"Key Policy Challenges for the G-7"
Address by Dr. Joseph Stiglitz
to the Institute of International Finance
Washington, DC
Sunday, October 8, 1995

**Introduction**

○ Thank you very much for inviting me to address this distinguished group.

○ The title of my talk is "Key Policy Challenges for the G-7," and I will speak about two long-run challenges facing economic policy-makers today: fiscal consolidation and reform of the official international organizations.

○ Of course, we all have different notions of "short run" and "long run." Toyoo Gyoten, the former Vice Minister for International Affairs at Japan's Ministry of Finance, tells a wonderful story of interviewing some foreign exchange traders. One of them said that he took short-run, medium-run, and long-run factors into account in his trading strategies. Gyoten became quite interested that the trader looked at long-run factors, and asked him what he meant by that. The trader paused and then responded: "Probably ten minutes." I can reassure you that is not what I mean by the long run.

## I. Short-run economic prospects

○ Before turning to longer-run issues, let me begin with a brief summary of current economic conditions in the G-7.

○ The G-7 experienced an impressive combination of strong growth and low inflation during 1994.

--Growth for the G-7 as a whole was 3.1 percent in 1994 (see chart). Private sector consensus estimates predict G-7 growth of 2.4 percent this year and next year (see chart).
**[It may be appropriate to note that all forecasts you will mention were constructed prior to the announcement of the Japanese stimulus package on September 20.]**

--Inflation remains low. Inflation across the G-7 in 1994 was 2.2 percent, reminiscent of the low inflation rates of the 1960s. Inflation is expected to be 2.5 percent this year and 2.6 percent next year (see chart). Inflation is not dead, but it may have a hard time buying life insurance.

○ The United States seems to be achieving a highly desirable "soft landing."

--Real GDP growth slowed at the beginning of this year, at 2.7 percent in the first quarter and 1.3 percent in the second quarter (see chart). Official administration forecasts are for growth of 2.8 percent on a year-over-year basis and 1.9 percent on a Q4/Q4 basis. More recent data, including the upward revision in the second quarter GDP figures, suggest that these estimates may be a bit conservative.

--U.S. economic growth continues to be driven by interest-sensitive spending and by exports. Real spending on producers' durable equipment rose by 25 percent in the first quarter and by an additional 12 percent in the second quarter (see chart). Export growth has also been substantial: real merchandise exports were 14 percent higher in the second quarter than a year earlier (see chart).

--Inflationary pressures remain subdued. The consumer price index in August was only 2.6 percent above its level a year earlier. For a variety of reasons, this may overstate the actual rate of inflation. The Administration and others are currently studying the various biases in the consumer price index.

--As the U.S. economy settles into what I hope will be an extended period of sustainable growth with low inflation, fiscal policy issues have become a central focus. I will return to a discussion of the historic deficit reduction that the Clinton Administration has achieved, as well as the impact for the long-run prospects of the U.S. economy, below.

○ The situation in Japan may be the most challenging.

--There has been essentially zero growth in the past three years (see chart).

--The Japanese government has finally acknowledged and has now begun to confront the bad loan problem of its financial sector. One lesson we have learned from our mistakes with the Savings and Loans experience is that it is better to confront bad loans quickly, rather than to allow the problem to linger on and grow. I hope that our experience proves useful to the Japanese authorities as they face the problems in their own banking sector.

--The U.S. Government welcomes both the reduction in the official discount rate (to 0.50 percent) announced on September 8 and the 14.2 trillion yen fiscal stimulus package announced on September 20. Economic conditions in Japan have important ramifications for the rest of the world, and I trust that the Japanese Government will continue to take whatever steps it feels is necessary to stimulate the economy and address problems in the banking sector.

○ The European economies are, in general, likely to continue to achieve moderate growth with relatively low inflation.

--Nevertheless, high levels of unemployment--and especially high levels of long-term unemployment--remain a substantial economic policy challenge.

--Recent attention in Europe has focused on fiscal consolidation issues, especially in the context of European Monetary Union and the Maastricht Treaty conditions. Such fiscal issues will be the focus of the next part of my talk, on longer-run economic prospects.

## II. Fiscal positions in the G-7

○ Fiscal positions in many of the G-7 countries are a cause for concern.

--According to the OECD, general

government deficits in the G-7 amounted to 3.6 percent of GDP in 1994 (see chart). This is slightly lower than the peaks reached in the early 1980's and early 1990's, but still remains quite high. The G-7 as a whole does not meet the Maastricht 3 percent threshold.

--There is considerable variation in deficit-GDP ratios across the G-7 economies (see chart). As is well known, the deficit problem is particularly severe in Italy, where the budget deficit amounted to 9.0 percent of GDP in 1994.

--Because of sustained and substantial deficits over the past fifteen years, government debt levels have reached very high levels in some countries. According to the OECD, the G-7's general government debt amounted to 40 percent of GDP in 1994, up from 21 percent in 1980 (see chart). Again, the data display considerable variation across the countries (see chart).

○ A natural and important question to ask is whether these deficit and debt levels matter. Are they a problem? The answer is yes.

--To put it simply: deficits can stunt long-term economic growth. If governments borrow against savings in order to finance current consumption--rather than investing in things like education and technology and infrastructure that will boost our future productivity--economic growth will be limited down the road.

--An alternative way of putting the same point is that under reasonable assumptions, government borrowing pushes up real interest rates. This increase in real interest rates crowds out private investment. If the government borrowing is used to finance public consumption, private investment falls without any offsetting expansion in public investment. This hurts productivity growth.

--Deficit reduction is therefore important because it frees up resources for investment and thus can boost long-term growth. The ultimate objective of fiscal consolidation is to raise growth and living standards.

--The crucial economic lesson is that eliminating the deficit is important, but it is not an end in itself. How the deficit is reduced is also crucially important. This is a theme I will return to below.

--Let me also stress that eliminating the deficit too quickly and without compensating changes in monetary policy entails short-run costs in terms of lower output and higher unemployment. The timing of deficit reduction matters, just as the method of deficit reduction does.

## III. Fiscal policies in the long run

○ Given that large budget deficits impede long-run growth, the current state of government finances in most countries would require corrective policy action--even if all else were to remain constant. But unfortunately all else is not going to remain constant. Demographic changes will put increasing pressure on fiscal positions in the G-7 in the future.

○ There is of course uncertainty over long-term patterns of immigration, mortality, and birth rates. Nevertheless, demographic changes are already determined to a significant degree. And they represent one of the most substantial long-run challenges facing the G-7.

○ In all G-7 countries except the UK, the elderly dependency ratio (defined as the ratio of elderly to a measure of the working age population) is expected to almost double by 2040.

--The elderly dependency ratio is expected to peak at about 40 to 50 percent for the United States, the UK, and Canada (see chart for US)

--The elderly dependency ratio is expected to peak at about 60 percent for Japan, Germany, and France

--The elderly dependency ratio is expected to peak at over 70 percent for Italy.

○ These demographic trends have significant implications for fiscal policy, especially in terms of public spending on health care and pensions.

--According to rough OECD projections, demographic and debt pressures would imply a truly dramatic deterioration in public sector finances. Under its more conservative set of assumptions, the OECD projects that government deficits would significantly deteriorate in all G-7 economies except the UK and Canada (see chart).

--The problem is particularly striking in Japan. The OECD projects that demographic and debt pressures under current policies will drive the Japanese deficit up to 20 percent of GDP in 2030.

--These projections should be treated with more than the usual degree of skepticism. But they do point to the need for substantial policy adjustments across the industrialized economies.

○ There are numerous policy responses to these projected imbalances--responses which will ensure that the imbalances do not in fact materialize as expected.

--Deficit reduction today generates more favorable debt dynamics in the future

--We can and must slow the rate at which health expenditures are rising.

## IV. The Clinton Administration's deficit reduction efforts

○ The United States has already begun the process of making these adjustments. I'd therefore like to turn to the historic fiscal consolidation efforts of the Clinton Administration.

○ Over the past two and a half years, we have made great strides in reducing our budget deficit. Indeed, the Clinton Administration has for the first time since President Truman succeeded in reducing the deficit three years in a row (see chart).

○ The deficit reduction has been even more impressive when viewed relative to the size of the economy (see chart).

○ As a result of the Clinton Administration's efforts, the debt-GDP ratio has stabilized after climbing sharply during the 1980's and early 1990's (see chart).

○ Another measure of the Administration's fiscal responsibility can be seen in what economists call the "primary balance"--which is simply the budget balance excluding interest payments. The Clinton Administration has been running primary budget surpluses--something which hasn't happened since Lyndon Johnson was President (see chart).

## V. The current budgetary battle in the US

○ Over the next two months, we will be engaging in a momentous debate about how the U.S. budget deficit should be further reduced. Both President Clinton and Congress agree: the deficit must be zeroed-out.

○ The question is therefore no longer <u>whether</u> to eliminate the deficit, but rather <u>how</u> to eliminate it. As I noted before, the manner in which the deficit is reduced and the timing of how it is reduced are both crucially important questions--one with significant implications for productivity growth and the other with implications for short-term economic performance.

○ Some in Congress are suggesting that our critical investments in education be put on the chopping block, along with everything else. I find this troubling and extremely short-sighted.

○ The two fundamental economic challenges facing the U.S. today are slow productivity growth and widening income inequality. For reasons only partly understood, there has been a marked slowdown in productivity since 1973 (see chart). At the same time, wage inequality has grown: wages have declined at the bottom of the distribution and risen at the top (see chart).

○ Investments in education offer the best hope of addressing both of these challenges. Educating the workforce will spur productivity growth, which will jump-start stagnating wages and raise the living standards of all workers.

○ A recent report released by the Council of Economic Advisers shows clearly that investments in education yield greater dividends today than ever before. To cite just some of the evidence:

--In 1979, a full-time male worker between the ages of 25 and 34 with at least a bachelor's degree earned 27 percent more per week than a worker with only a high school degree. By 1993, that difference had grown to 65 percent (see chart).

--Recent studies suggest that one year of college education increases annual earnings by between 5 and 13 percent. This holds true not only for four-year institutions, but also for community colleges.

--High school dropouts are far more likely to be convicted of crimes that those with higher levels of education. On any given day in 1992, almost one-quarter of all males between 18 and 34 who had not received a conventional high school diploma were either in prison, on probation, or on parole. This compares to less than 4 percent of those with a high school diploma (see chart).

○ Government investments in education mean higher wages for our workers, a stronger economy, and a better, healthier society. Now is the time to renew our commitment to education, not to back away from it. Deficit reduction should <u>not</u> be accomplished by cutting away at our human capital investments.

○ Some people clearly see things differently. The Clinton Administration proposes to invest $76 billion more in education by the year 2002 than the Budget Resolution passed by Congress (see chart).

○ The fight over education spending is just one example of how there is a right way and a wrong way to reduce the deficit. We must continue to build on the historic deficit reduction we've already achieved. But doing it the wrong way and doing it too quickly could be just as disastrous as not doing it.

## VI. Other policy challenges: international public goods

○ In addition to fiscal policy issues, there are many other ways in which governments can raise living standards. Indeed, I have a reputation for being enthusiastic about the wide variety of ways in which governments can play such a positive role.

○ Unfortunately, I won't be able to go into detail on all of these ideas. But because I am addressing this august international body, and because the topic is one that is being discussed in Washington this weekend, I did want to focus briefly on the roles of official institutions in improving living standards across the globe.

○ A brief digression into economic theory may be beneficial in framing the issue properly. I will therefore briefly don my professorial hat. Please accept my apologies and bear with me.

○ Economists have recognized a class of goods, called pure public goods, that have two properties: they are non-rival in consumption (so that if I consume it, it does not diminish the consumption available to you) and non-excludable (so that it is difficult, if not impossible, to exclude you from enjoying the benefits of it).

--The classic examples of public goods include national defense, police protection, and basic scientific research.

○ Some public goods are local: that is, they benefit only those who reside in a particular area or nation. But I want to call attention to another important class of public goods: international public goods, which benefit people across the globe.

○ These international public goods are, or should be, the collective responsibility of all nations. And unless this collective responsibility is recognized, the goods will be underprovided.

○ There are at least four categories of international public goods: international stability and security, assistance to the less developed economies, science, and the environment. Because of my limited time, I will focus on the first of these.

○ International stability and security has many facets of relevance to official institutions, including the maintenance of macroeconomic and financial market stability, the maintenance of a liberal international trading system, and assisting the reform process in the economies in transition. As an illustrative example, I want to examine this final item, the reform process in the economies in transition.

○ Trillions of dollars were spent winning the Cold War. To maintain this victory, the industrialized democracies should at least be willing to spend billions.

--Ensuring the success of the reform effort in the economies in transition is a collective good: all of the world benefits from international security, and no country or countries can be free riders.

--More than aid is involved. "Trade not aid" is fast becoming a popular mantra, and there is a lot of truth to the saying. Trade assists the reform effort by providing hard currency, helps to correct distorted internal prices, increases interdependence, stabilizes democratic political reforms, and raises incomes and living standards.

--There are, however, strong forces in the industrialized world resisting the free flow of trade from the economies in transition. The entrance of those economies into world markets has been a significant shock to producers of aluminum or uranium or steel. And people often don't like shocks.

--The producers of these raw materials, like other producers, prefer not to have competition. That is understandable. But what is not understandable nor excusable is that Western governments have not done enough to prevent these producers from using unfair trade laws and other means to block exports from the economies in transition. In one example, a producer lobby was able to create what was effectively a government-sanctioned cartel that was supposed to restrict Russian output.

--Limiting trade with the economies in transition is a case in which the interests of consumers and the whole world are sacrificed at the hands of a few producers, willing to fight change rather than adapt to it.

--In order to address the needs of the economies in transition, Western governments must take a more liberal and enlightened approach to trade. We must not say "open up and reform your economies" and then close ours. We must not allow the narrow interests of producers to limit exports from the economies in transition outweigh the broader national and consumer interests in expanding those exports.

○ What is required, to return to the more general theme, is collective action in a collection good. This is true for the entire class of international public goods that I delineated before.

## Conclusion

○ This weekend, as we discuss possible changes to the roles played by official international institutions, we should keep in mind the framework of international public goods.

