadegan field and Bangestan reservoirs in southern Iran; as well as the offshore Dasht-e-Abadan site near the southwestern port city of Abadan—begin to come online.

Iran has also commenced efforts to become a major global exporter of natural gas. Since 2002, it has supplied Turkey with substantial natural gas deliveries via a bi-

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[1] Energy Information Administration, United States Department of Energy, "Country Analysis Brief: Iran," April 2004, http://www.eia.doe.gov/emeu/cabs/iran.html.

[2] See, for example, Michael Rubin, "What Are Iran's Domestic Priorities?" Middle East Review of International Affairs 6, no. 2 (2002), 26–27.

[3] *Aftab-e Yazd* (Tehran), May 10, 2006, as translated in Mideastwire Daily Briefing, May 12, 2006, http://www.mideastwire.com.

[4] Robin Wright, "Iran's New Alliance with China Could Cost U.S. Leverage," Washington Post, November 17, 2004, A21.

lateral pipeline link and, according to official Turkish government statistics, could provide roughly 20 percent of total Turkish natural gas consumption by the end of the decade.[5] A similar arrangement is emerging between Iran and Armenia as part of a pipeline, currently under construction, that could supply Armenia with up to 47 billion cubic meters over a period of 20 to 25 years, beginning in 2007.[6] Iran has opened similar discussions with Georgia, and has even taken steps to coordinate natural gas policy with Moscow as part of a Russia-led natural gas cartel now emerging in the post-Soviet space.[7]

At the same time, the Iranian regime has dramatically increased its ability to leverage its strategic location in the Strait of Hormuz, the principal passageway for roughly two-fifths of world oil trade. According to U.S. intelligence estimates, a sustained national military rearmament over the past several years has provided Iran with the ability to temporarily shut off the flow of oil from the Persian Gulf, even with a Western military presence in the region.[8]

It is a testament to this energy clout that, as the international crisis over Iran's runaway nuclear ambitions has deepened, Iranian officials have repeatedly raised the specter of a disruption of energy trade in the Persian Gulf. Regime officials such as Mohammed-Nabi Rudaki, deputy chairman of the Iranian parliament's national security committee, have warned that the Islamic Republic has the power to "to halt oil supply to the last drop from the shores of the Persian Gulf via the Straits of Hormuz" should serious measures be undertaken against the Islamic Republic at the United Nations.[9] Similarly, Iranian president Mahmoud Ahmadinejad has warned the United States and Europe that the global price of crude has not yet reached its "real value."[10] Even Iran's Supreme Leader, the Ayatollah Ali Khamenei, has threatened the West with disruptions in fuel shipments from the Persian Gulf in the event of a "wrong move" against Iran.[11] And regime officials have concretely demonstrated their capacity to do so, holding a week-long series of aerial, naval and ground maneuvers in the Persian Gulf in April 2006 to showcase the force-projection capabilities of their elite clerical army, the Pasdaran.

ASSESSING IRANIAN VULNERABILITIES

Given such posturing, it is not surprising that some analysts have concluded that energy is Iran's "trump card" in its dealings with the West.[12] This economic leverage, however, is a two-way street—and on at least three fronts, Islamic Republic is susceptible to economic pressure from the international community.

Commodity shortages

Despite massive oil exports of some 2.5 million barrels a day, Iran currently imports more than a third of its annual consumption of over 64.5 million liters of gasoline from a variety of foreign sources (among them India, France, Turkey and China) at an estimated cost of more than $3 billion annually.[13] These imports are not surplus; Iran reportedly maintains just 45 days worth of gasoline domestically, and requires steady supplies of refined petroleum products from abroad for the continued functioning of its economy.[14] Mounting international pressure, moreover, is already raising the costs of these deliveries. One leading Iranian policymaker has predicted that the regime will need to spend an extra $5 billion this year alone to

[5] "Turkish Energy Policy," Turkish Ministry of Foreign Affairs, n.d., http://www.mfa.gov.tr/grupa/an/policy.htm.

[6] "Iran, Armenia Sign Agreement on Gas Export," Asia Pulse, May 18, 2004.

[7] "Russia Favors Iran Route for Crude Exports," Tehran Times, June 14, 2004.

[8] Defense Intelligence Agency Director Lowell E. Jacoby, "Current and Projected National Security Threats to the United States," statement before the U.S. Senate Select Committee on Intelligence, February 16, 2005, http://intelligence.senate.gov/0502hrg/050216/jacoby.pdf.

[9] Yossi Melman, "Iranian official: U.N. Sanctions May Lead Us to Seal Off Persian Gulf," Ha 'aretz (Tel Aviv), January 24, 2006, *http://www.haaretz.com/hasen/spages/674159.html.*

[10] "Iran: Oil Undervalued," United Press International, April 20, 2006.

[11] "Tehran Warns of Fuel Disruptions," BBC (London), June 4, 2006, http://news.bbc.co.uk/2/hi/middle east/5045604.stm.

[12] See, for example, Clifford Kupchan, "Tehran's Trump Card," Los Angeles Times, April 23, 2006, *http://www.latimes.com/news/printedition/suncommentary/la-opkupchan23apr23,1,4489060.story?coll=la-headlines-suncomment.*

[13] Energy Information Administration, U.S. Department of Energy, "Country Analysis Brief: Iran," January 2006, *http://www.eia.doe.gov/emeu/cabs/Iran/Background.html;* "Iran's Refining Capacity to Increase to 900,000,'" *iranmania.com,* February 19, 2006, *http://www.iranmania.com/News/ArticleView/Default.asp?ArchiveNews=Yes&NewsCode=40656&NewsKind=CurrentAffairs.*

[14] Study by Iran's Institute for International Energy Studies, as cited in Ali Nourizadeh, "Exploring Iran's Military Options," Al-Sharq al-Awsat (London), January 23, 2006, *http://aawsat.com/english/news.asp?section=3&id=3528.*

maintain its established policy of deep subsidies on the sales of gasoline and avoid domestic rationing.[15] This suggests that the imposition of an embargo on foreign gasoline supplies to Iran could achieve rapid results—ranging from the depletion of hard currency reserves to a work stoppage in many of Iran's industrial sectors.

