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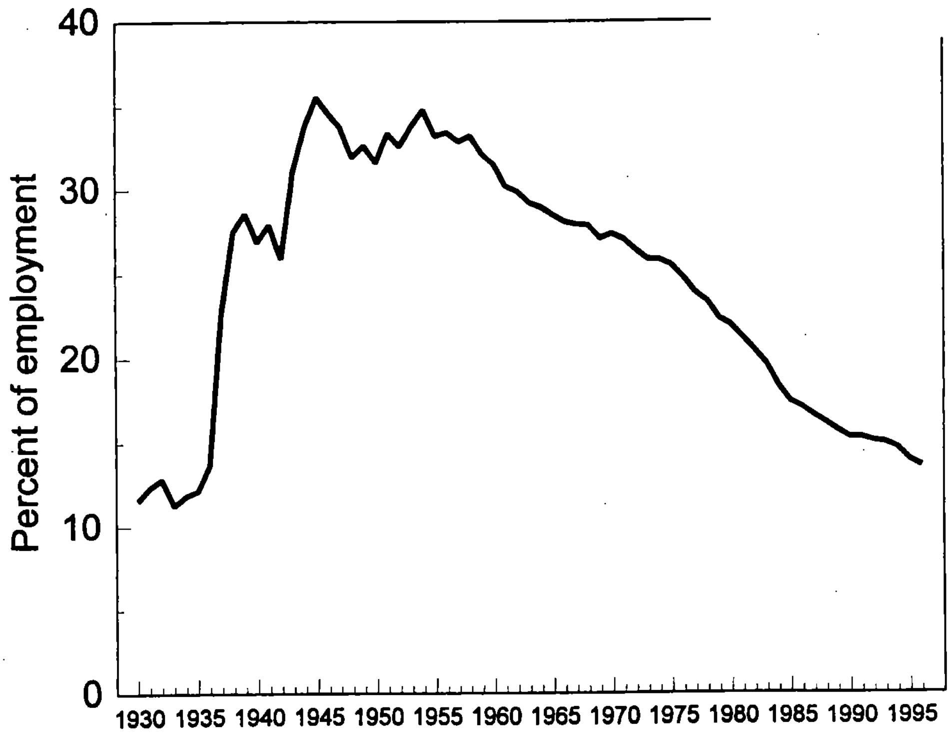
WEEKLY ECONOMIC BRIEFING OF THE PRESIDENT OF THE UNITED STATES

Prepared by the Council of Economic Advisers
with the assistance of the Office of the Vice President

February 14, 1997

CHART OF THE WEEK

Long-Term Trends in Union Membership



Unions represented about a third of all employed workers in the decade following World War II, but they represent only about 14 percent today. Through the 1960s and 1970s, union membership continued to grow, but more slowly than employment. More recently, membership has been falling. In 1996, 16.3 million workers were union members, down from a peak of 20.2 million in 1978. Reasons for the decline include increasing employment in less-unionized sectors (services), regions (the South), and demographic groups (women), as well as intensified management opposition to unions (see *Weekly Economic Briefing*, September 12, 1994).

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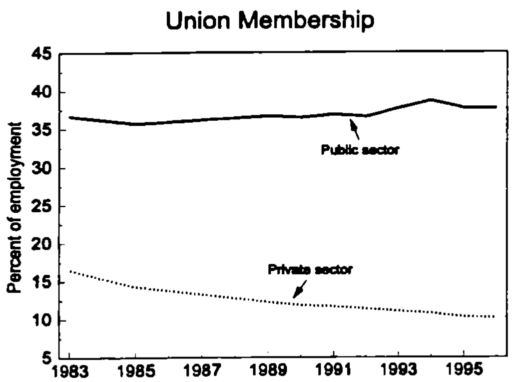
CURRENT DEVELOPMENT