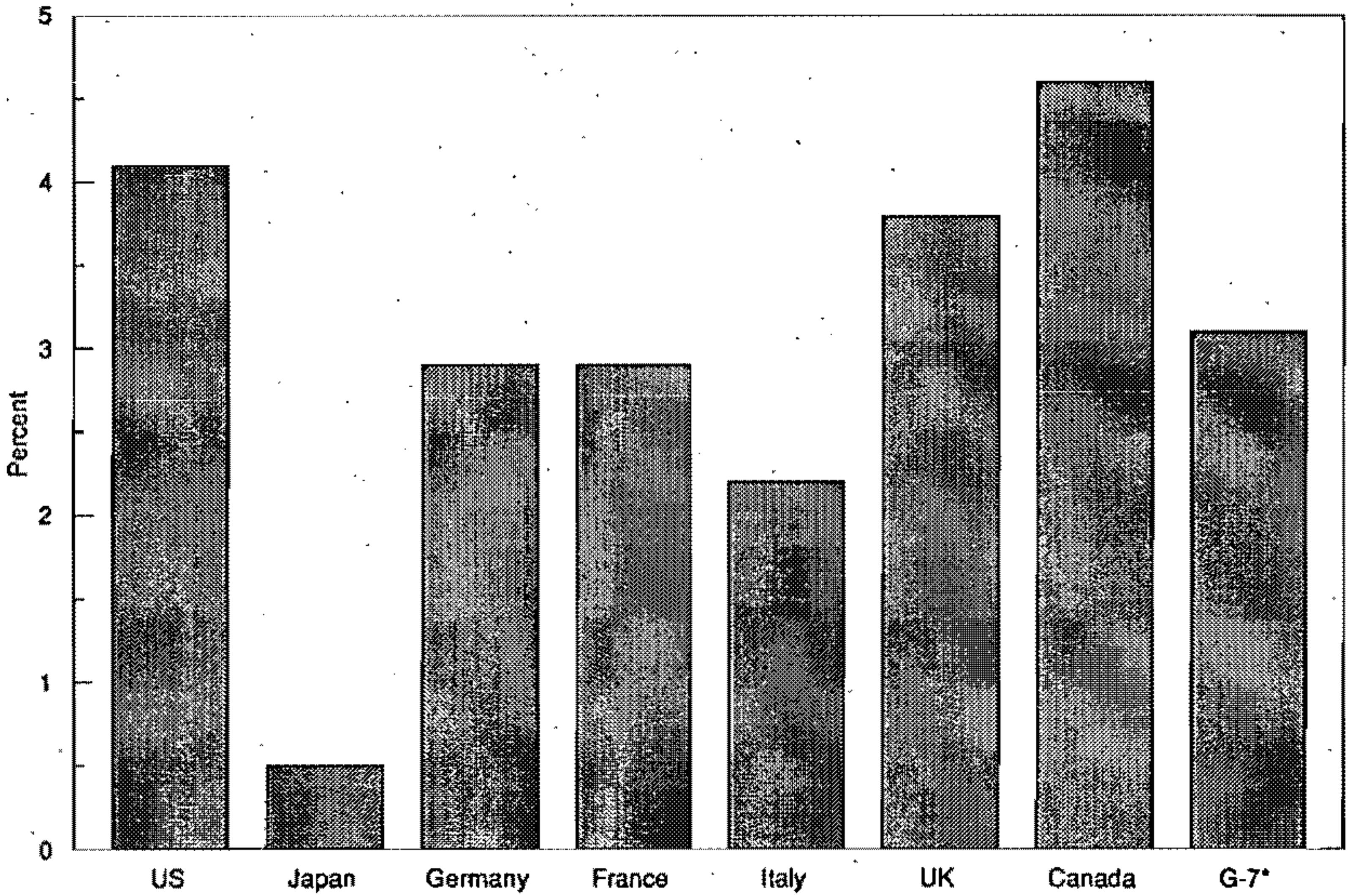
--We should recognize that official institutions should ideally provide those, and only those, goods. Ensuring that such goods are provided is crucial to ensuring long-run prosperity. At the same time, in this era of tight budget for both national governments and official international bodies, it is more important than ever that roles not be duplicated--both between the public sector and the private sector, and also within the public sector itself.

○ In closing, I would note that the efficient provision of international public goods, in this era of fiscal consolidation, is one of the most important problems requiring G-7 leadership. And it is one of the most challenging. Thank you.

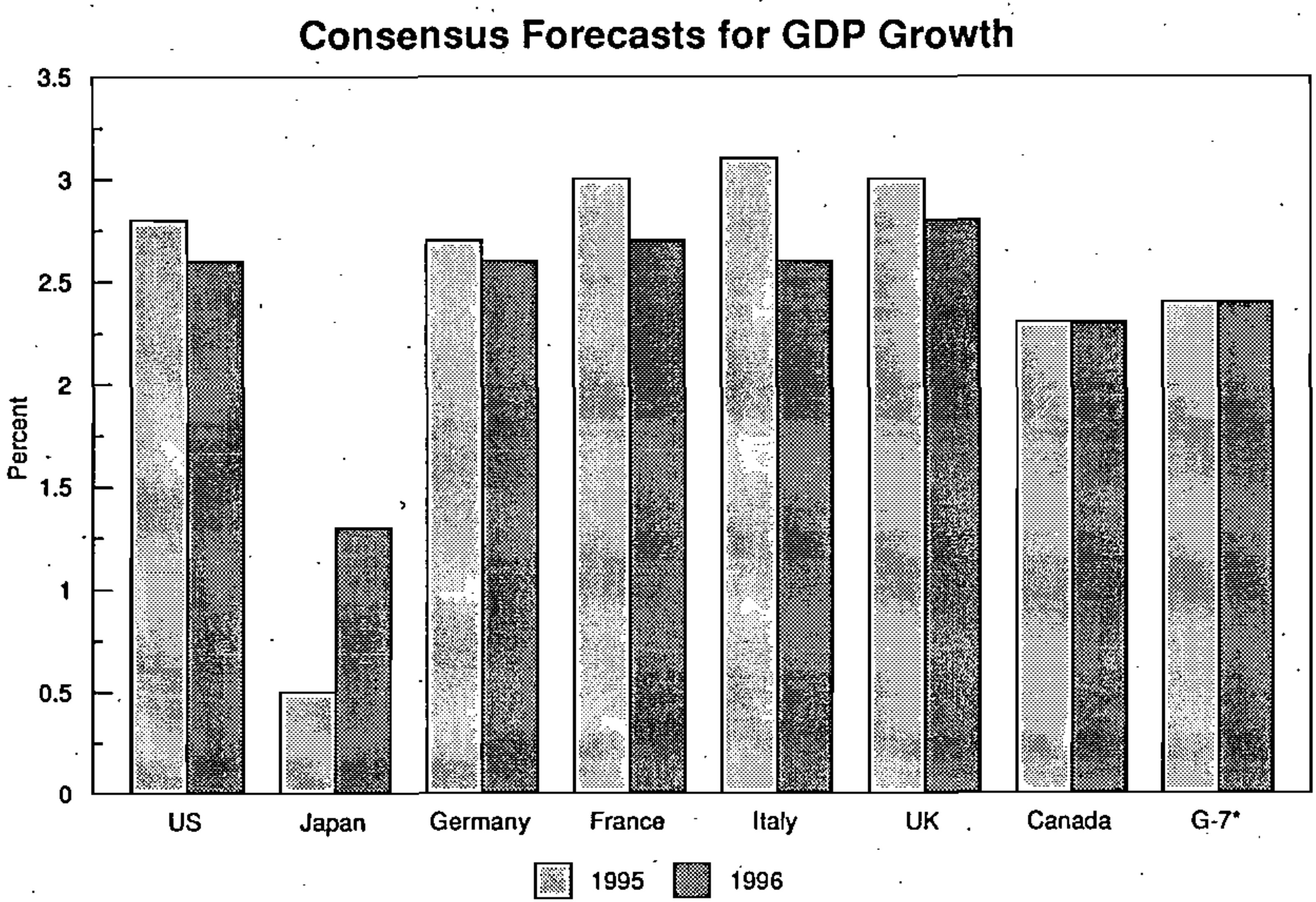
# Two Key Policy Challenges for the G-7

- Fiscal Consolidation
  - while ensuring full employment
  - while promoting investment in human and physical capital
  - while improving equality of opportunity
- Reform of Official International Institutions
  - providing international public goods
  - avoiding duplication