Centralized economic hierarchy

Today, the vast majority of regime wealth is concentrated in the hands of a very small number of people, whose associates and relatives dominate the Iranian economy. The extended family of former Iranian president (and current Expediency Council chairman) Ali Akbar Hashemi Rafsanjani, for example, now virtually controls copper mining in Iran, the regime's lucrative pistachio trade, and a number of profitable industrial and export-import businesses.[16] A related economic power center is Iran's *bonyads,* the sprawling, largely unregulated religious/social foundations overseen by Iran's Supreme Leader, which account for between 10 and 20 percent of Iranian national GDP.[17] Given this economic hierarchy, targeted financial measures that restrict the ability of these individuals and organizations to access international markets—and curtail their capacity to engage in commerce—are likely to have an immediate and pronounced effect on regime decisionmaking.

Foreign direct investment

The dozens of billions of surplus dollars collected by the Iranian government over the past 2 years as a result of the rising price of world oil have done little to diminish Iran's need for foreign direct investment. According to authoritative estimates, Iran's energy sector still requires some $1 billion annually to maintain current production levels, and $1.5 billion a year to increase capacity.[18] Without such sustained capital, studies say, Iran could revert from an energy powerhouse to a net energy importer in the span of very few years.[19] Given the scope of current investment in Iran, it is unrealistic for the U.S. and its allies to expect to be able to achieve a comprehensive economic isolation. However, if broad and forceful enough, multilateral sanctions may complicate Iran's access to foreign funding, and/or force a depletion of the hard currency reserves that the regime has amassed over the past several years.

THINKING BEYOND THE UNITED NATIONS

Today, the United States has the ability to capitalize upon these vulnerabilities. International economic sanctions can help to slow Iran's nuclear progress and signal the international community's opposition to an Iranian bomb. If coupled with effective public diplomacy, such measures can also drive a wedge between the Iranian government and its people over the prudence of nuclear acquisition. Moreover, history has shown that the effectiveness of sanctions can be enhanced by the speed and scope with which they are applied.[20]

It is becoming exceedingly clear, however, that the United Nations is not the optimal vehicle by which to apply such pressure. Already, protracted diplomatic wrangling has provided Iran with valuable time to reduce its economic vulnerabilities. In recent months, Iran has carried out large-scale transfers of assets from Europe to financial institutions in China and Southeast Asia,[21] as well as initiating a major privatization of governmental funds.[22] Most recently, Iran's parliament has approved a new fiscal budget that calls for a halt to imports of refined petroleum prod-

[15] Gareth Smyth, "Iran 'Will Need $5bn Subsidy' to Avoid Petrol Rationing," *Financial Times* (London), May 28, 2006, *http://news.ft.com/cms/s/0627359c-ee77-11da–820a-0000779e2340, i rssPage=3f6a0854-c8f8-11d7-81c6-0820abe49a01.html.*

[16] Paul Klebnikov, "Millionaire Mullahs." Forbes, July 21, 2003, *http://www.forbes.com/forbes/2003/0721/056 print.html.*

[17] Ibid.

[18] "NIOC Undertaking Host of Projects to Boost Oil Output," *Middle East Economic Survey* XLVIII, no. 19 (2005), as cited in A.F. Alhajji, "Will Iran's Nuclear Standoff Cause a World Energy Crisis? (Part 1 of 2)," *Middle East Economic Survey* XLIX, no. 13 (2006) *http://www.mees.corn/postedarticles/oped/v49nl3-50DO1.htm.*

[19] Kenneth Katzman, *The Iran-Libya Sanctions Act (ILSA)* (Washington: Congressional Research Service, July 21, 2003), 2.

[20] George A. Lopez and David Cortright, "Economic Sanctions in Contemporary Global Relations," in David Cortright and George A. Lopez, eds. *Economic Sanctions: Panacea or Peacebuilding in a Post-Cold war World?* (Boulder: Westview Press, 1995), 9.

[21] "Iran Moves Assets to China, East Asia, worldtribune.com, January 23, 2006, *http://www.worldtribune.com/worldtribune/06/front2453758.41875.html.*

[22] Meysam Salehian, "Central Bank vs. Government," Rooz (Tehran), May 10, 2006, *http://roozonline.com/english/015477.shtml.*

ucts and the institution of gasoline rationing starting this Fall.[23] The goal of these efforts is clear: to limit Western economic leverage over Iranian behavior.

Timing should also be a major consideration. In late May, Secretary of State Condoleezza Rice signaled a sea change in American policy toward Iran when she announced that the United States would join Europe in proffering a "package" of incentives aimed at bringing the Islamic Republic back to the nuclear negotiating table. Iran, in turn, has maintained that it is studying the offer and will provide a formal reply in late August.[24] It is unclear whether the international community will wait until then to seek Security Council action against Iran, but it is reasonable to expect that forceful international action still remains some weeks or months away—allowing Iran to continue minimizing economic vulnerabilities and forging ahead with its nuclear effort. All of this means that, if and when economic sanctions are again on the table, their stated task—to alter the regime's behavior with relation to its nuclear program—will be even more difficult to achieve than it is today.

Moreover, if and when United Nations sanctions do materialize, they are likely to be deeply influenced by politics. Russia and China both wield veto power over Security Council action against Iran, and while Moscow and Beijing appear to have endorsed more robust measures against Iran should the current negotiations fail, any steps taken will need to be carefully calibrated so as to preserve the support of those states. As a practical matter, this means that the economic pressure applied against Iran will be both gradual and limited in scope.