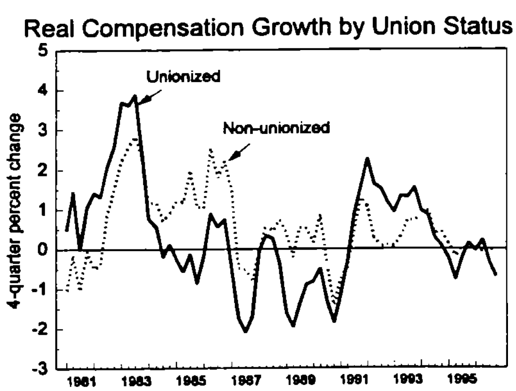
Trends in Union Membership and Earnings

At least three aspects of trends in union membership and earnings are noteworthy.



Membership trends. The overall decline in membership has been concentrated in the private sector (see upper chart). While the share of private sector workers who are union members fell from 16.5 percent in 1983 to 10.2 percent in 1996, the share of public sector workers has remained roughly constant at about 37 percent.

Compensation trends. Compensation has often changed at different rates in the unionized and non-unionized sectors of the economy (see lower chart). During much of the 1980s, for example, compensation grew more slowly in the unionized sector than in the rest of the economy, and more slowly than inflation. More recently, the trends have been similar in both sectors.



Wage premium. Weekly earnings for the typical unionized worker were about a third higher than those of the typical non-unionized worker in 1996. Part of this difference reflects the fact that unionized workers tend to be concentrated in higher paying jobs (in larger firms, urban areas, and manufacturing and public utilities industries). Unionized firms faced with higher wages may also have the ability to screen for and select workers with better-than-average skills and training from the queue of workers seeking union-wage jobs. Nevertheless, econometric studies that try to control for these other factors suggest that working in a unionized firm raises a worker's earnings by 10 to 15 percent. In short, being in a union matters, even after taking other factors into account.

SPECIAL ANALYSIS

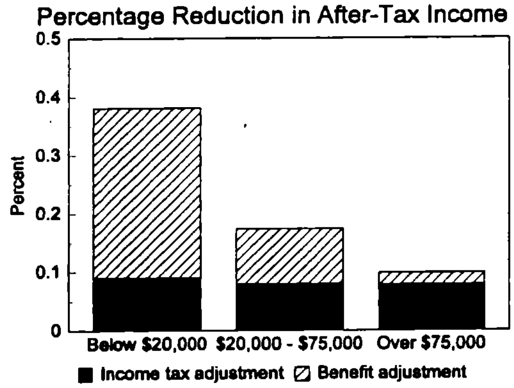
Distributional Effects of Adjusting the CPI

The Advisory Commission to Study the Consumer Price Index (popularly known as the "Boskin Commission") reported that increases in the CPI overstate increases in the cost of living by about 1 percentage point per year. In light of this finding, the commission advised the President and the Congress to reevaluate the indexing provisions in various Federal spending programs and the Tax Code. Analysis prepared for the commission by the Congressional Budget Office (CBO) shows that a reduction in the inflation adjustment for indexed programs and individual income taxes would have the largest relative impact on low-income households.

What would be affected? Smaller cost-of-living adjustments would increase individual income tax payments by reducing the size of the earned income tax credit, the standard deduction, the personal exemption, and the income breakpoints where higher marginal tax rates begin. Smaller cost-of-living adjustments would also reduce payments for Social Security and Supplemental Security Income (SSI) benefits, veterans' compensation and pensions, and Federal employee pensions.

Taking into account these effects, CBO estimates that reducing annual cost-of-living adjustments by 1 percentage point would lower the Federal deficit by almost $650 billion over 10 years. Of this total, half comes from reduced benefit payments (primarily Social Security and SSI), a third from larger tax payments, and the rest from lower debt service.