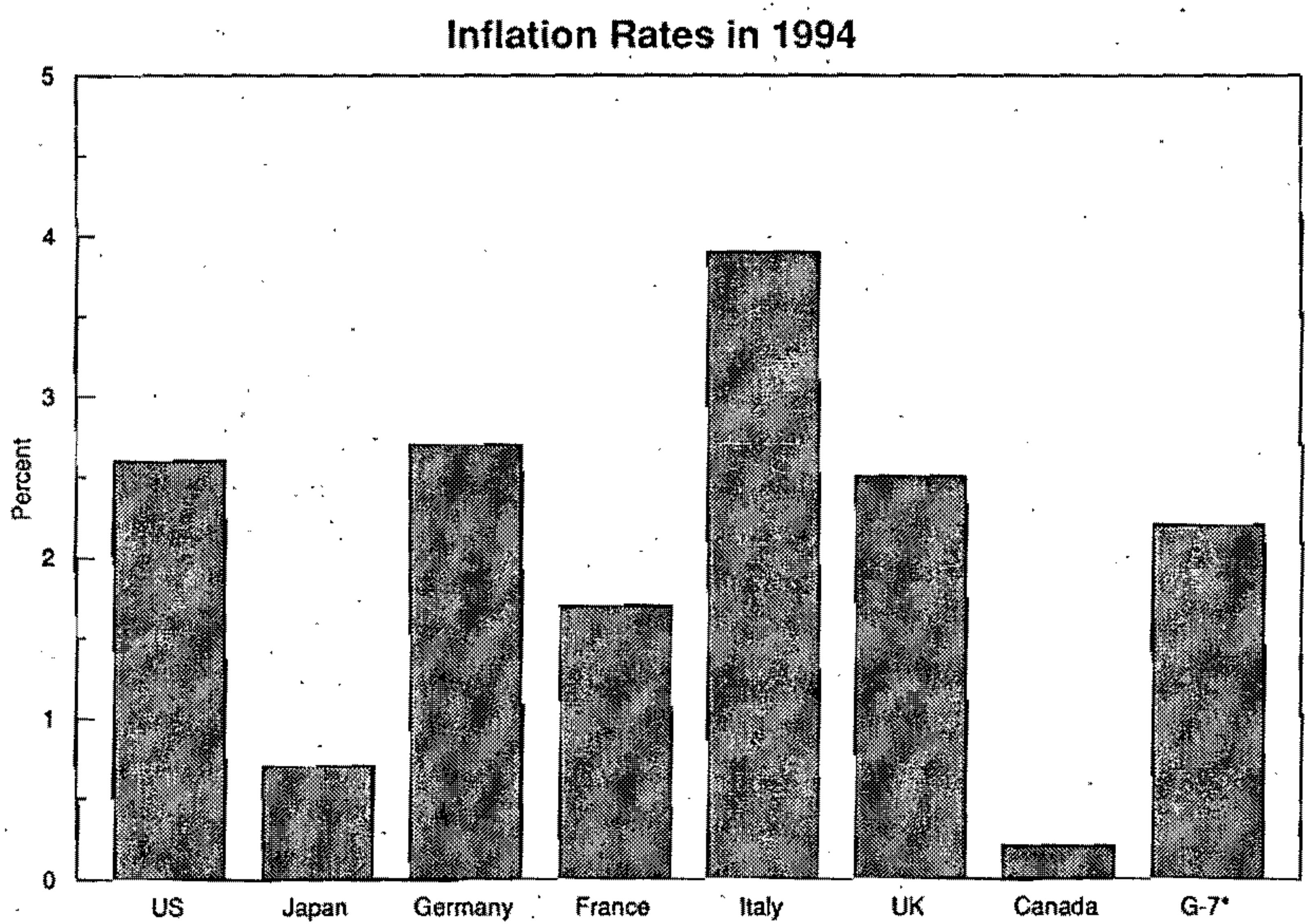
# Real GDP Growth in 1994



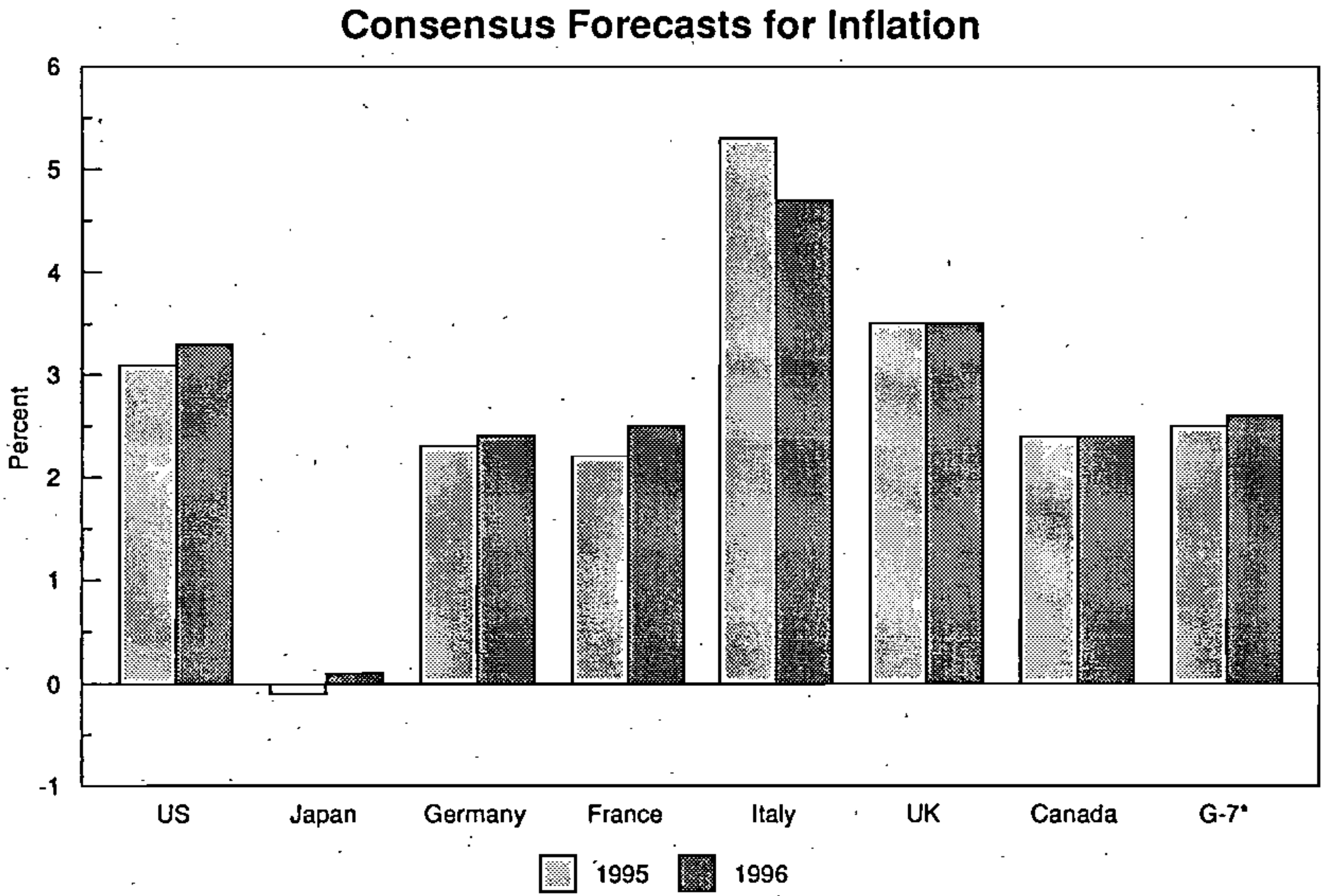

*1994 Purchasing Power Parity weights



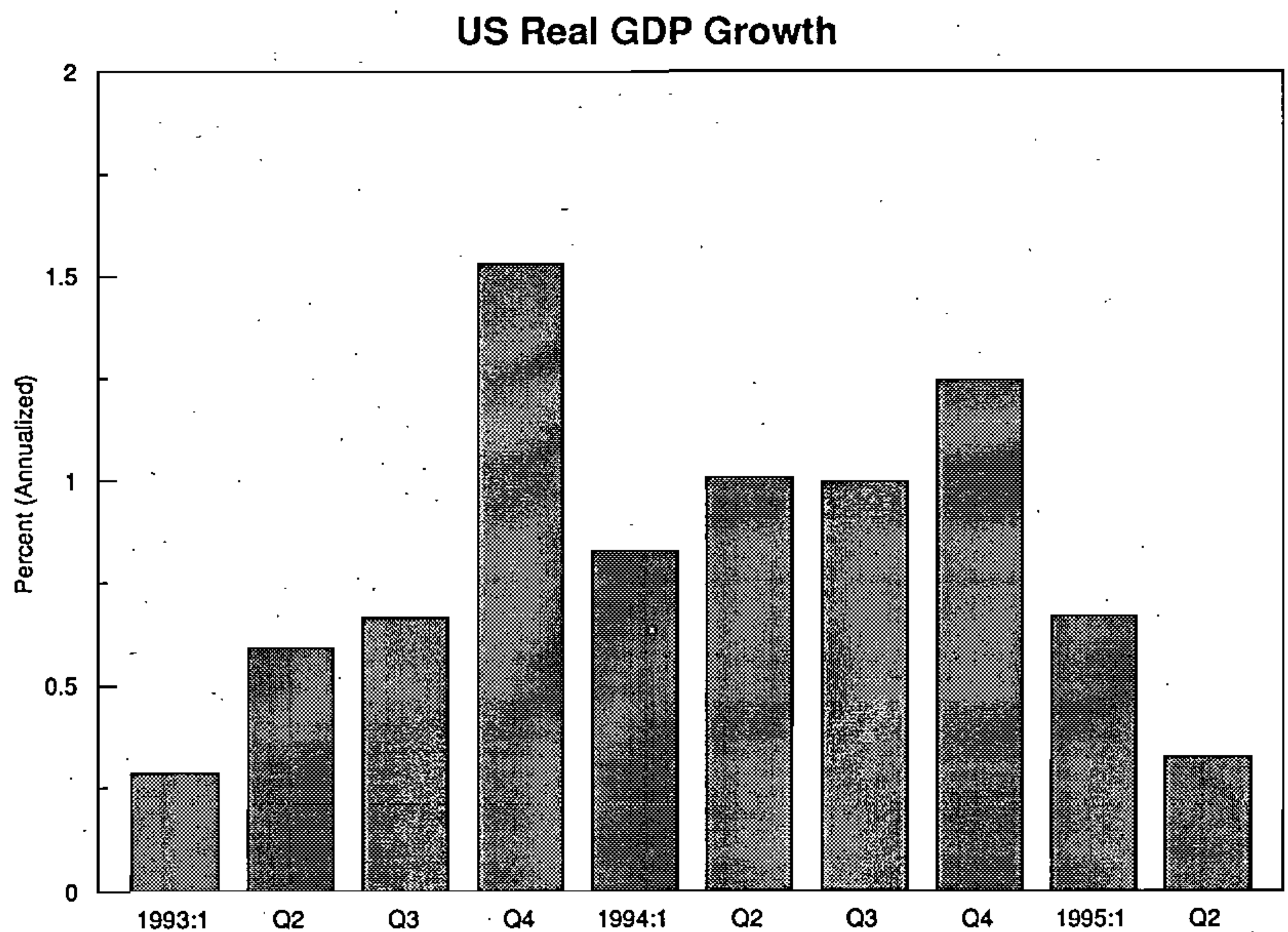

Source: Consensus Forecasts, August 1995
*1994 Purchasing Power Parity weights



*1994 Purchasing Power Parity weights

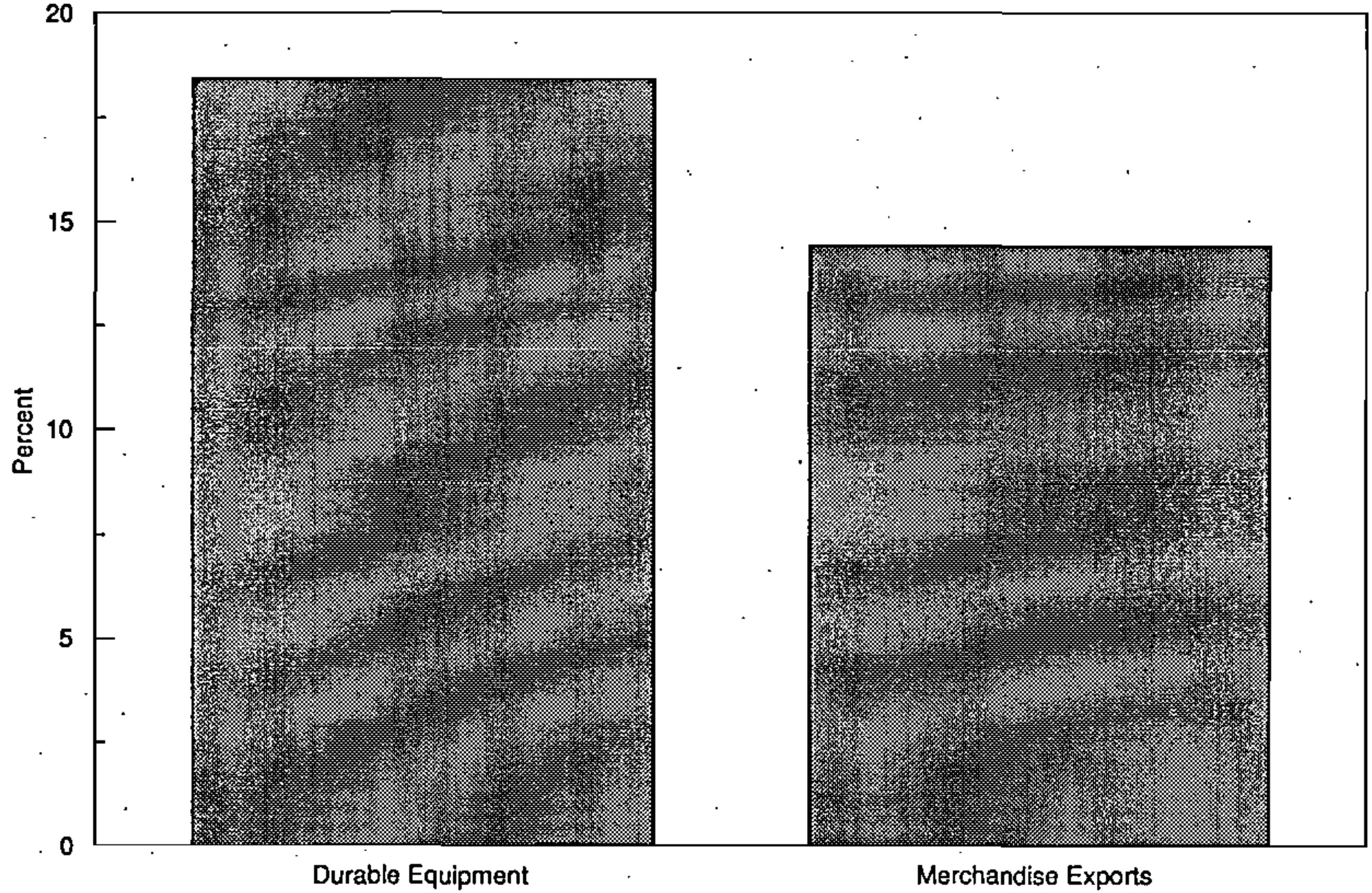



Source: Consensus Forecasts, August 1995
*1994 Purchasing Power Parity weights

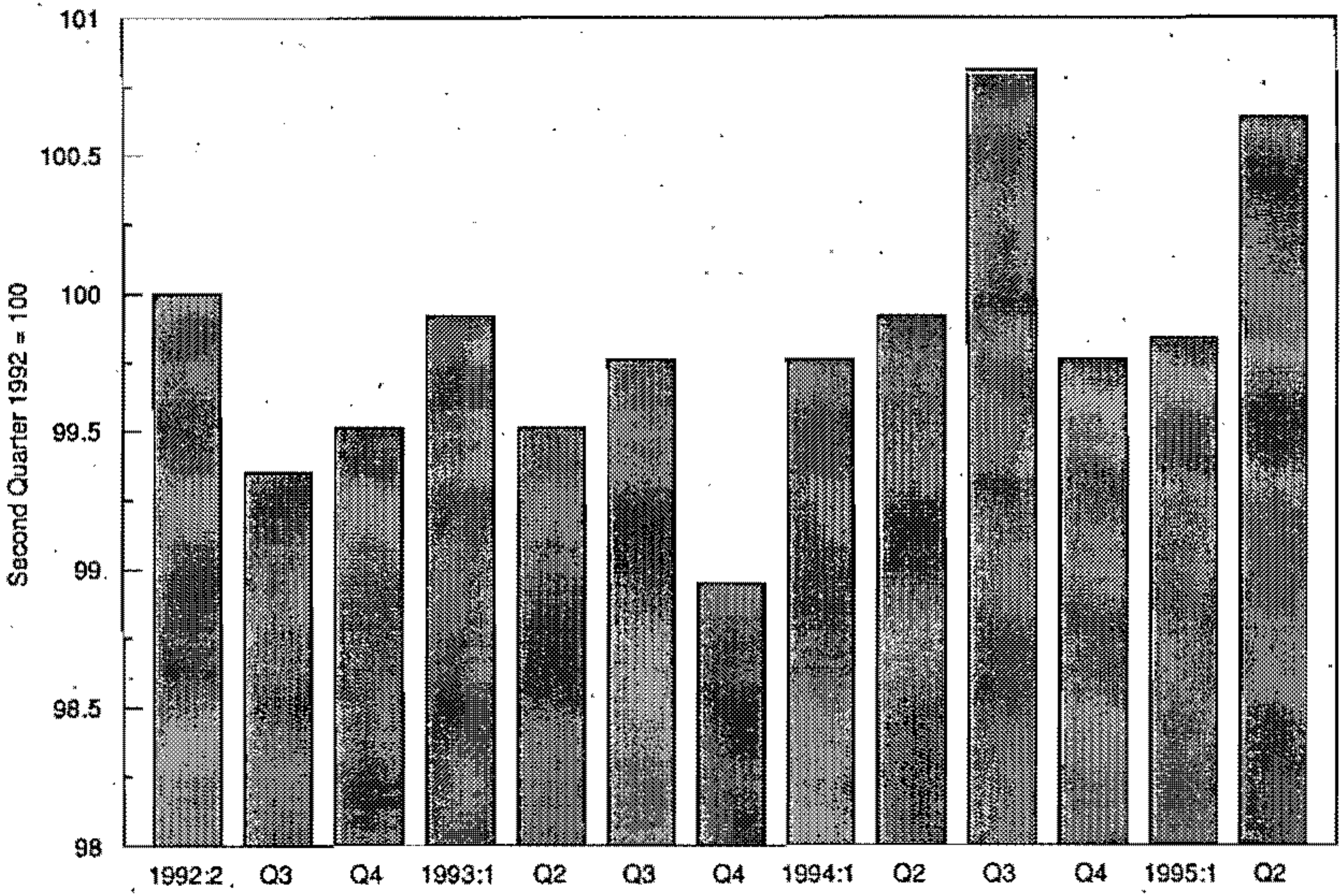

US Real GDP Growth
Percent (Annualized)
2
1.5
1
0.5
0
1993:1
Q2
Q3
Q4
1994:1
Q2
Q3
Q4
1995:1
Q2