Given these difficulties, Washington would be far better served by the establishment of an economic coalition outside of the confines of the United Nations. Through such a construct, the United States would have far greater ability to control the timing, extent and application of economic pressure on Iran, without Security Council-imposed constraints. It would also provide the U.S. and its coalition partners with greater political flexibility to apply those specific measures most likely to alter Iranian behavior.

THE LIMITS OF IRANIAN OIL POWER

Today, Iran holds the ability to exert a high price from the world if it is stymied in its nuclear efforts. But political and economic realities suggest that Iran's oil power is far more limited than commonly understood.

Iran could indeed curb oil exports, as regime officials have repeatedly threatened. However, if the Islamic Republic withdraws oil from world markets, it faces the prospect of losing much-needed long-term energy clients, such as China and India, which can be expected to quickly seek replacement suppliers. Moreover, the resulting perceptions that Iran is an "unreliable" energy partner are likely to reduce foreign direct investment flowing into the country—thereby placing Iran's current status as a global energy player in jeopardy.[25]

By the same token, a cutoff of oil exports is likely to reverse Iran's recent political gains abroad. Simply put, should Iran's energy brinksmanship hurt the economies of its political allies, those countries are far less likely to unconditionally support Iran on the perceived source of the economic turbulence: Iran's nuclear program. This change will be true in spades for major investors into Iran's energy sector (such as Japan, China and France).

Most of all, Iranian officials—despite official bluster—understand that actual use of the "oil weapon" is likely to carry dire consequences for their regime. The international community's current diplomatic overtures toward Tehran have been generated in no small part by problems attaining consensus on more robust measures. Substantial Iranian interference with the global energy market could change all that, galvanizing a consensus for aggressive containment—or even regime change—on the part of numerous energy-hungry nations.

Is there a guarantee that sanctions will succeed in altering Iranian behavior and curbing its nuclear efforts? The answer is no. On the contrary, American policymakers should refrain from seeing economic sanctions as an isolated measure; historically, a strong correlation exists between the imposition of sanctions and the subsequent escalation to the use of force (e.g., Panama in 1989, Iraq in 1991, and the Balkans during the mid-1990s). However, what is clear is that a failure by the international community to promptly utilize its existing economic leverage vis-à-vis Iran will make other, less attractive solutions—chief among them the use of force—much more likely.

[23] Christian Oliver, "Iran to Halt Gasoline Imports, Impose Rationing," Reuters, June 23, 2006; "Iran Calls Halt to Petrol Imports," BBC (London), June 23, 2006.

[24] "Iran Nuclear Response 'in August,'" BBC (London), June 21, 2006, *http://news.bbc.co.uk/2/hi/middle east/5102544.stm.*

[25] Alhajji, "Will Iran's Nuclear Standoff Cause a World Energy Crisis? (Part 1 of 2)."

Ultimately, the United States must make a choice. Is it, and the world, willing to pay the political and economic price associated with a serious strategy to confront Iran? The alternative is to internalize a permanent hike in the cost of doing business with a region dominated by an atomic Islamic Republic.

PREPARED STATEMENT OF DR. ANDREW K. DAVENPORT, VICE PRESIDENT, CONFLICT SECURITIES ADVISORY GROUP, INC.

Mr. Chairman, thank you for the privilege of appearing today on Iran's oil and gas industries and the rather unique perspective through which my company views corporations from around the world that are financing and developing the energy-related projects that generate Iran's primary source of revenue.

By way of introduction, I am Vice President of Conflict Securities Advisory Group, a Washington, DC-based research and risk management firm that was founded 5 years ago to service a growing demand from institutional and individual investors—as well as policy practitioners—for data on those U.S. and foreign companies that maintain business ties to U.S. State Department-designated terrorist-sponsoring states. Our firm performs this research to help investors and corporations better understand their exposure to so-called global security risk, defined as the often-asymmetric financial risk to a company's share value and reputation that can accompany these business ties.

I would like to speak, first, about the broad role that Iran's oil and gas industries play in supporting virtually all facets of the Iranian government and then address the company-specific dimensions of that equation. I will also touch on the impact of U.S. policy on corporate decisionmaking regarding the pursuit of these business opportunities.

IRAN'S OIL INDUSTRY: THREE INTERLOCKING PRESSURES

In our view, three central issues define Iran's oil industry today.

(1) Iran's oil exports play the central role in financially underwriting the country's government. As oil prices increase, Tehran experiences economic windfalls that have a direct impact on the government's discretionary spending across the board. Iran has obviously benefited enormously from the recent rise in global oil prices. It is important to remember, however, that we have in the past seen periods where the opposite has been true. In the 1990s, for example, relatively low oil prices had Iran on the verge of defaulting on its international debt obligations. Had it not been for the intervention of the country's various creditors, in part through the actions of specific foreign companies, Iran would have faced a considerably more severe financial crisis.

Of course, Iran's is not the only economy that lives and dies on oil prices. The Soviet Union in the 1980s is perhaps the best case study of a government experiencing the highs and lows of relying too heavily on oil prices.

(2) Despite the lucrative nature of Iran's oil exports, its energy industry as a whole has distinct weaknesses that, since the revolution in 1979, have prevented it from reaching its full potential. Iran's oil industry is state-controlled, old, inefficient and in need of significant upgrades that only foreign companies, with their access to large-scale capital and advanced equipment and technology, are capable of carrying out. These upgrades are essential for Iran to cushion the impact of increasing domestic oil consumption and aging oil fields that are currently putting downward pressure on the country's oil exports.

In order to reach the country's stated goal of increasing daily oil production from 4 million to 5 million barrels per day by 2008 and to 8 million barrels per day by 2010, Iran will need to upgrade significantly its existing fields and begin producing from new ones. Tehran's challenge is to attract foreign investment in sufficient quantity to reach these goals, despite unpopular contract terms and intense international security concerns. As I will address in a few minutes, although companies are starting to change the way they do business in Iran due to security risk factors, in our view, security concerns are not stemming the tide of companies interested in doing business there. The real inhibitor to foreign investment seems to lie more in bureaucratic obstacles within the country.