Percentage Reduction in After-Tax Income



Who would be affected? CBO analysis shows that the resultant tax increases would be spread roughly proportionately across the income distribution (see chart). On the benefit side, however, reductions would be larger (as a fraction of after-tax income) for lower-income households, primarily because SSI and Social Security benefits are a larger share of their income. As a result, the combined effect of reduced cost-of-living adjustments is larger on a percentage basis for lower income households. In the first year of a "CPI minus 1 percentage point" cost-of-living adjustment, households with annual incomes below $20,000 would, on average, experience a reduction in after-tax income of 0.4 percent (about $30), while average after-tax income for households with annual incomes over $75,000 would decline by only 0.1 percent (about $105). As the effects of these annual adjustments compound over time, the income losses grow larger. Moreover, the percentage difference between high- and low-income households widens substantially.

SPECIAL ANALYSIS

Giving "Lives" a Dollar Value: Are Efficiency and Ethics in Conflict?

In numerous contexts—regulatory reform, environmental protection, airline safety, medical insurance, and tort liability—legislators, regulators, judges, and ordinary citizens make decisions regarding how much should be spent to reduce the chance of a premature death. It is important to recognize that deciding to spend only a limited amount in these contexts need not violate ethical beliefs that life is priceless.

The policy challenge. Evaluating policies on economic grounds depends on how well outcomes match the choices well-informed, affected individuals would make. By that standard, limiting expenditures to reduce risk is justified only if consumers would similarly limit what they would spend for increased safety. Can such limits ever be reconciled with a willingness to pay any price to save a particular life?

Statistical lives. Assigning finite values per life saved arises out of the statistical nature of most risk-related policy contexts. An environmental rule, for example, might be found to result in five fewer fatal cancers among a population of a million. The benefits of this rule to those million people would, to an economist, be measured by how much each would pay to reduce his or her own risk by that small amount. Suppose each person would pay $20 for this small improvement. They would then collectively be willing to pay $20 million, or "$4 million per life saved." Under simplistic cost-benefit tests, if this rule would impose $10 million in costs, it would be worth instituting; if it would impose $30 million in costs, or "$6 million per life saved," it would not.

Measurement. People typically require only relatively small benefits to accept small increments of risk. Data often used to assess the value of safety are wage premiums necessary to enter hazardous lines of work, such as construction or mining. Recent valuations are roughly $5 million for the loss of one statistical life. Care in using these estimates is crucial, since those willing to work in hazardous occupations may be less averse to risk than the population at large.

Reconciling economics with pricelessness. When risks are large, the amount people are willing to spend per life saved can increase, becoming arbitrarily large in a clear life-or-death context. This is not a sign of "economic irrationality." For one thing, the prospect of an arbitrarily large amount of money is not worth much if the chance one will be around to spend it is very small (or none at all). Thus, assigning a finite willingness-to-pay to save a "statistical" life remains consistent with views that when any identifiable life is at stake, no expense need be spared.

BUSINESS, CONSUMER, AND REGIONAL ROUNDUP

Corporate Borrowers Follow Treasury's Lead. The enthusiastic response to the Treasury Department's first auction of inflation-indexed securities in late January (which generated bids totaling more than five times the volume of securities offered) was followed by substantial private issuance of indexed securities last week. Some of the issues were by quasi-governmental organizations, including the Federal Home Loan Bank System and the Tennessee Valley Authority, but others were by private firms, including Toyota, Salomon Brothers, and J.P. Morgan. Thus far, private issuance has totaled about $1.7 billion, or about a quarter of the $7 billion of inflation-indexed securities issued by the Treasury. In some cases the method of indexation used by the private issuers differed from that employed by the Treasury. The Treasury securities pay a fixed rate of interest on a principal amount that is adjusted to take account of inflation, with the inflation-adjusted principal repaid at maturity. By contrast, some of the private securities adjust the interest payments to take account of inflation, and leave the principal amount unadjusted.