## US Economic Performance

### Growth Second Quarter 1995 from Year Earlier

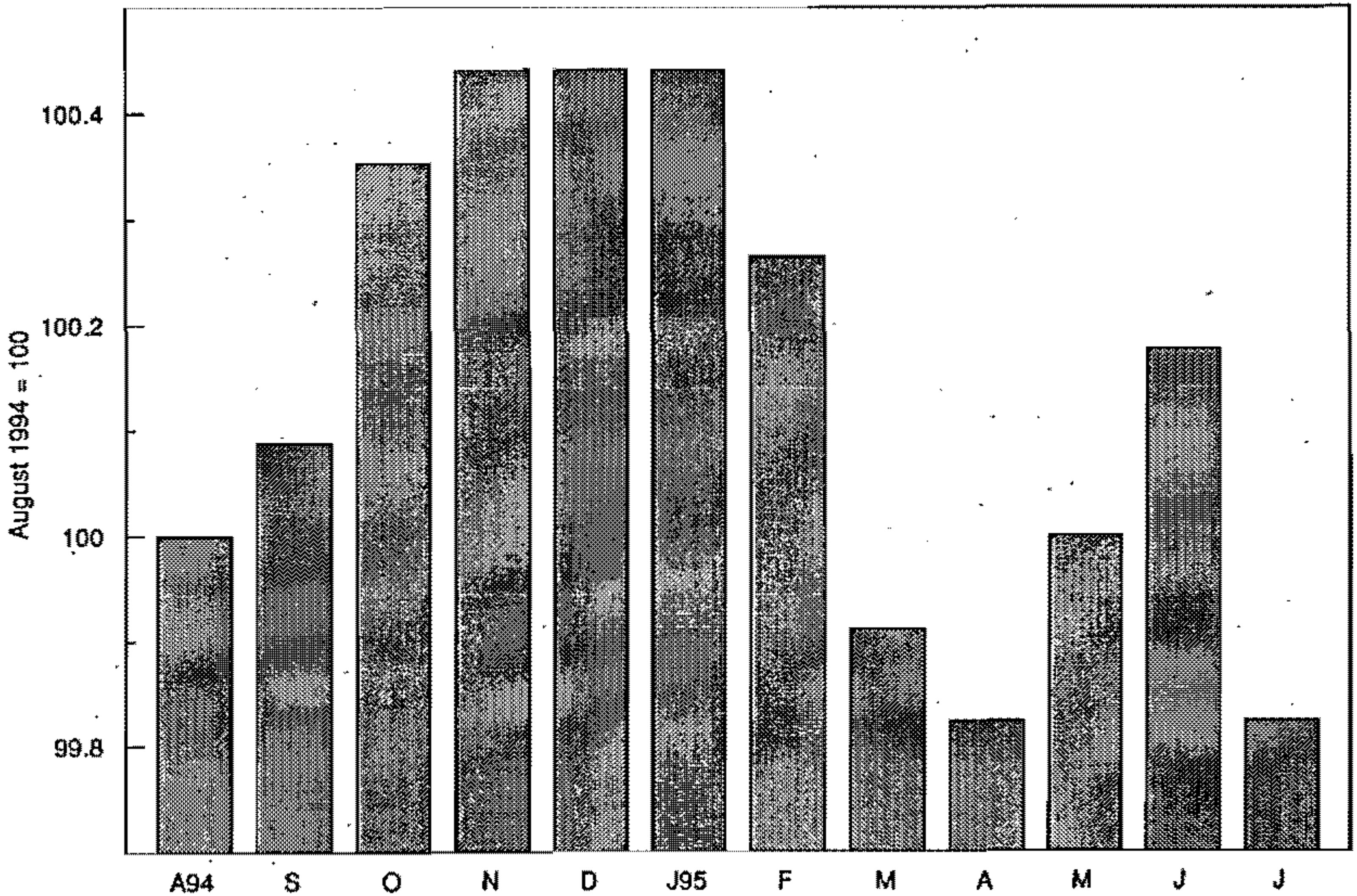


## Index of Japan's Real GDP

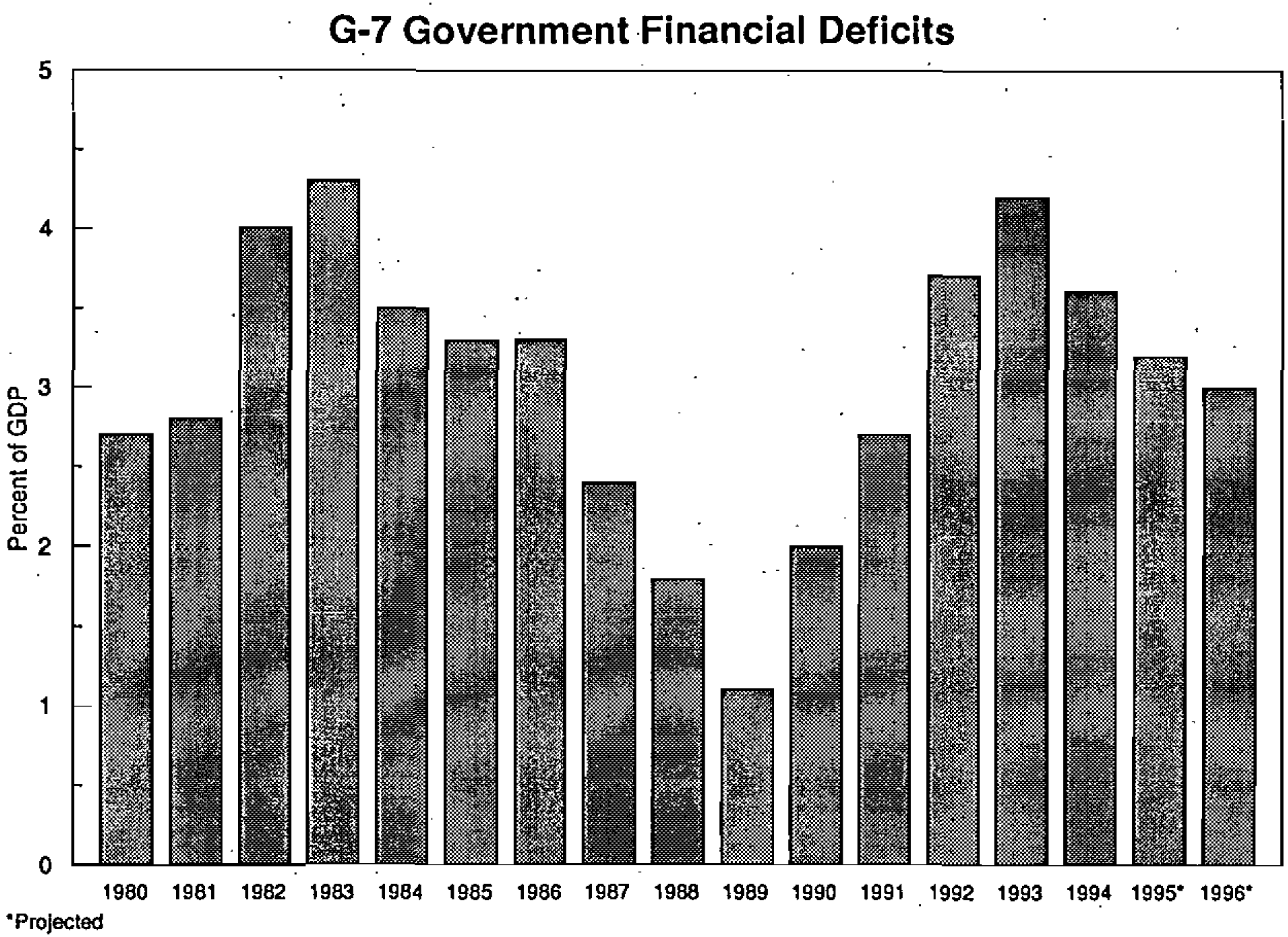



Source: IMF

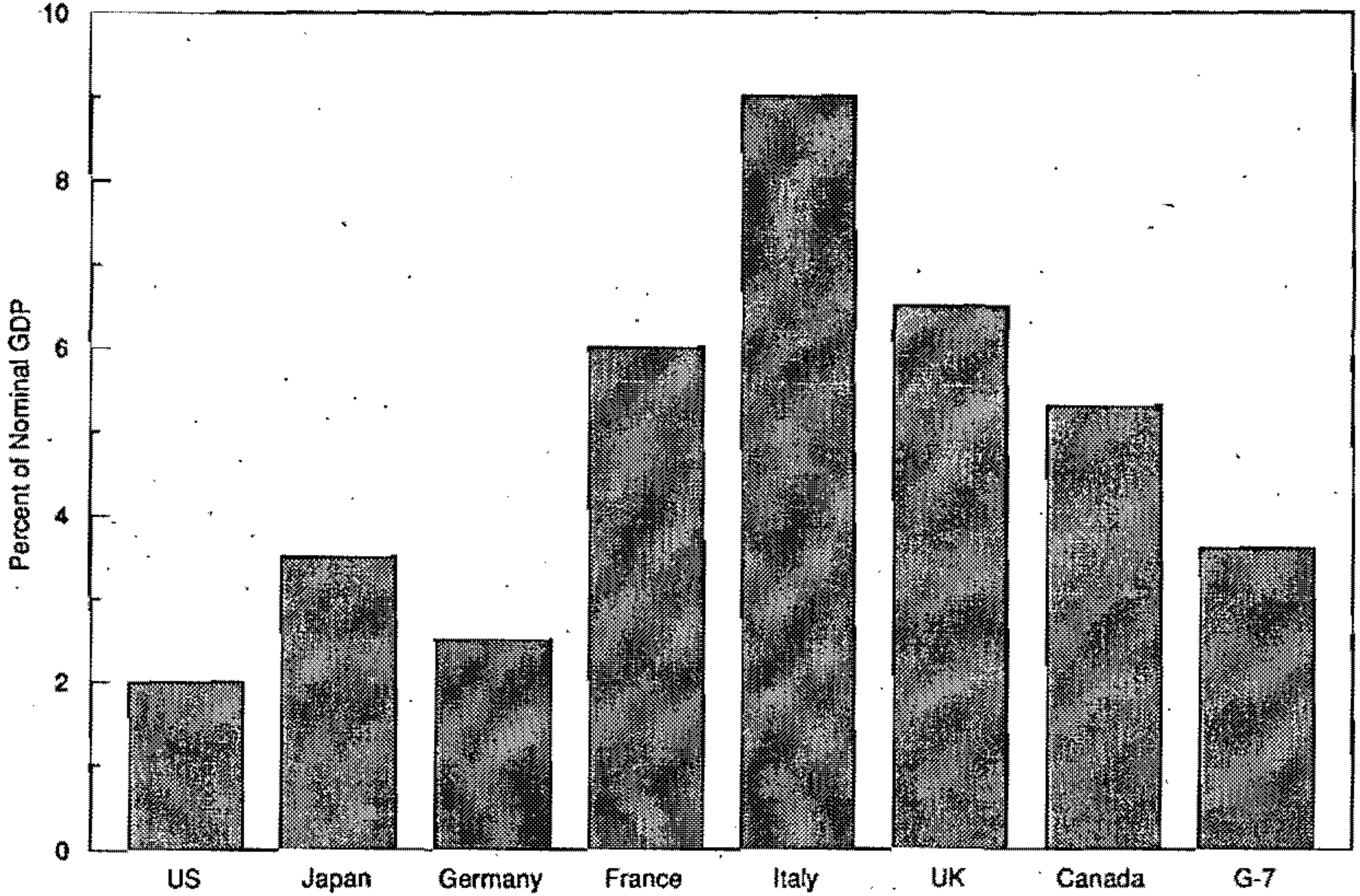
## Japan's Consumer Price Index




Source: IMF

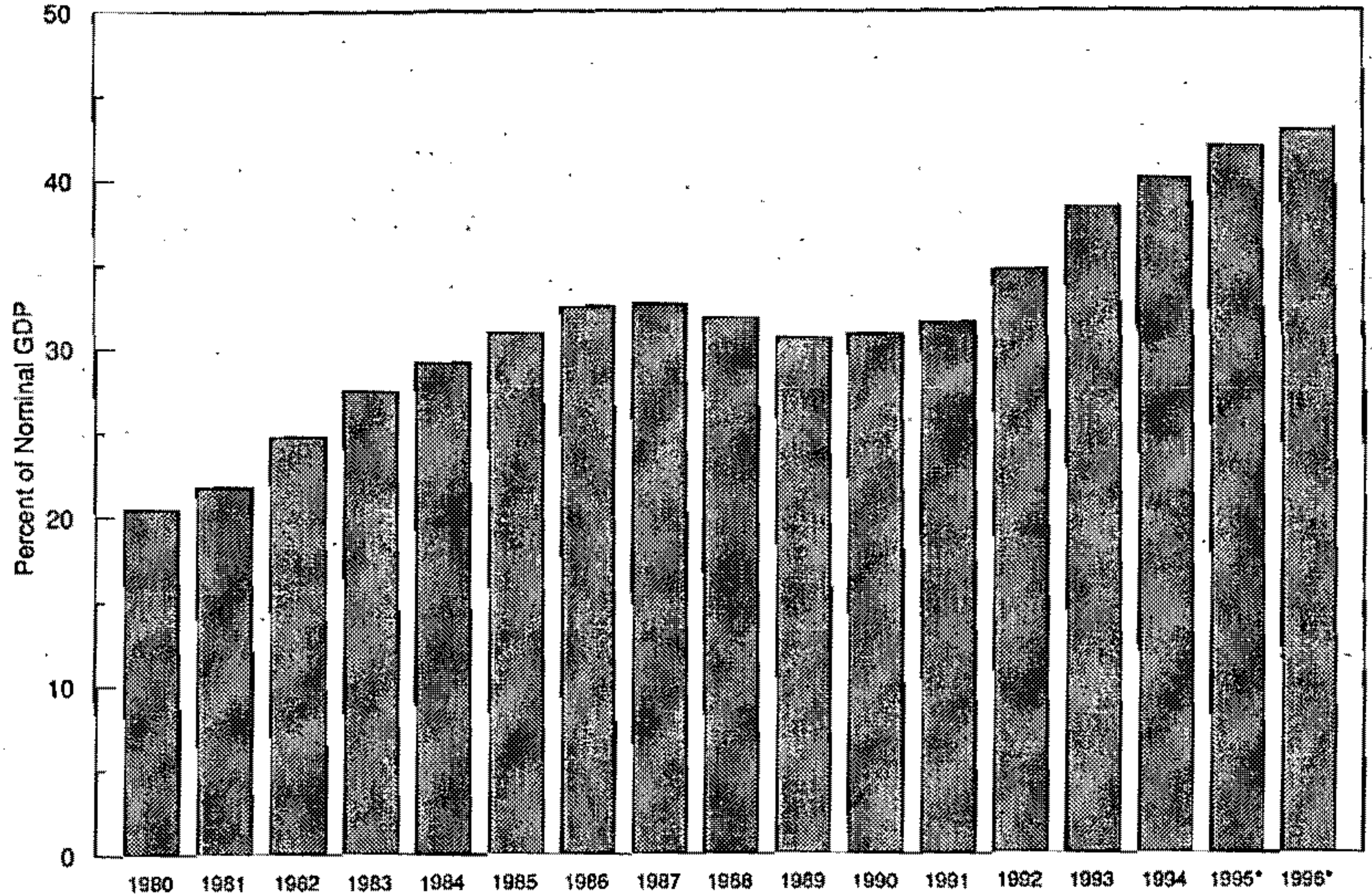

G-7 Government Financial Deficits
Percent of GDP
0
1
2
3
4
5
1980
1981
1982
1983
1984
1985
1986
1987
1988
1989
1990
1991
1992
1993
1994
1995*
1996*
*Projected