(3) The country's gasoline-related expenditures have put added strain on Iran's budget. Despite booming revenues, Iran's lack of refining capacity has forced the country to spend billions of dollars importing gasoline. Moreover, the decision by Iran's parliament to lock domestic gas prices at 2003 levels could cause even more pronounced problems for Iran, as billions of dollars in state subsidies, which could increase under the new President, lead to increased consumption. Increased con-

sumption leaves less oil for export and, combined with decreasing production, could eventually have a material impact on export-related revenues.

Over the coming years, the intersection of these three important energy industry pressures will put the Iranian government and the companies that do business in the country at a crossroads. With Iran almost completely dependent on its energy exports for revenues and in desperate need of foreign investment to keep these revenues flowing, foreign companies will become even more important to the prosperity of Tehran.

IRAN'S OIL INDUSTRY AND PROSPECTS FOR THE FUTURE

The summary statistics regarding the role of oil in the Iranian economy tell the story: Iran holds an estimated 10 percent of the world's proven oil reserves; its oil exports generate 80 to 90 percent of the country's total export earnings and 40 to 50 percent of its total government budget.

Although the state-owned National Iranian Oil Company largely runs the Iranian oil industry, we understand that oil export revenues are effectively funneled straight to the country's central bank, also known as Bank Markazi. Accordingly, as might be expected, oil export revenues quite literally equate to discretionary funds for Tehran. Although Iran's military and nuclear spending is largely unknown—at least through public sources—it can be reasonably expected that both, in addition to most other government programs, are benefiting directly from recent oil windfalls.

To maintain these higher revenue flows, however, not only will oil prices need to remain high, but Iran will need to invest heavily in its existing and prospective energy projects. Aging oil fields require upgrades and new fields require development. Most would agree that the success of both requires billions of dollars in foreign investment, capital and technology in the coming years.

Although Tehran has not attracted as much foreign assistance as it would like, our research shows that there are a wide variety of corporations currently working in Iran's oil industry. In fact, there seems to be no shortage of corporate interest in Iran's economy. In our view, even considering the outrageous pronouncements of Iran's new president, short of international sanctions, no significant number of companies will forego the country's business opportunities. History has shown time and again that companies will do what the law allows. As long as operating in Iran is legal, the draw of a growing economy and the country's vast oil and gas resources will lure companies in. Of course, companies are aware of the political environment, but, simply put, the risk appears to be worth the reward in the increasingly competitive global energy industry.

There are, however, a few important exceptions. A number of companies have correctly identified a growing sensitivity in the U.S. investor community to business associations with Iran. The prospect of being labeled as "Doing Business with the Enemy"—the title of a 60 Minutes segment on this issue that aired twice over the past 2 years—has influenced the behavior of some companies that place more value on their corporate reputation in the U.S. than on their business prospects in Iran. For most other companies, however, this calculation is still in flux.

For at least five prominent U.S. companies, Comptroller William Thompson of New York City made this calculation a good deal easier by registering public shareholder resolutions with the SEC on behalf of the City's fire and police pension funds calling for a Board-level review of their corporate ties to Iran and terrorist-sponsoring states. Specifically, Comptroller Thompson was interested in whether their operations in Iran or these other countries circumvented the spirit, if not the letter, of U.S. sanctions law. He was referring to what some have called a major "loop hole" in U.S. law that allows U.S. companies to do business in sanctioned states via armslength overseas subsidiaries.

After some wrangling, these companies made adjustments to corporate policy and, in certain cases, renounced any future business ties to Iran whatsoever. The five companies referenced are ConocoPhillips, General Electric, Halliburton Cooper Cameron and Aon.

In my view, two important conclusions relevant to this committee can be drawn from this anecdote. First, companies that discount escalating security concerns in their risk-reward analyses may be less likely to discount the views of leading shareholders. Second, companies most vulnerable to this market-related pressure are those who have more business or reputational exposure in the United States.

For example, let us assume that Company X and Company Y both have business ties to Iran. Company X has a large market presence in the U.S. and therefore has considerably more to lose in U.S. sales than Company Y. Company X would be expected to be more responsive to the concerns of Americans regarding its activities in Iran. In our experience, the same holds true in the capital markets. Let us say that 10 percent of Company Y's stock is held by U.S. investors, compared to 35 percent of Company X's. In this case, U.S. investors who care about Iran and, like Comptroller Thompson, act on those concerns would have more leverage with Company X and wield more influence over its corporate governance policies regarding business activities in the country. In today's global economy, market forces such as security-minded shareholder activism can be more effective than regulatory regimes.

The impact of corporate reputational concerns and market forces, however, should not only be measured by whether or not a company chooses to exit completely from Iran. For many companies with large exposure to the country, pulling up stakes is simply not an option. One positive development stimulated by increased investor, government and media attention to this issue has been a new sensitivity by companies to the structure of their corporate ties to Iran. Increasingly, foreign companies are scrutinizing their projects and transactions in Iran to ensure that they do not have the potential to contribute inadvertently to security concerns.

Some non-U.S. companies have begun to self-police their operations in Iran at standards above and beyond the requirements of their national laws to protect their reputations from potential Iran-related harm. While this may be short of what some policymakers would prefer, it demonstrates an innovative, market-oriented reaction that has a high likelihood of reducing the security risks that these corporate ties can represent.

For example, if a company's business in Iran involves the transfer of dual-use equipment or technology, there is often little the U.S. can do short of extraterritorially sanctioning the company. Were that company, however, in deference to its shareholders or reputation in the U.S. and elsewhere, to undertake additional due diligence, substitute the problematic equipment or seek contractual assurances that it will not be diverted to non-civilian projects, U.S. policy concerns would benefit. No sanctions, no international controversies, no government intervention would be entailed. Rather, in this example, the company is self-policing its business activities in a risky country in response to market forces.