Inflation's Overstatement Overstated? An overwhelming majority—96 percent—of economists agree with the Advisory Commission to Study the Consumer Price Index (the "Boskin Commission") that the CPI overstates the true inflation rate, according to a recent *USA Today* survey of 49 economists. About half agreed with the commission's finding that the bias was about 1.1 percentage points per year. The rest thought it was less than that (with a mean of about 0.5 percentage point). A separate survey of two dozen experts conducted by the commission's chairman found stronger support for the commission's findings. Among the 20 who responded, the mean estimate of the annual CPI bias was 1.2 percentage points, the median estimate was 1.1 percentage points, and and no ones best estimate of the bias was less than 0.5 percentage point.

***Economic Report of the President* a Hot Seller at GPO.** The *Economic Report of the President*, released this week, has been a perennial favorite of customers of the Government Printing Office. This year's discussion of the economy has a stunning green cover and costs $20 in the paperback edition. Recent sales data show that the *ERP* is number five on the all-time bestseller list (not number two as first reported in a confidential White House briefing), having sold over 1.3 million copies during its half-century run. It trails big sellers such as the United States Government Manual and the International Certificate of Vaccination. The Report sold over 12,000 copies (not including government agencies or depository libraries) in 1996—three times the sales of the *Budget*. Average annual total distribution of the *ERP* has been about 45,000 copies in recent years. It is also available on the Internet. A key audience is college economics students.

INTERNATIONAL ROUNDUP

New Study Shows that Trade Raises Growth. Although economists have long recognized that trade and growth are correlated, researchers have struggled to establish causation. Does trade cause income to rise? Or does higher income lead to more trade? A new study examining about a hundred medium and large countries addresses this issue by looking at trade that is not determined by income, but rather by countries' geographic characteristics, such as proximity to other countries and whether they are landlocked. Results show that these geographic factors have large effects on trade and that trade has substantial effects on income, even after the effect of higher income in encouraging more trade is removed. For example, an increase of a single percentage point in the share of both imports and exports in GDP raises income per person by 2 percent or more over 25 years. Related research concentrating on East Asia shows that high levels of trade—stemming in part from a favorable geographic position—have been an important source, albeit not the only source, of these countries' rapid growth.

China Emerges as Major Source of Capital Flows. China's role as a recipient of capital inflows has been widely noted (it is, on average, second only to the United States as a recipient of foreign direct investment). Less noted are capital outflows from China. Yet China is the eighth largest supplier of net capital on world markets, according to the International Monetary Fund. Between 1989 and 1995, for example, gross outflows of long-term capital from China totaled $120 billion. At present, much of this represents repayment of debt and capital flight; only about 7 percent represents "registered" direct foreign investment. The Government of China has been actively encouraging direct overseas investment, however, as an avenue for securing cheaper inputs, gaining access to proprietary technology, increasing foreign exchange earnings, and diversifying some of China's large state-owned enterprises.

Tax Competition Concerns Highlighted in Struggle to Meet Maastricht Criteria. Germany, Belgium, and France have denounced differentiated tax regimes designed to lure investment and savings to low-tax countries. Ireland was singled out for criticism because it offers tax incentives for large-scale investment; Luxembourg was attacked for "poaching savings" through an exemption for non-residents in its withholding tax on savings. Although issues of fiscal harmonization have been played down in EU negotiations, efforts to meet the Maastricht Treaty deficit criterion (3 percent of GDP in 1997) for entry in 1999 have forced EU governments to focus efforts on revenue generation. This has heightened concerns about capital flight to neighbors with lower tax rates. Although some worry that economic and monetary union will aggravate the effects of tax differentials, most EU members view fiscal policy independence as a critical component of national sovereignty and necessary to balance the centralization of monetary policy. The issue of "unfair" tax competition has also been raised at the OECD where a report on the topic is being prepared.

RELEASES THIS WEEK

Industrial Production and Capacity Utilization
****Embargoed until 9:15 a.m., Friday, February 14, 1997****

The Federal Reserve's index of industrial production was unchanged in January. Capacity utilization declined 0.2 percentage point to 83.3 percent.