## Government Financial Deficits in 1994

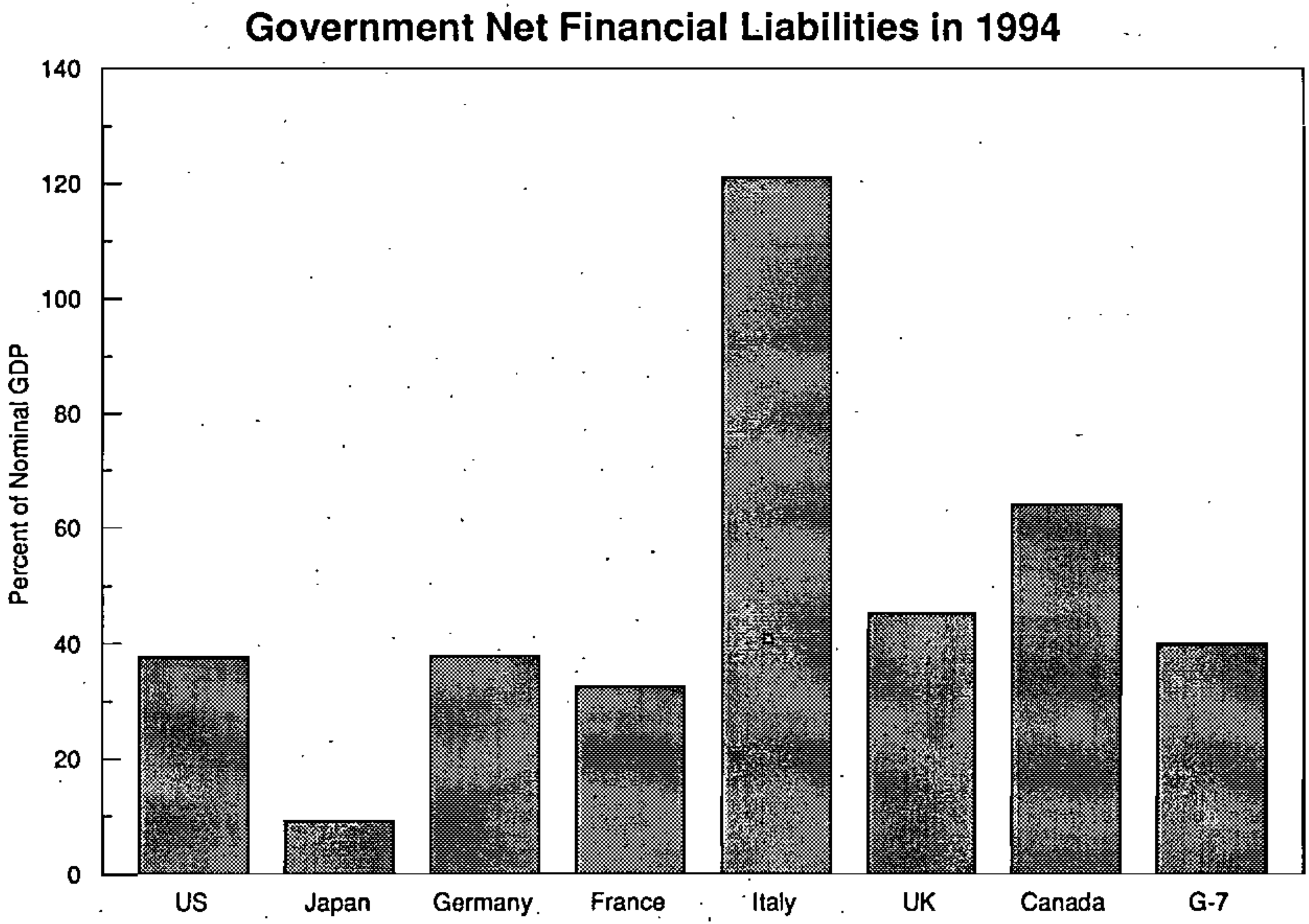



Source: OECD

# G-7 Government Net Financial Liabilities

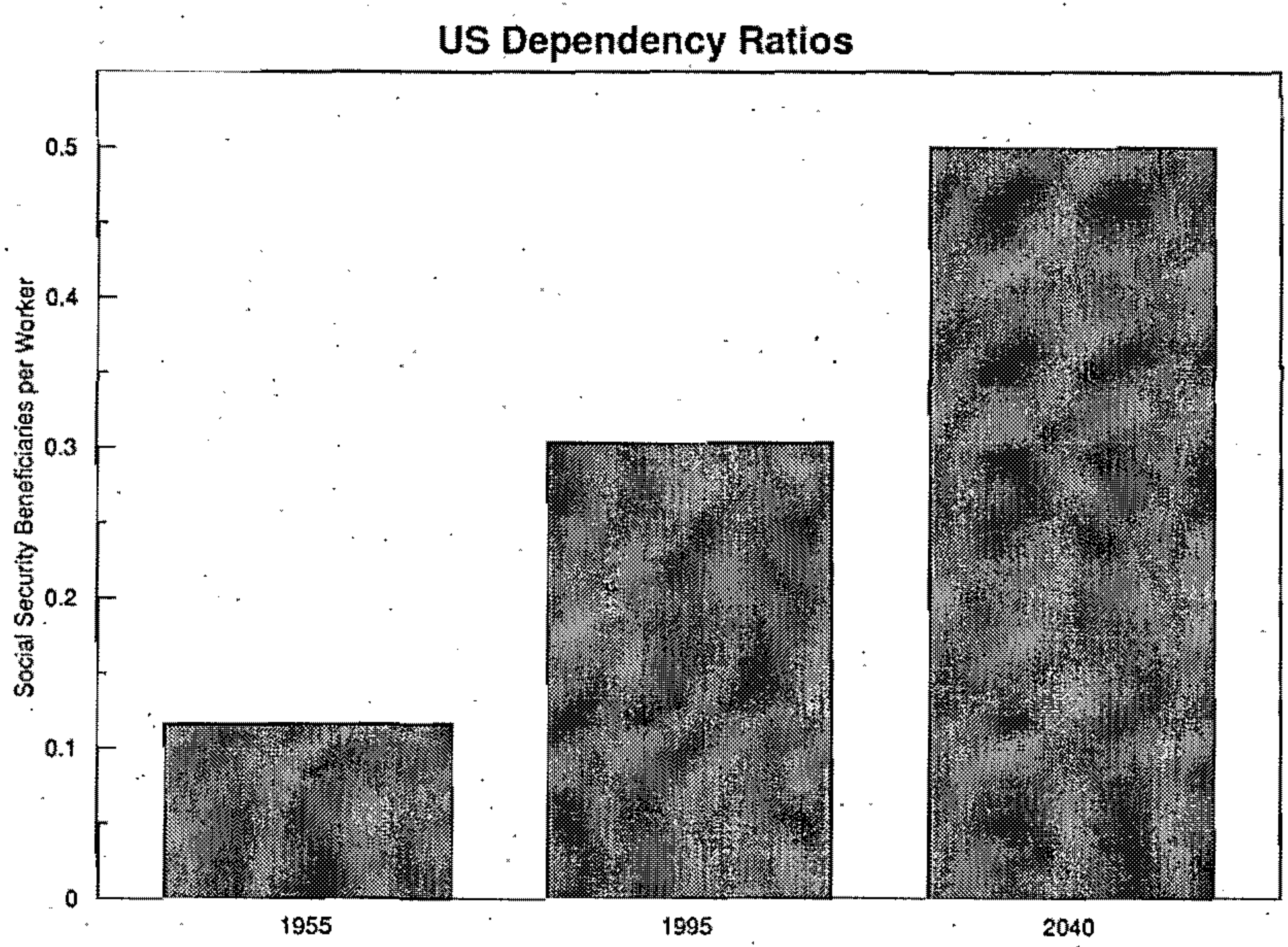



*Projected

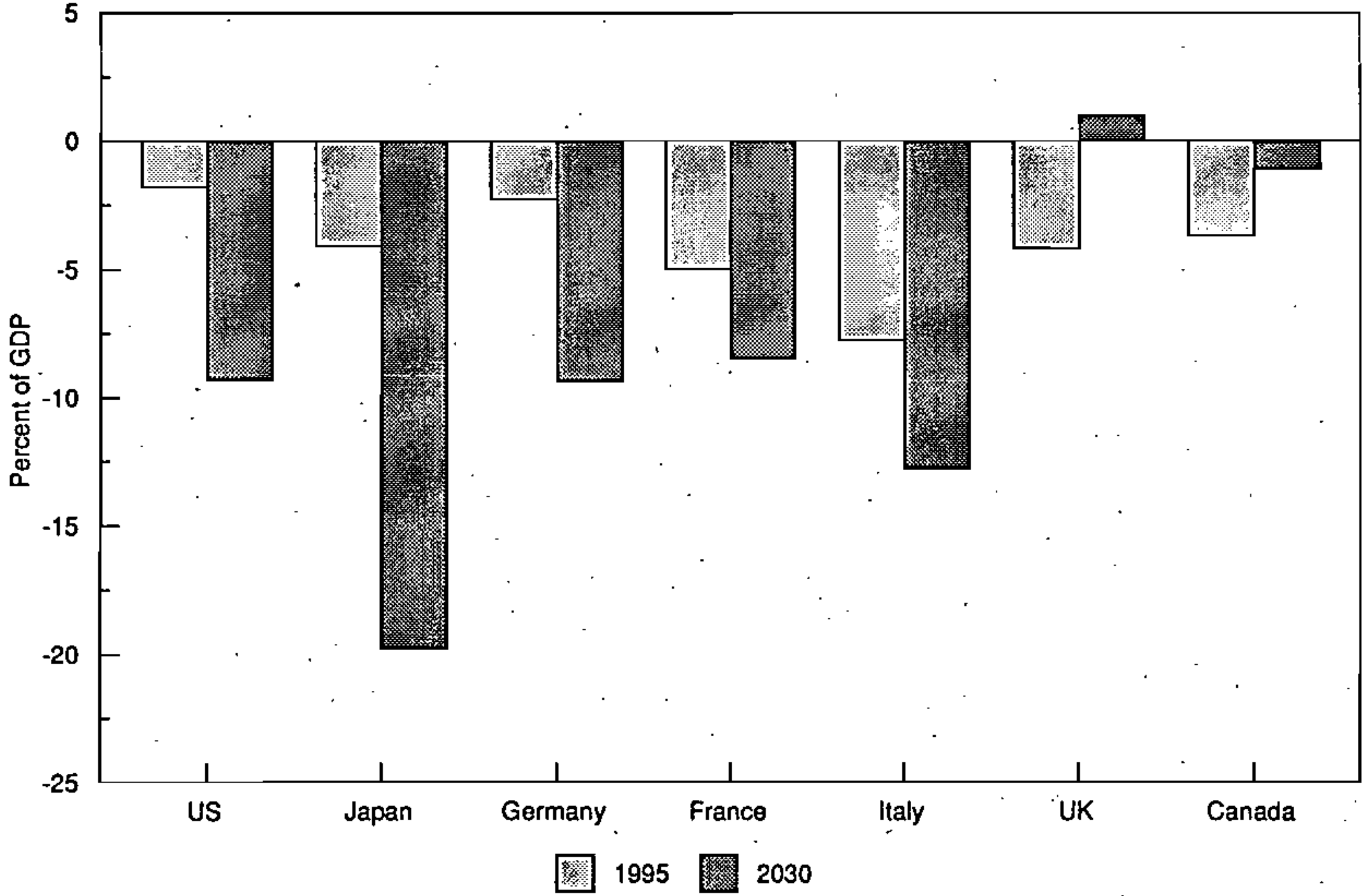


Government Net Financial Liabilities in 1994
Percent of Nominal GDP
140
120
100
80
60
40
20
0
US
Japan
Germany
France
Italy
UK
Canada
G-7

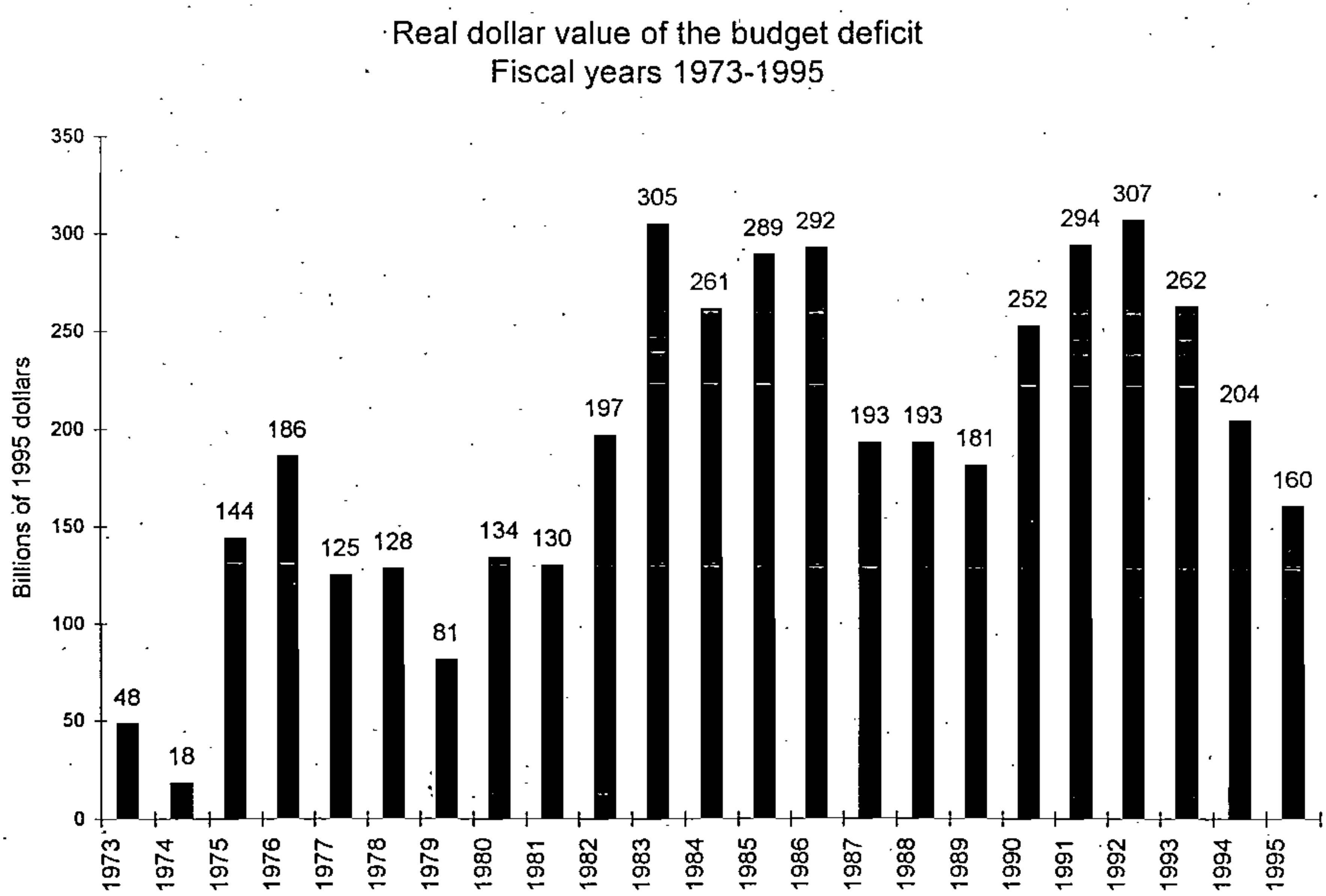

Source: OECD

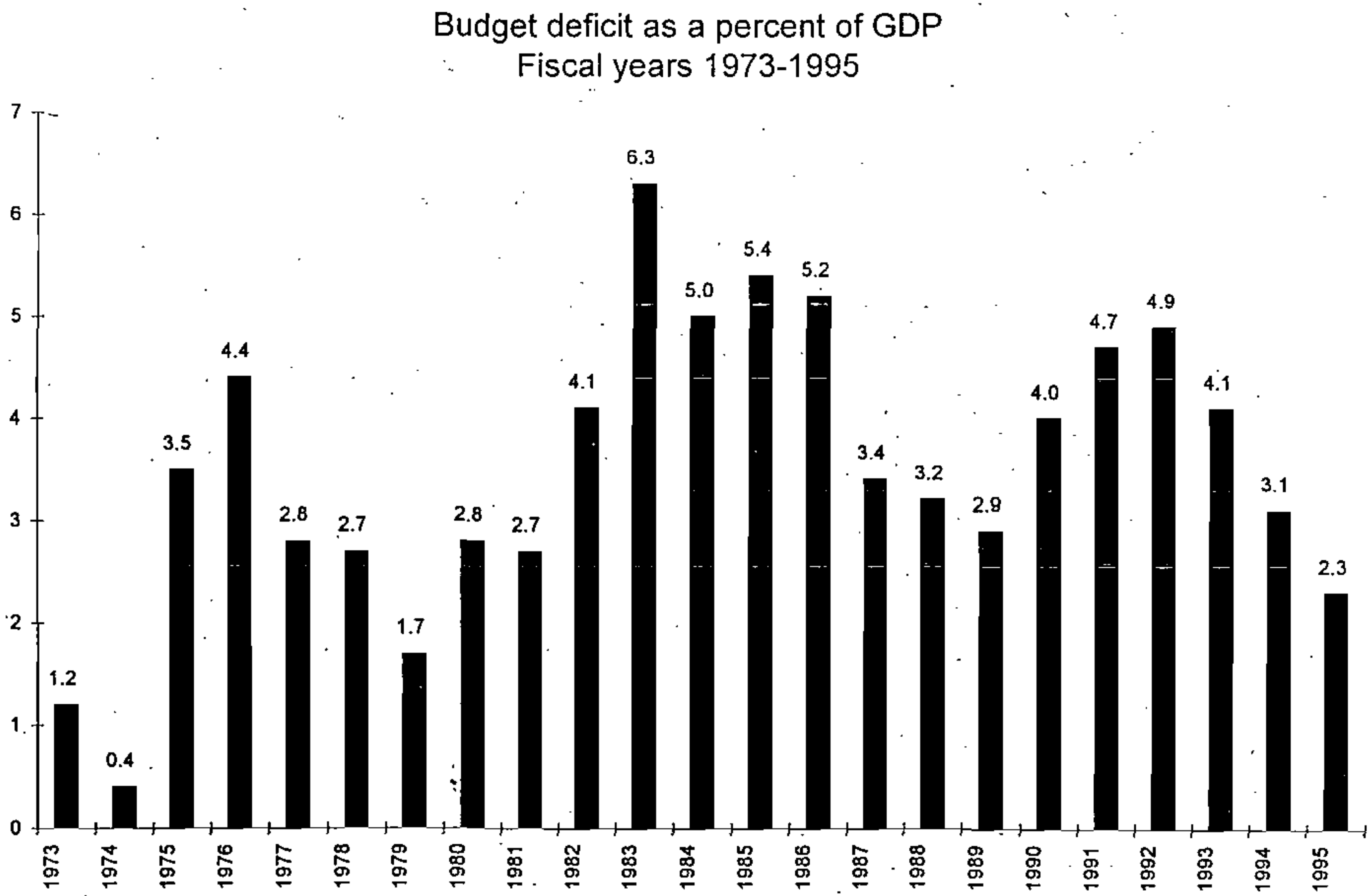

US Dependency Ratios
Social Security Beneficiaries per Worker
0.5
0.4
0.3
0.2
0.1
0
1955
1995
2040

## Projected Fiscal Balances Under Current Policies




Source: OECD


Real dollar value of the budget deficit
Fiscal years 1973-1995
Billions of 1995 dollars
0
50
100
150
200
250
300
350
48
18
144
186
125
128
81
134
130
197
305
261
289
292
193
193
181
252
294
307
262
204
160
1973
1974
1975
1976
1977
1978
1979
1980
1981
1982
1983
1984
1985
1986
1987
1988
1989
1990
1991
1992
1993
1994
1995



Budget deficit as a percent of GDP
Fiscal years 1973-1995
7
6
5
4
3
2
1
0
1.2
0.4
3.5
4.4
2.8
2.7
1.7
2.8
2.7
4.1
6.3
5.0
5.4
5.2
3.4
3.2
2.9
4.0
4.7
4.9
4.1
3.1
2.3
1973
1974
1975
1976
1977
1978
1979
1980
1981
1982
1983
1984
1985
1986
1987
1988
1989
1990
1991
1992
1993
1994
1995