Increasingly, our firm is witnessing corporations—out of concern over their reputation in the United States—insisting on certain contract terms with Iran, rather than vice-versa. In our view, this increased security-consciousness, when it occurs voluntarily, should be viewed as a good thing.

IMPACT OF U.S. POLICY

Given recent events and the importance of foreign companies to the Iranian economy, one might ask: what role does U.S. foreign policy play in the considerations of companies abroad operating in Iran. For a long time, the answer, for non-U.S. companies, has been very little. The primary impact of President Clinton's 1995 Executive Order banning U.S. involvement in Iran's energy sector was that it cost Iran access to certain U.S. technology. At the same time, it cost U.S. companies business opportunities in Iran. For foreign companies, however, the Order had little impact and business in the country continued at an even faster rate than before, as Iran was in the midst of opening up to foreign investors.

Congress then passed the 1996 Iran Libya Sanctions Act (or ILSA), which sought to punish non-U.S. companies investing more than $20 million annually in Iran's oil and gas industries by restricting their access to the U.S. economy. As a consequence of the controversial "extraterritoriality" of the law and for diplomatic face-saving, ILSA sanctions were never implemented. Soon after the act was passed, several large companies, including France's Total and Russia's Gazprom, violated its provisions and, following an official review, went unpunished. These early precedents cleared the way for other companies to do the same and, today, there are, by our estimates, over 20 companies in technical violation of ILSA.

With U.S. sanctions policy toward Iran remaining fairly consistent since the mid-1990s, one might further ask: what has changed over the past few years causing some corporations to second-guess their operations in Iran and others to enact voluntary, security-oriented governance policies with respect to these higher-risk activities? Surely, the nuclear standoff and President Ahmadinejad's election have complicated the business environment, but the beginning of today's corporate trends vis-à-vis Iran predates, for the most part, both of these developments.

Our findings demonstrate that after September 11, the stigma associated with corporate ties to U.S. State Department-designated terrorist-sponsoring states increased significantly. This stigma reverberated in the local and national press. State and municipal governments began analyzing how their retirement and other public investment funds were invested in companies that collectively form the economic backbones of these irresponsible, dangerous governments. Grassroots attention to these countries as supporters of terrorism and proliferators of weapons of mass destruction and ballistic missiles raised substantially the reputational risk associated with these corporate ties and the potential for corporate activities to be linked by the public to heightened security concerns.

This grassroots movement continues today. For example, the Missouri Investment Trust recently became the first public fund in the country to institute a policy that, after a careful review, screens out certain companies with business in Iran and other terrorist-sponsoring states. A so-called "Terror-Free" mutual fund, the Abacus Bull Moose Growth Fund administered by Roosevelt Investment Group, has likewise been created in response to market demand.

Even though, most of the time, corporate activity in Iran does not represent a significant portion of a company's overall business, the importance of the issue of terrorism in the U.S. has created the potential for such ties to negatively impact corporate share value and reputation and, in some cases, even raise questions of legal liability. Accordingly, some companies are rightfully seeking to safeguard their corporate operations from these types of associations by integrating expanded, security-minded new due diligence into their overall corporate risk management programs. To be clear, this is market-oriented cause-and-effect.

As I noted earlier, most companies are unwilling to forego the Iranian market, especially firms from countries that place huge importance on Iran as a source of energy supplies. Increased vigilance, however, with respect to the security dimensions of their business activities in the country is leading to a new sensitivity to U.S. security concerns on the part of some international companies doing business where U.S. companies cannot.

CORPORATE INVOLVEMENT

According to our Global Security Risk Monitor online research product that seeks to identify and profile every publicly traded company in the world that has any kind of business tie with terrorist-sponsoring states, over 300 publicly traded companies have carried out business with Iran during the past 3 years.

This number does not include those private or state-owned companies that are also doing business in the country. While most companies with the risk appetite to do business in Iran are these larger publicly traded entities, this does not hold true in all cases.

Nevertheless, the point remains the same: there are a large number of companies that are key participants in Iran's economy. These companies are often among the largest in the world and held in most American investor's portfolios, including the Thrift Savings Plan that invests on behalf of Members of Congress and many other U.S. public officials. Although most of these firms are involved in the country's energy sector, a number are in other sectors, contributing to Iran's efforts to diversify away from its somewhat one-dimensional economy. These ties range from petrochemical to telecommunications projects to manufacturing plants to power generation projects and so on.

Most of the larger-scale projects, however, are infrastructure-oriented and do not involve the revenue-generating potential for the government that exists in the energy sector. In fact, Iran's diversification efforts seem directed more at infrastructure projects than at launching a new era of market-oriented policies that have the potential to stimulate economic growth and, as a result, generate new streams of government revenues. Although the country may seem more up-to-date as a result, government revenues and stability remain firmly dependent on its export of energy.

The bottom line is that foreign publicly traded companies play a tremendously important role in Iran's current and future economy.

CONCLUSION

As stated, short of strong multilateral sanctions, which seem unrealistic barring some kind of serious escalation of the current Iranian nuclear crisis, there will continue to be companies looking to enter the Iranian market or expand the corporate presence. The reach of U.S. policy, therefore, is limited. These new market-oriented concerns, however, are not. In our view, it is ultimately the implications of potential reputational damage that will cause public companies to reconsider their policies and business activities. As this reputational risk increases, so too will corporate self-policing. Should companies choose to remain in Iran, they could be encouraged by shareholders and others to do so in a more security-sensitive mode than ever before. Such new corporate guidelines and due diligence measures will not be lost on the Iranian government and the state-owned companies that will have to learn to be responsive to the reputational burden that they bring to each of their prospective and existing business partners.