Producer Price Index
****Embargoed until 8:30 a.m., Friday, February 14, 1997****

The producer price index for finished goods fell 0.3 percent in January. Excluding food and energy, producer prices were unchanged.

Retail Sales

Advance estimates show that retail sales rose 0.6 percent in January following an increase of 0.3 percent in December. Excluding sales in the automotive group, retail sales increased 0.4 percent.

Productivity

Nonfarm business productivity rose 2.2 percent at an annual rate in the fourth quarter of 1996. Manufacturing productivity rose 3.8 percent.

MAJOR RELEASES NEXT WEEK

Consumer Prices (Wednesday)
U.S. International Trade in Goods and Services (Wednesday)
Housing Starts (Thursday)

U.S. ECONOMIC STATISTICS

	1970–1993	1996	1996:2	1996:3	1996:4
Percent growth (annual rate)					
Real GDP (chain-type)	2.7	3.4	4.7	2.1	4.7
GDP chain-type price index	5.3	2.1	2.2	2.0	1.8
Nonfarm business (NFB) sector:					
Productivity (chain-type)	1.5	**1.2**	0.6	**0.0**	**2.2**
Real compensation per hour:					
Using CPI	0.6	**0.4**	0.1	**1.0**	**0.4**
Using NFB deflator	1.3	**2.1**	2.0	2.0	**2.4**
Shares of Nominal GDP (percent)					
Business fixed investment	10.9	10.4	10.3	10.6	10.5
Residential investment	4.5	4.1	4.2	4.1	4.0
Exports	8.2	11.3	11.3	11.1	11.5
Imports	9.2	12.6	12.6	12.7	12.7
Personal saving	5.1	3.6	3.2	3.9	3.8
Federal surplus	−2.7	N.A.	−1.7	−1.6	N.A.

	1970–1993	1996	Nov. 1996	Dec. 1996	Jan. 1997
Unemployment Rate	6.7**	5.4**	5.3	5.3	5.4
Payroll employment (thousands)					
increase per month			181	261	271
increase since Jan. 1993					11500
Inflation (percent per period)					
CPI	5.8	3.3	0.3	0.3	N.A.
PPI-Finished goods	5.0	2.8	**0.2**	**0.6**	**−0.3**

**Figures beginning 1994 are not comparable with earlier data.

New or revised data in **boldface**.
PPI data **embargoed until 8:30 a.m., Friday, February 14, 1997**.

FINANCIAL STATISTICS

	1995	1996	Dec. 1996	Jan. 1997	Feb. 13, 1997
Dow-Jones Industrial Average	4494	5743	6436	6707	7022
Interest Rates					
3-month T-bill	5.49	5.01	4.91	5.03	5.00
10-year T-bond	6.57	6.44	6.30	6.58	6.32
Mortgage rate, 30-year fixed	7.95	7.80	7.60	7.82	7.65
Prime rate	8.83	8.27	8.25	8.25	8.25

INTERNATIONAL STATISTICS

Exchange Rates	**Current level Feb. 13, 1997**	**Percent Change from**	
		Week ago	**Year ago**
Deutschemark-Dollar	1.687	2.1	14.1
Yen-Dollar	124.4	0.4	16.3
Multilateral $ (Mar. 1973=100)	95.01	1.5	9.3

International Comparisons	**Real GDP growth (last 4 quarters)**	**Unemployment rate**	**CPI inflation (last 12 months)**
United States	3.4 (Q4)	5.4 (Jan)	3.3 (Dec)
Canada	1.6 (Q3)	9.7 (Dec)	2.2 (Dec)
Japan	3.2 (Q3)	3.3 (Dec)	0.5 (Nov)
France	1.4 (Q3)	12.8 (Oct)	1.7 (Dec)
Germany	1.9 (Q3)	7.5 (Nov)	1.4 (Dec)
Italy	0.7 (Q3)	11.9 (Jul)	2.6 (Dec)
United Kingdom	2.6 (Q4)	7.8 (Dec)	2.4 (Dec)