Debt-to-GDP Ratio

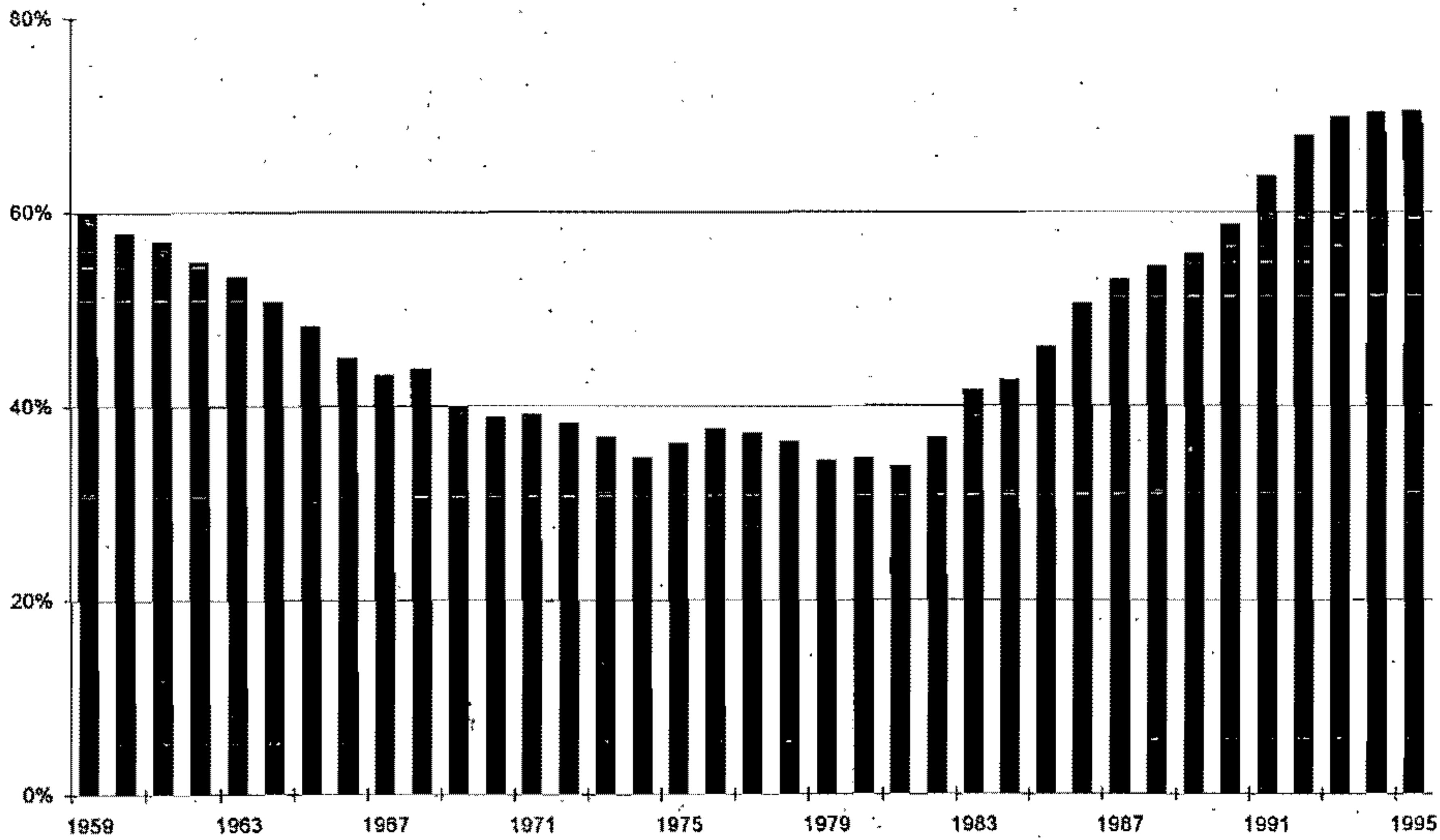
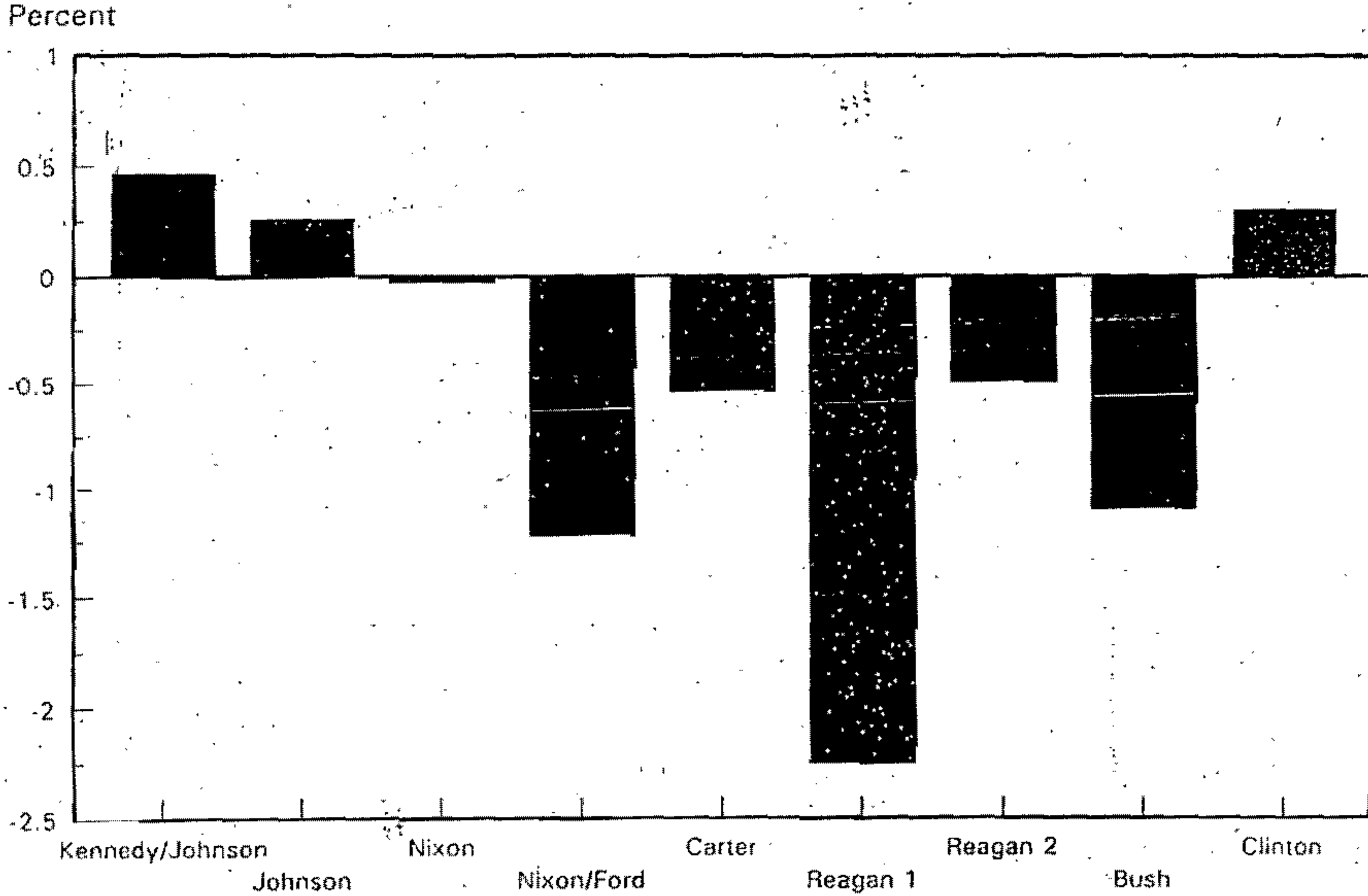


CHART 4

## Primary Surplus as a Share of GDP

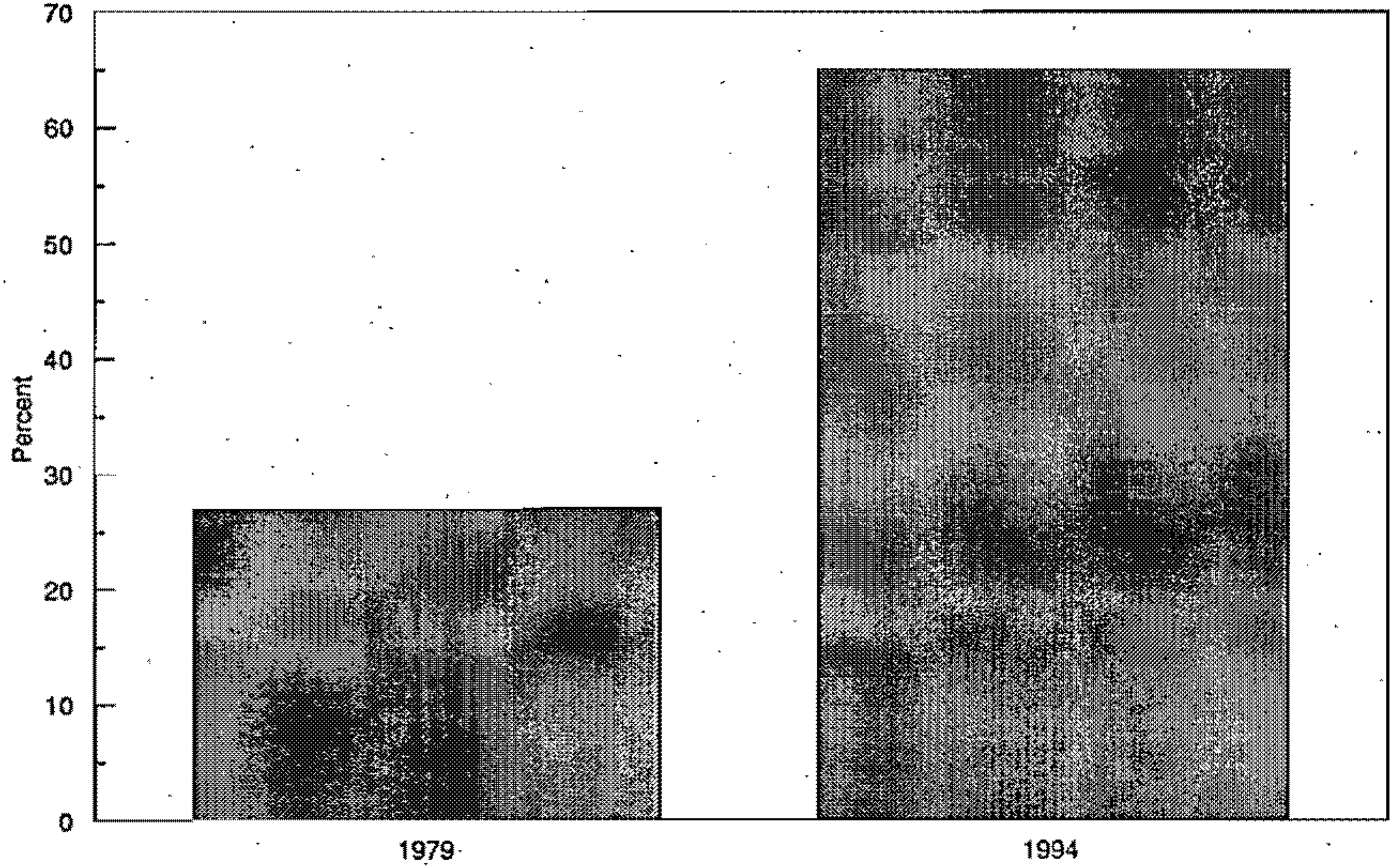



Note: Primary Surplus is revenues less program spending.