PREPARED STATEMENT OF DR. JEFFREY J. SCHOTT, SENIOR FELLOW, INSTITUTE FOR INTERNATIONAL ECONOMICS

Iran has long been an important player in world oil markets. Today, it is the second largest producer and exporter of oil among the members of the Organization of Petroleum Exporting Countries (OPEC). Iran exports about 60 percent of its annual oil production of about 4 million barrels of per day.

Iran has been a major beneficiary of recent developments in world oil markets. World oil prices have soared in response to (1) rapid growth in global demand, fed by voracious new users in China and India; (2) declining oil production in the OECD area; and (3) security concerns in important producing areas such as Iraq and Nigeria. While oil production has surged in Russia and increased moderately in Saudi Arabia, the increased volumes have not been enough to forestall a sharp tightening of global supply/demand balances that have propelled a massive increase in world oil prices.

Over the past decade, the volume of Iran's annual oil exports has averaged almost 2.5 million barrels per day. Over this period, the prices of Iran's light and heavy crudes have increased almost fourfold from about $16 per barrel in 1995 to the current level of more than $60 per barrel. As a result, the value of Iran's oil exports has grown from about $15 billion in 1995 to more than $46 billion in 2005 (see table 1).

Iran now pockets an extra $30 billion of oil export revenues compared to a decade ago. Oil profits fuel the Iranian economy; they also finance Iranian investment in weapons development and support for terrorism. What is good news for the ayatollahs is not so good for the United States. We are paying a high price for these developments and not just at the pump. Petrodollars make Iran more capable of pursuing its nuclear ambitions and funding Hezbollah and other terrorist organizations, and more immune to US economic coercion.

U.S. policy has tried to blunt Iranian adventurism for several decades through international diplomacy and economic sanctions. International cooperation with US initiatives have been modest, and extensive US unilateral sanctions against Iran—codified in the Iran and Libya Sanctions Act of 1996—have not achieved their difficult goals. Despite this checkered past, some US political leaders are now calling for broader economic and/or military responses to the ongoing Iranian nuclear program and support for Hezbollah. In formulating the appropriate US response to these outrages, the Congress should reflect on our past sanctions experience as well as the new diplomatic and economic conditions that will constrain the effectiveness of new U.S. and multilateral measures.

U.S. ECONOMIC SANCTIONS AGAINST IRAN: EXPERIENCE TO DATE[1]

The UniteStates first imposed economic sanctions against Iran in response to the hostage crisis of 1979–1981. The comprehensive trade and financial sanctions eventually provided a crucial negotiating chip to win the release of the American hostages on the day of President Reagan's inauguration.

A few years later, Iran was implicated in the terrorist bombing of a Marine Corps barracks in Lebanon. Iran was added to the US list of countries that support terrorism. In incremental steps, the United States imposed new restrictions on US trade with Iran targeted primarily at limiting development of the Iranian oil industry and thus its capability to fund terrorist groups. Subsequently, concerns about Iran's nuclear power programs prompted additional US sanctions to impair the military potential of Iran, particularly regarding the development of chemical, biological, and nuclear weapons. The Iran and Libya Sanctions Act (ILSA) of 1996 supplemented these measures with additional restrictions on foreign companies that undertake new oilfield investments in Iran.

Overall, sanctions have not prompted Iran to renounce the use of terrorism or the acquisition of nuclear weapons. While other industrialized countries also implemented narrowly targeted trade sanctions designed to limit Iran's access to products and technologies that could support the production and delivery of nuclear, chemical, and biological weapons, they continued to trade extensively and invest in Iran. Meanwhile, other countries supplied Iran with arms and nuclear equipment and technologies.

The ILSA sanctions did lead some companies to defer bidding on new contracts to develop Iranian oil and gas properties. US sanctions deserve some of the credit, but most of Iran's problems in attracting new investment were caused by self-in-

[1] This section draws heavily on the Iran case study from the forthcoming 3rd edition of Economic Sanctions Reconsidered, by Gary Hufbauer, Jeffrey Schott, Kimberly Elliott, and Barbara Oegg (Washington: Institute for International Economics, forthcoming 2007).

flicted wounds created by its own domestic policies. Despite these problems, Iranian oil production has grown modestly over the past decade since ILSA was enacted.

The appendix to this statement provides a chronology of the key events in the decades-long sanctions effort. It sets out a troubling story that brings to mind Yogi Berra's insightful commentary: "it's déjà vu, all over again". The same problems confronting US policy two decades ago now again dominate the headlines: funding terrorists in Lebanon, testing North Korean missiles, and Iran's pursuit of nuclear weapons. Economic sanctions have not blunted Iran's foreign adventurism, though they undoubtedly have inhibited the task and made it more costly to pursue.

ECONOMIC SANCTIONS AGAINST IRAN: NEXT STEPS

The Congress is now considering extension or expansion of the ILSA sanctions against Iran. Drawing counsel from the IIE study on sanctions, based on 25 years of research and the authors' personal experience in formulating US sanctions policies in the late 1970s and early 1980s, I believe the current law should be renewed as is. But Members of Congress should make a realistic assessment of the benefits that can be obtained through the deployment of sanctions.

Can sanctions stop Iran from eventually developing a nuclear weapon? Probably not. Iranian leaders have been developing this capacity for more than two decades-despite diplomatic entreaties, limited economic sanctions, and the threat of military strikes. They believe that nuclear weapons will bring them regional dominance and that—just like India and Pakistan—the West will grudgingly accept their accession to the nuclear club without significant retribution.

Nonetheless, history shows that targeted sanctions can push back the day of reckoning. Since the Nuclear Non-Proliferation Treaty entered into force in 1970, four countries have acquired nuclear weapons: Israel, India, Pakistan, and North Korea. The latter three were subject to significant US sanctions and some multilateral measures. Economic sanctions did not prevent proliferation but collective denial by Western powers of key ingredients of the bomb maker's art—reprocessing technology, centrifuges, tubing, metallurgy, timers—substantially slowed the process.