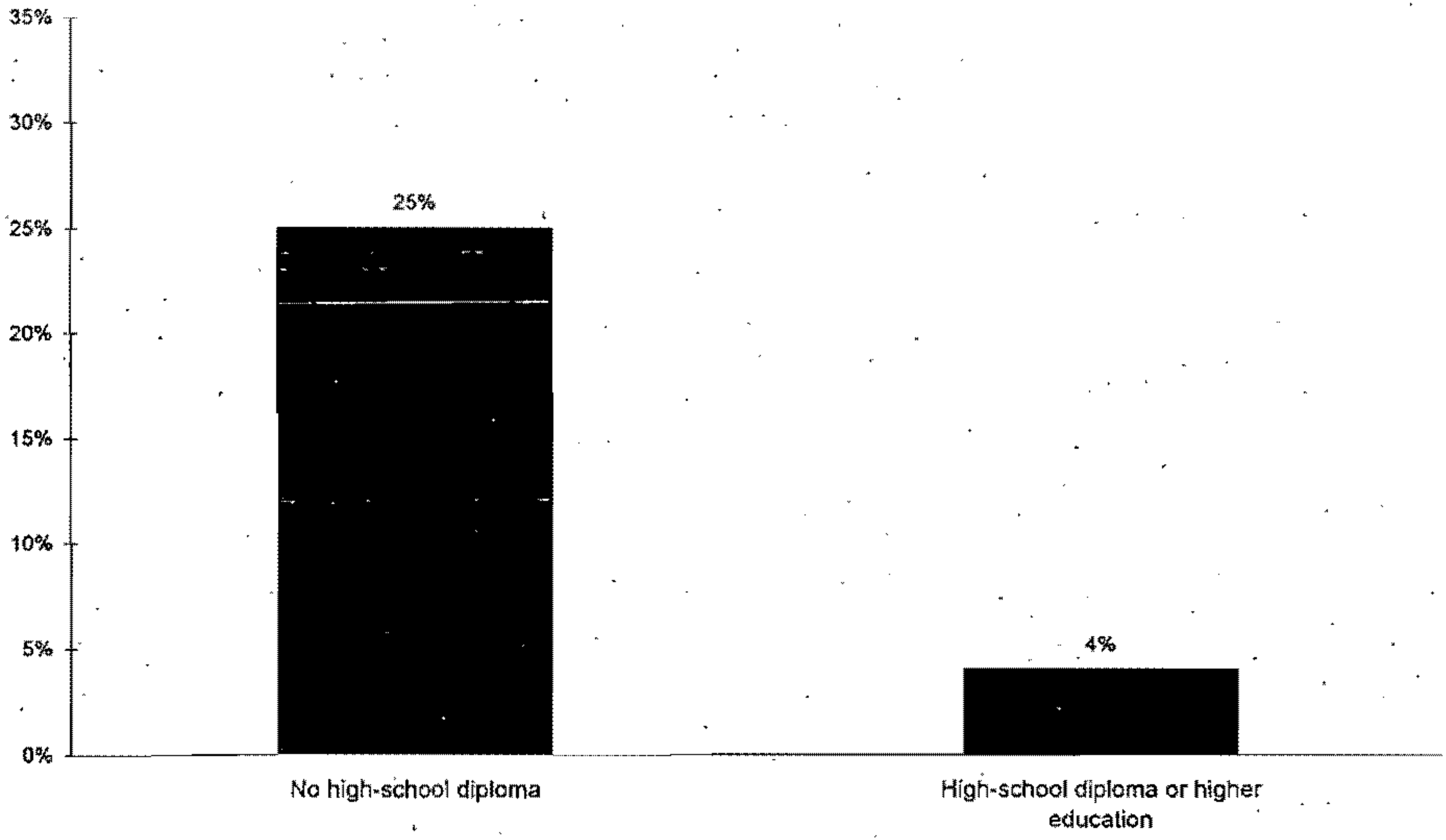
Source: Office of Management and Budget

## The Returns to Education

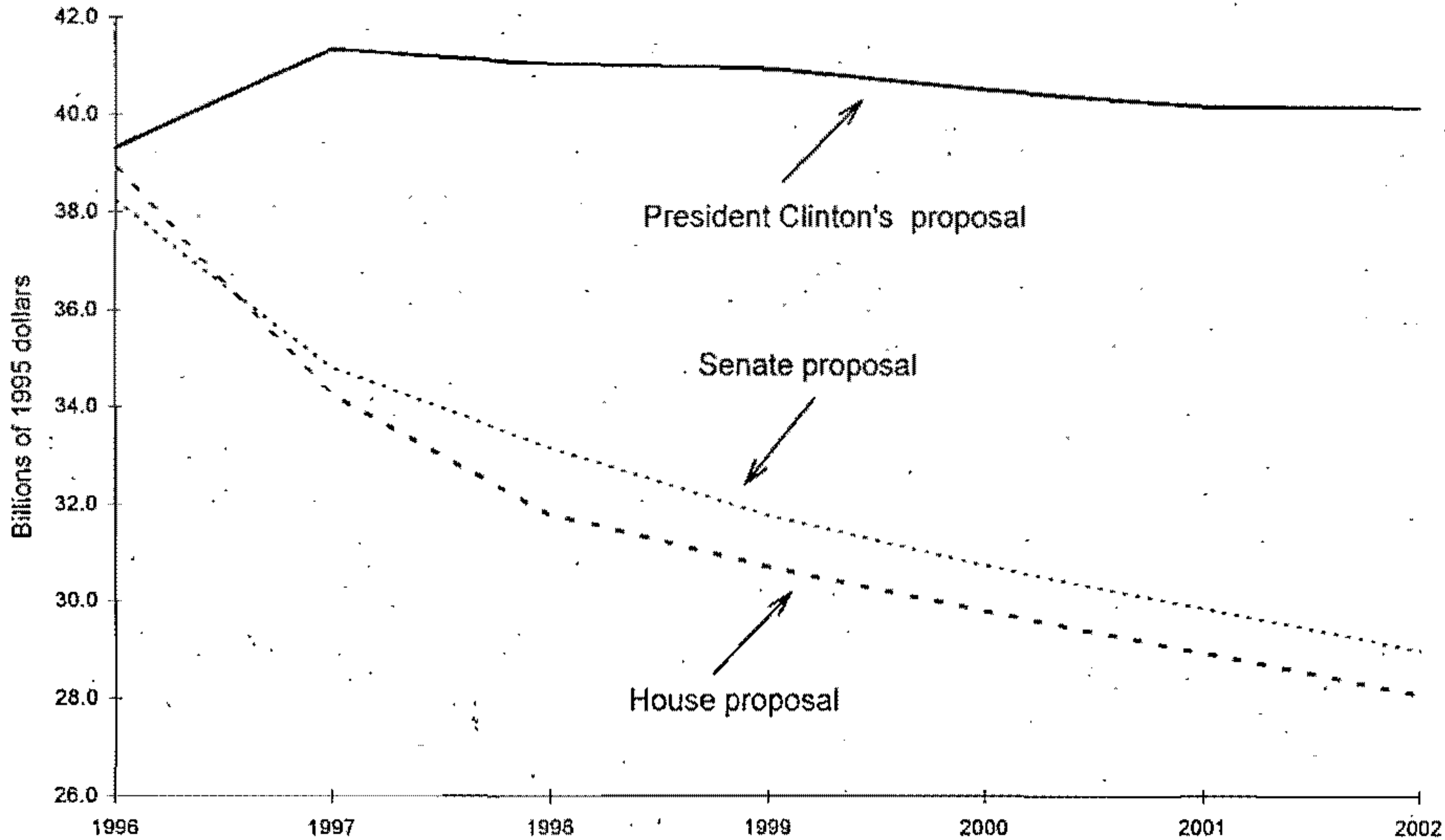
**Percent Difference in Earnings of College+ and High School Graduates (full-time males, 24-35)**



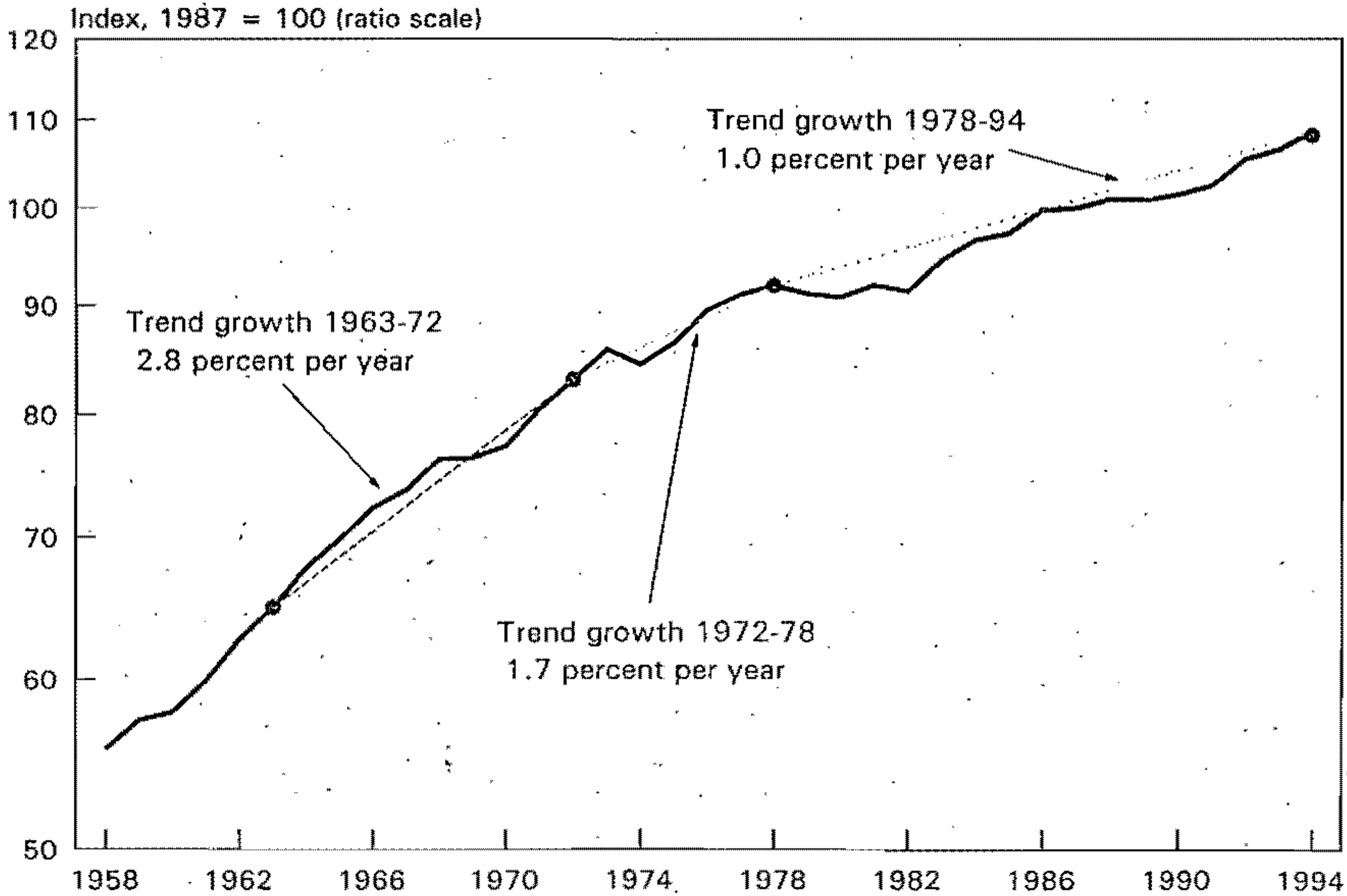
Probability of being in prison, on probation, or on parole in 1992
Men Aged 18 to 34



Investment in Education and Training

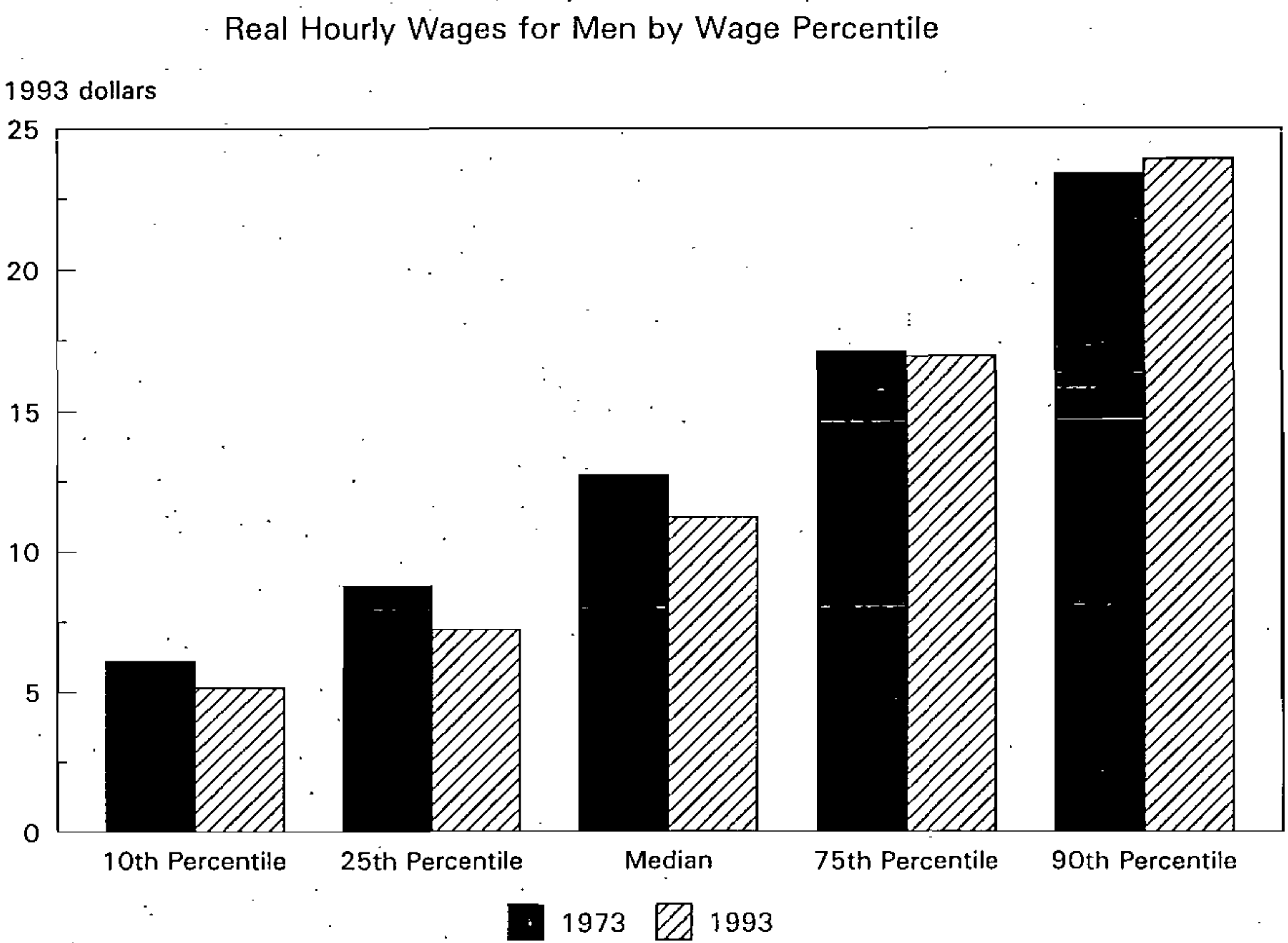


Output per Hour in the Private Nonfarm Business Sector




Note: Data are based on a chain-weighted measure.

Sources: Council of Economic Advisers and Department of Labor.




Source: Department of Labor.

**USA-ROC Economic Council Plenary Session**

**Remarks by Dr. Joseph E. Stiglitz**
**Chairman, Council of Economic Advisers**

September 23, 1995

It is a special pleasure to be before you today here in Anchorage for many reasons. First, it provides a chance for me to reciprocate the hospitality that I have received from Taiwan on my visits there. I first visited Taiwan at the invitation of one of Taiwan's great economists, Professor S.C. Tsiang, who I had the great pleasure of knowing over many years while he was teaching at Cornell. As most of you know, Professor Tsiang is generally given credit for being the intellectual force behind Taiwan's early macro-economic successes as well as its financial market liberalization which played such a critical role in its successful development strategy. I later had the honor of being invited to give a series of lectures at the Chung-Hua Institution for Economic Research and the Academia Sinica. On that occasion, I also was the guest of Samuel Shieh, the governor of the Central Bank, whose successor Mr. Sheu we shall have the pleasure to hear this evening. And the Deputy Governor, Dr. Paul Chiu, hosted on my behalf a delightful lunch which I still remember fondly. I also had the chance to have some extended discussions with another one of great architects of Taiwan's success, K.T. Li.

The second reason that this is a special pleasure is that Alaska has represented a state which I have held with special fondness over many years. I have had the good fortune of having spent considerable time in this great state, traversing it from Prudhoe Bay above the arctic circle to Valdez, at the other end of the pipeline, to Juneau and Anchorage. I hope that you take the occasion to see some of the natural beauties--environmental amenities which we as an Administration are fighting hard to preserve--as well as its impressive economy.

But the real reason that it is such a pleasure to be here is that the subject which I wish to discuss--some of the lessons to be drawn from the amazing economic success of Taiwan and other countries of East Asia as we face the challenges of the dynamic changes facing our economies--is a question which has both fascinated me as an academic during my years before joining the Clinton Administration and which has influenced my thinking about economic policy in the United States.

I should add, as a final prefatory remark, that in many respects, the economic record of the United States during the past two and a half years is itself amazing. It is a miracle of sorts, one which is only gradually being appreciated. It is not only that almost 7 and a half million jobs have been created, but that this remarkable growth has been attained with remarkable price stability. The overall combination of economic growth and price stability represents a macro-economic performance that has not been seen for three decades. And while many of our economic policies--such as the marked deficit reduction, leading at last to the stabilization of the debt GDP ratio after a dozen years during which it grew seemingly out of control, a reduction in the deficit GDP ratio by more than half in a space of two and a half years, and the attainment of a primary surplus, that is, revenues in excess of expenditures net of interest expenses on inherited debt, for the first time since the Kennedy and Johnson Administrations--while these and other policies created a favorable economic climate, it is the business community to which credit must really be given. They have created almost all of the new jobs in our economy, they are responsible for the increased productivity--the increase in the last quarter was four times the level of recent trends--and for the increased exports--a growth over the last year by more than 15%, a number that may seem low by the standards of the Asian tigers, but which is truly impressive by standards anywhere else, and particularly for countries at our stage of development. Let me foreshadow the theme which I want to develop: governments play a vital role in creating an economic environment which facilitates economic growth. A central part of that environment is sound macro-economic policy, but a part the importance of which is also only gradually being appreciated is good "micro economic policies" , policies that affect financial markets, regulations that impact on a host of other sectors, and legal frameworks, such as intellectual property, that provide the institutional infrastructure required by any effective economy. And an essential ingredient in the success of any of these policies is positive and constructive relations between government and business. While governments have a vital role to play, markets are at the heart of any successful economy.

By any measure, Taiwan and other East Asian economies have achieved extraordinary successes. Strong economic growth, strong growth of exports and ready adaptation of technological developments. This a record that is rightfully admired around the world.

So, the question is: how did it happen? Is there a secret behind this success? A magic ingredient that is the source of the East Asian "miracle?"

A friend in Taiwan once gave me the following explanation: He said "Taiwan's economic success is due to the actions of its economists and its engineers. The economists went to the United States, and the engineers stayed and ran economic policy."

This probably simplifies the real story somewhat. And -- as President Clinton's Chief Economist -- I have to say: this is clearly not the explanation for the success of the U.S. economy over the last 2 years.