Sanctions will not prevent a determined and well financed country from eventually crossing the nuclear threshold. Even the tightest sanctions regime can be evaded with sufficient incentive. Witness the billions of dollars of goods smuggled into Iraq during Saddam Hussein's reign. Land borders are porous, especially in the Middle East, and sea and air freight are difficult to monitor effectively without intense military operations. With Iran's petrodollar bonanza, it will be able over time to procure the necessary material and technology to achieve its nuclear ambitions.

To be sure, comprehensive economic sanctions against Iraq, which were generally respected by the major powers including China and Russia, arguably contributed to thwarting Saddam Hussein's nuclear program. Since those measures coincided with low oil prices, little economic pain was felt in the world at large, even though Iraqi oil shipments were sharply curtailed. This fact was crucial to global cooperation in enforcing U.N. sanctions for more than a decade.

Broad economic sanctions, comparable to the isolation of Iraq in the 1990s, are no longer feasible. Unlike the cheap oil of the 1990s, oil prices today are at or near record levels. Given tight global supplies, Iran has greater leverage to counter sanction major oil consuming nations by cutting back its oil exports. Few producing nations have the spare capacity to increase shipments to offset potential Iranian cutbacks, so prices would likely rise sharply. Iran would sell less—and earn more.

For that reason, it's hard to find politicians who would support a comprehensive sanctions strategy. Many Americans would question harsh measures that might push oil above $100 per barrel and trigger a world recession. Europe, China, and Japan have similar concerns and would only endorse sanctions that are paced and mild, not sudden and harsh. Russia will be even more ambivalent, for two reasons: it has gained a lot from the oil price spikes generated by Mid East tensions since its oil production has increased by almost 50 percent since 2000 to 9.5 million barrels per day; and it wants to continue to cultivate Tehran as its best foothold in the Middle East.

So what should we do? The most immediate and obvious task is continued denial of critical components (e.g., cascade centrifuges) for Iran's nuclear industry. The policy already receives support from the major powers but additional efforts should be made to ensure that second tier powers undertake and enforce these restrictions as well. Other targeted sanctions against Iran's ruling class should also be considered, including travel restrictions and overseas asset freezes. These measures will have minimal impact on Iran's financial ability to finance terrorism or build a nuclear bomb. Rather the strategy of limited sanctions, accompanied by coordinated diplomacy, is to let time mellow Tehran's nuclear intentions. This is a less than satisfying result but effectively what we can achieve, given current conditions in world energy markets.

Table 1.—Iran: Petroleum Production, Exports and Revenues, 1995–2005

	Production[a] (1000 barrels/day)	Crude oil exports[b] (1000 barrels/day)	Value of petroleum exports[b] (millions of dollars)	Iran light crude[b] (spot price per barrel, $)	Iran heavy crude[b] (spot price per barrel, $)
1995	3,744	2,621	14,973	16.17	16.26
1996	3,759	2,630	19,441	19.03	18.49
1997	3,776	2,587	15,553	18.24	18
1998	3,855	2,512	10,048	11.97	11.45
1999	3,603	2,291	16,098	17.25	16.93
2000	3,818	2,492	25,443	26.75	26.02
2001	3,730	2,185	21,420	22.9	21.67
2002	3,414	2,094	19,219	23.52	23.09
2003	3,999	2,396	26,124	26.89	26.33
2004	4,081	2,684	34,289	34.6	33.06
2005	4,049	2,700[c]	46,600[c]	50.66[c]	48.32[c]

[a]Source: BP Statistical Review of World Energy 2006.
[b]Source: OPEC, Annual Statistical Bulletin (2004).
[c]Source: Energy Information Administration, Department of Energy; price data as of December 30, 2005.

APPENDIX. U.S. Sanctions Against Iran: Chronology of Key Events, 1984–2006

23 January 1984	Alleging Iranian involvement in Marine base bombing in Lebanon, US State Department adds Iran to list of nations supporting terrorism, and thus subject to stringent export controls.
26 October 1987	President Reagan invokes section 505 of the International Security and Development Cooperation Act of 1985 and embargoes all imports from Iran, prohibits export of 14 types of potentially militarily useful goods, including inboard and outboard motors, mobile communications equipment, electrical generators, hydrofoil vessels.
15 March 1995	President Clinton issues executive order barring US citizens and companies from financing, supervising and managing oil development projects in Iran-blocking Conoco's pending $1 billion investment in Iranian offshore oil project.
30 April 1995	Citing proliferation and terrorist concerns, the White House announces it will ban, effective 8 June 1995, all direct US trade with Iran, as well as an estimated $4 billion in indirect trade, mainly by American companies selling Iranian oil in third countries. French, German and British officials call sanctions the wrong approach and announce they will continue their policy of "critical dialog" with the Iranian regime. Oil analysts estimate that Iran will have no trouble finding buyers for its exports to replace American companies.
7 March 1996	US and Israeli intelligence sources allege Iranian involvement in a recent wave of terrorist attacks in Israel.
2 May 1996	US military officials charge Iran has acquired Nodong II missiles from North Korea and is building underground bunkers to deploy them.
23 July 1996	The House passes Senate version of the Iran and Libya Sanctions Act (ILSA), which penalizes companies investing over $40 million in 1 year in Iran's oil and gas sector; after 1 year, the annual investment limit triggering sanctions drops to $20 million. Potential sanctions include two or more of the following: (1) denial of credits from the US Export-Import Bank; (2) denial of export licenses for controlled goods or technology; (3) prohibition of loans of more than $10 million from US financial institutions for a 12-month period; (4) prohibition of foreign financial institutions from dealing in US government debt or US government funds; (5) prohibition against participation in any US government procurement project; (6) import restrictions. Sanctions are required to be in effect for up to 2 years, and in "no case" can they be applied for less than 1 year. The President may waive all or part of the sanctions against a foreign company if doing so is deemed to be in the national interest. Bill sunsets 5 years after enactment unless Congress votes to extend.

APPENDIX. U.S. Sanctions Against Iran: Chronology of Key Events, 1984–2006—Continued

19 August 1997	President Clinton issues an executive order that explicitly prohibits re-exports of US goods, technology and services to Iran.
21 February 1998	Despite US objections, Russia decides to expand role in building nuclear power plant in Iran.
22 July 1998	Iran tests a missile with an 800-mile range, capable of reaching Israel. American officials say the "Shahab 3" missile came from North Korea.
25 November 1998	Russia signs an $800 million deal to finish building the Bushehr nuclear power plant in Iran; announces it may bid on three more nuclear reactors for $3 billion. Russia assures US that agreement concerns peaceful nuclear cooperation only.
23 February 1999	US imposes import sanctions on 10 Russian entities for giving assistance to Iranian nuclear and missile programs.
28 April 1999	President Clinton announces that the US will exempt exports of food and medicine from future sanctions imposed by the executive branch. The new rules also apply to food and medicine sales to Iran, Libya, and Sudan, which will be permitted on a case-by-case basis. Specific licensing rules will be drawn up for each country and there will be no US government, funding, financing or guarantees for the sales.
Early Dec. 1999	US officials say that intelligence reports suggest that Iran has recently increased aid to terrorist groups opposing the Middle East peace process.
15 March 2000	President Clinton signs the Iran Nonproliferation Act of 2000 into law. Act requires the president to send report to Congress identifying countries and entities assisting Iran with its weapons programs and gives the president the authority to impose sanctions on these countries but does not make sanctions mandatory. The Act also bars the US from making "extraordinary" payments to the Russian Space Agency to build the International Space Station or any other organization of the Russian government until the president determines that Russia is actively opposing proliferation in Iran. The president may waive sanctions for national security reasons.
17 March 2000	Secretary of State Albright announces that US will lift ban on Iranian non-oil exports such as carpets, caviar, pistachios and dried fruit, and states that US will increase efforts to reach a settlement to all legal and financial claims between the two countries and to reduce barrier to cultural exchanges. US sanctions barring American investment in Iran's oil sector, however, remain in place.
14 April 2000	US government determines that five entities in North Korea and Iran have engaged in missile technology proliferation activities that require imposition of sanctions under the Arms Export Control Act. Sanctions are largely symbolic.
27 July 2001	Congress renews ILSA for another 5 years, despite opposition from the US business community and the Bush administration. The "ILSA Extension Act of 2001" requires the president to submit a report to Congress within 24 to 30 months on the effectiveness of the sanctions, their impact on other US economic and foreign policy interests and the humanitarian situation in Iran and Libya. European Commission criticizes the ILSA extension and threatens to retaliate if sanctions are imposed against European companies.
13 February 2002	US blocks Iran's bid to join the WTO.
25 July 2002	Under the Iran-Iraq Arms Non-proliferation Act of 1992, the US sanctions nine Chinese companies and one Indian entity for selling prohibited goods to Iran.
21 October 2002	Russian officials refuse an American proposal to lift restrictions on the import of spent nuclear fuel into Russia (which can be reprocessed to make enriched uranium or plutonium for nuclear weapons) in return for Russia's ceasing all atomic cooperation with Tehran, including the construction of the Bushehr reactor.
21–22 February 2003	IAEA Director General Mohamed ElBaradei visits Iran to make nuclear inspections and urge Iran to sign the Additional Protocol to the IAEA Safeguards Agreement, which would require an increase in the transparency of the Iranian nuclear program and provide the IAEA with increased access.

APPENDIX. U.S. Sanctions Against Iran: Chronology of Key Events, 1984–2006—Continued

May 2003	Responding to US pressure, Russia informs Iran that it will not deliver the nuclear fuel for Bushehr unless Iran signs the Additional Protocol.
4 June 2003	Russia changes course from its May 2003 announcement, now declaring it will not link the supply of nuclear fuel in Bushehr to Iran's signing of the Additional Protocol.
6 June 2003	IAEA report to its Board of Governors concludes that Iran has failed to meet its "safeguards" obligations by failing to fully account for nuclear material imported from China in 1991.
10 November 2003	IAEA report to its Board of Governors condemns Iran for 18 years of manufacturing enriched uranium and plutonium as part of a secret nuclear program.
18 December 2003	Iran signs the IAEA Additional Protocol.
13 March 2004	IAEA Board of Governors unanimously rebukes Iran for failing to disclose significant aspects of its nuclear program. In February 2004, US investigations into the nuclear network masterminded by AQ Khan of Pakistan (the father of Pakistan's nuclear bomb) uncover Iran's plans to build advanced P2 reactors for enriching uranium. Retaliating against the IAEA rebuke, Iran immediately bars nuclear inspectors from entering the country.
28 October 2004	Iran and China sign a preliminary agreement to allow China's Sinopec Group to develop Iran's Yadavaran oil field in exchange for agreeing to buy 10 million tons of Iranian liquefied natural gas annually for 25 years.
26 May 2005	Prompted in part by Iran's recent nuclear cooperation in negotiations with the EU, the US announces it will allow Iran's WTO membership talks to begin.
4 February 2006	IAEA governing board refers Iran to the U.N. Security Council over concerns that the country is developing nuclear weapons.
14 February 2006	Iran resumes uranium enrichment. Earlier, Iran announced it would no longer permit surprise inspections of nuclear facilities.

Source: Gary Hufbauer, Jeffrey Schott, Kimberly Elliott, and Barbara Oegg. Economic Sanctions Reconsidered: History and Current Policy. Third Edition. Washington: Institute for International Economics, forthcoming 2007.

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