But, the questions are very interesting. And, they are important in informing future debates about strategies for economic growth. In this talk, I intend to address the following: What were the <u>true</u> sources of East Asian growth? What role did government and public policy play? And, finally what role <u>should</u> government play with the new and exciting changes and challenges in our industries and our economic environment? An environment, I might add, that you in this room are creating and fostering.

But, first, I think it is important to take stock of the changes in the U.S. economic relationship with Taiwan and other East Asian nations.

While trade was once largely a transatlantic phenomenon for the United States, today, successful American businesses turn to markets in the East in ever increasing numbers. The statistics are telling:

* The 14 Asian APEC economies accounted for over <u>one-third</u> of our trade last year -- this is larger than any other single regional grouping. And -- even more notable -- it was <u>60 percent</u> larger than U.S. trade with Europe.

* Taiwan is a key player in this ever expanding trade relationship. Taiwan is our <u>7th</u> largest trading partner, with two-way trade amounting to $44 billion. Taiwan is also our 6th largest <u>export</u> market, the largest of any country outside the OECD.

The Clinton Administration has recognized and responded to this dramatic change in the international business environment. We welcome the growth in our economic ties with Taiwan and East Asia. And, we are committed to the APEC process for achieving free trade in the region by the year 2020.

With this increase in trade and the rapid growth of the East Asian economies, there has been a maturing of our trade relations with the region. Although some disputes remain, the United States welcomes the co-operation it has received from Taiwan on tariff reductions, protection of endangered species, and intellectual property protection.

And, let me say: as an author of several text books, the intellectual property issue is of particular importance to me. I admit, on my very first trip to Taiwan -- when copyright violations were still widespread -- I went to a bookstore in the heart of Taipei to check whether any of my books were being "bootlegged."

Before entering, I seriously wondered: would I be more upset by seeing bootlegged books -- knowing that I was losing royalties from the unauthorized editions -- or would I feel worse from not seeing my books and discovering that my work was being ignored in Taiwan? In true Confucian fashion, I decided that status was more important than material reward. Luckily, I was not disappointed!

But, yes, there has been progress on intellectual property issues -- in Taiwan and elsewhere in the Pacific Rim. That progress has yielded enormous benefits for Taiwan -- in terms of increased innovative activity and increased access to cutting edge foreign technologies. And, that progress has come as a result of our strong and growing economic ties.

So, now let me turn to the important questions I want to address. First, how did the

East Asian miracle happen?

In my earlier days outside of government, I participated in a World Bank study that looked at the fundamental sources for the East Asian miracle. The bottom line was: there are no simple and magic answers. No recipe that can be translated into easy success for other developing countries.

Instead, the East Asian "miracle" was a result of a combination of strong successes in certain basic areas. Let me list them:

First, a **stable business environment**. This included macroeconomic stability -- low inflation and realistic exchange rates -- but also stable and predictable rules of the game for business.

There were also **high rates of saving and investment**. And, there's no miracle here -- these economies grew because they invested heavily. And, governments contributed by running balanced budgets, or budget surpluses, and by raising the returns to private saving. But it was not only that governments had sound budgets--they made choices that about how to spend their limited money in ways which enhanced economic growth. They had a clear sense of priorities. For instance, they invested heavily in education, the returns to which have proved to be enormous. This is a lesson which some in Washington need to take to heart.

Indeed, not only was their a strong **emphasis on education**, particularly a high level of primary and secondary education, but there was a strong concern to make sure that there was widespread access to education, for females as well as males. The countries of East Asia showed that egalitarian policies could enhance growth. One didn't need to rely on trickle down economics.

And, finally, there was a basic **openness to technology**, and strong efforts to learn from, and adapt, foreign best practice.

A more controversial element of the East Asian "miracle" is the role of industrial policy -- the combination of intervention, promotion and direction that characterized many of the East Asian countries. There is among academic circles still some controversy about whether these policies made a difference -- whether they raised growth or changed the industrial structure. My study of the countries of East Asia convinced me that at least some of them did have significant positive effects.

But from some perspectives, the more interesting question, I think, is not whether industrial policy worked, but rather why it did not fail. Government intervention can -- and has been -- a major retarding factor in so many other countries. So, why not in East Asia?

The answer is: the most successful East Asian governments were able to craft economic policies and build relationships between business and government that employed market forces rather than blunted them. The most successful East Asian governments actively consulted the business community and assisted industry, but they also maintained domestic competition.

In a word, industries obtained the benefits of economic cooperation both among the firms within the industry and between industry and government without society having to pay the price of economic collusion and--at least up to a point--without the marked disadvantages that result from what economists refer to as capture, where government simply serves the interests of industry without keeping paramount the broader societal perspective of national interest

Success in competing on world markets through exports was strongly emphasized. And the benefits that government bestowed -- credit, foreign exchange, investment approvals -- were based on performance, on the outcomes of market-based contests among domestic firms.

Many of the East Asian governments demonstrated a ready ability to know when government should get in and where government should stay out. Achieving that delicate balance between doing what supports growth -- such as investing in infrastructure and R&D -- and not intervening too heavily is a very difficult task. And the most successful East Asian governments were able to find that appropriate middle ground, a middle ground which so many countries, both developed and less developed, have found difficult to find.

To be sure, East Asian governments have made some mistakes. In particular, where they have protected uncompetitive industries from competition; where they have excluded foreign investment; and, where they have failed to protect intellectual property. But, the most successful governments reversed course when they saw their policies were having the wrong effect.

As a result, the East Asian successes have shaped thinking about development policy. These successes have had a strong and important influence on views about the appropriate relationship between business and government. (A relationship that is -- and will be in the future -- central to all of our economic debates.)

Making government work more effectively and less intrusively has been a top priority for the Clinton Administration. And, the proper role of government is now at the core of the debate between the major political parties in the United States.

But this is not just an issue for the American political debate. Economic changes and developments in the past few years will force all of us -- in the United States and across the world -- to re-examine what is the most effective role that government can play.

Let me give you one example: services industries -- finance, information and communications.

These dynamic industries are the industries of our economies' future growth and strength. Intellectual creativity is the primary input -- and this input knows no bounds.

Change in these industries is happening like rapid-fire. Competition is springing up in industries once viewed as monopolies. And, trade is taking place in industries once viewed as purely local. I believe that we in the United States are rising to the challenge. Evidence of efficiency increases, improvements in the quality of the services provided and decreases in the costs of providing those services abound. Some of the countries of East Asia, while they have led the way in improvements in efficiency in manufacturing, have lagged in these vital sectors, and as a result, improvements in standards of living--which is, after all, the ultimate objective of all of this economic activity--have lagged.

Governments -- in East Asia and elsewhere -- have tended to be more heavily involved in these industries than they have been in manufacturing. And there is now a pressing need to reassess government's proper role.

Achieving the proper balance in government policy is now more important than ever. The goal is to dismantle unnecessary government regulations and interventions while creating a framework of rules that allows the private sector to flourish and -- at the same time -- protect the public interest. This task--again a careful balancing act--has been one of the foundations of this Administration's economic policy. I can speak proudly of some of the reforms that we have already accomplished, such as in the banking sector, and I can speak warily of some of those upon which we are embarking, such as telecommunications, where the Administration has been working hard for a bill which promotes long run competition while it provides adequate safeguards during the transition period in which there remain significant imperfections of competition.

In the financial sector, the reassessment of government's role means liberalization of existing rules the main effect of which is to impede competition while strengthening prudential supervision. I cannot overemphasize the importance of the delicate balance--the failure to achieve such a balance during the previous Administrations in the United States, with inadequate prudential supervision, was a major contributing factor to the S & L debacle, which not only cost taxpayers billions and billions of dollars, but led to massive misallocation of resources and, in my judgment, was a major contributing factor to the economic slowdown that we have had to work so hard during the last two years to recover. In communications it means allowing freer rein to market forces and new entrants, while at the same time addressing monopolies or access barriers where they still exist.

These issues are particularly important for Taiwan, given its ambition to become a regional center in finance, transportation, and communications. The reasons for formation of economic centers -- or "clusters" -- are interesting. Often centers are the product of historical accident. But sometimes they have developed because of official efforts--the careful balancing of which I spoke earlier, a balancing which includes, as a central ingredient, a willingness to tolerate new entrants and activities.

This requires both a cosmopolitan attitude and a willingness to take risks. Those who can -- and do -- move fastest to address the new competitive challenges are the ones who will be most likely to create and foster successful regional and international centers.

Finally, I'd like to conclude with a few remarks about the future.

Over the past few years, the economies of East Asia -- as well as the APEC region more broadly -- have become increasing integrated. Intra-regional investment, subcontracting, and trade in finished goods occupy a growing share of the total trade for these economies, and, at the same time, trade with APEC as a whole has grown rapidly.

These interweavings are welcome. And, in fact, their continuation may be necessary for the continuation of the Asian miracle--or the beginning of the next Asian -- or Asian-Pacific -- miracle.

Today's economic changes and challenges all point to the importance of larger and more integrated markets: larger markets provide necessary economies of scale; intra-regional investment provides the presence that is so often necessary for the delivery of modern services; and, greater integration makes possible those instantaneous communications that are the heart and core of our most dynamic, creative industries.

But, further integration of the economies of the region will require a number of other things. I want to emphasize two:

- First, **political and economic stability**. This is critical to fostering the confidence necessary for the large-scale private sector investments that are so necessary for future growth. This in turn requires that disputes among parties be settled amicably, something that is strongly supported by the United States. It also requires a recognition that some of the modus vivendi that have evolved over recent decades may provide the most constructive framework for the continuation of the political and economic stability which have served the region so well.

- And, second, is **further steps in economic liberalization and deregulation**. These now often stand as barriers to domestic competition and innovation, as well as to trade.

President Clinton is strongly committed to active engagement in the Asia-Pacific. Two years ago at Blake Island he articulated his vision of a Pacific community based on shared prosperity and values. Last year along with 17 other Asia-Pacific leaders, President Clinton committed to achieving free and open trade and investment in the region by 2020..

And this year, he will join the other Pacific leaders in taking the first concrete steps to making that vision a reality.

But, U.S. interests go beyond economic and commercial. We are by our heritage and our character interested in individual rights and the spread of democracy. This would be true even if democratization and the expansion of individual and human rights had no bearing on economic and income growth.

But, in fact, the spread of democracy is both supported by economic development, and plays a strong role in fostering continued economic growth. This is increasingly true as our businesses and our economies demand greater and greater individual creativity.

It is people like you who will be the driving force for future integration in the APEC region. You -- the business men and women of America and East Asia -- are the source and the energy for the changes and developments in our economies. You are the source of the economic changes that are forcing governments to respond and change.

The fact that increased integration now seems desirable -- even inevitable -- is largely due to the explosive growth in private sector activity in the Asia-Pacific region. Support and encouragement from the private sector has been crucial in establishing APEC as a framework for advancing integration and co-operation in the Asia-Pacific region. We hope and encourage -- and, indeed, challenge -- you to continue your strong participation in the future.

* * *

**Remarks by Laura D'Andrea Tyson**

**Chair**

**Council of Economic Advisers**

**to the**

**Center for National Policy**

**February 14, 1994**

It is an honor to be with you today for the official release of the Annual Report of the Council of Economic Advisers and the Economic Report of the President for 1994.

One year ago, when many of you were reading last year's Economic Report of the President, the Clinton Administration economic team was hard at work developing its strategy to address the nation's short-term and long-term economic problems.

At that time, the economy seemed trapped in a largely jobless, seesaw economic recovery that carried considerable downside risk. The recovery from the 1990-91 recession had been subpar--the economy was growing at less than one-half the growth rate characteristic of a period of recovery after recession. Throughout 1992, the unemployment rate remained above 7.% and at year's end more than 9 million Americans were out of work.

These short-term problems were superimposed on two distinct

These short-term problems were superimposed on two distinct but interrelated long-term problems. The first was the problem of the deficit. According to our projection, even if the pace of the recovery picked up, it was likely to be strangled by growing structural deficits, ballooning borrowing needs of the government, and a resulting rise in long-term interest rates that would sooner or later choke off private spending.

When the federal budget is on a sustainable path, the deficit should come down as the economy picks up pace. Instead our numbers indicated that with unchanged policies, the deficit and the government's borrowing needs would rise over time and this would derail the economy's recovery. In short, our economy was not on a sustainable path. The foundation of the recovery was cracked and threatened to give way to the shock of escalating budget deficit.

A second and related long-term problem was sluggish productivity growth, as a consequence of which real compensation and real per capita income were advancing at a disappointing rate, and real median family income was barely increasing. The situation was even worse for low-income families whose incomes were declining both absolutely and relatively. For many low-income working families, after-tax incomes barely exceeded those income levels available through welfare.

The most fundamental explanation of these disturbing long-term trends was insufficient private and public investment--in the foundations of productivity growth and living standards--new capital equipment and technology, human resources, national infrastructure and research and development.

The policy challenge that confronted the Clinton Administration one year ago was the need to design an economic strategy that would simultaneously address the economy' short-term and long-term problems. The key to the strategy was a credible and gradual deficit reduction program--large enough to have a dramatic effect on the course of the deficit over time, but not so large that it threatened to kill off a faltering recovery. Moreover, because of the nation's longer-term problems, this program required a shift in government spending and taxation. A shift toward more spending on public investments that are the foundations of private prosperity. And a shift in the burden of taxation to provide stronger rewards to work to low-income families.

Just four weeks after he took office, President Clinton introduced his economic strategy in a detailed budget plan presented to a joint session of Congress. Today, one year later, the economy is strong again and appears to be getting stronger. Recent economic data confirm that the economy is on a sustainable expansionary path with increasing output, rising employment and a strengthening manufacturing sector. Improvements in a variety of interest-sensitive sectors--business, consumers durable and residential construction--are stimulating and reinforcing growth in other parts of the economy. Consumer and business confidence are up, employment has increased more in the last year than in the previous four years, and inflation is tame. Growth in 1994 at 2.9% was the best performance in the last five years.

Moreover, as the most recent budget projections indicate, the deficit is now falling relatively to the size of the economy. The 1995 deficit is 40% below where it was projected a year ago--and is slated to be only 2.5% of GDP--the lowest level since 1979. Economic expansion has not been realized at the expense of fiscal responsibility. Instead, both our short-tern and long-term economic prospects now rest on a much more solid fiscal foundation, not the cracked one we inherited.

What accounts for the change in the economy's short-term fortune? Have we made significant and sustainable progress on the deficit? And have we put in place policies that will bolster productivity growth and living standards for all Americans in the future?

This year's Economic Report answers these questions and demonstrates that the Administration's economic strategy has put the economy on track for sustained economic expansion in the short run, while addressing the economy's longer-term problems as well.

Deficit Reduction and Economic Expansion

The key to the change in the short-term fortunes of the economy in 1993 was the dramatic decline in long-term interest rates--which fell about 100 basis points between November 1992 and December 31, 1993. And the evidence reviewed in the ERP indicates that this decline in turn was in large measure the result of the response of financial markets to our deficit reduction program. Nor is the CEA the only observer to make this point. Even Alan Greenspan recently noted that the actions taken to reduce the deficit last years have been instrumental in creating the basis for declining inflationary expectations and easing pressures on long-term interest rates.

Long-term interest rates anticipate change; they shift in the present based on credible expectations about the future. The dramatic decline in long-term rates since the election of 1992 reflects sustained confidence in the Nation's financial markets that the Clinton economic plan will finally and significantly reduce the Federal budget deficit.

Some of our critics dispute this claim, particularly on the revenue side. They continue to argue that higher income tax rates on the wealthiest won't contribute as much as we think toward shrinking the deficit. They tell us that taxpayers faced with higher rates will vigorously search out ways to reduce their taxable income--they'll take more vacations or shift their investments to tax-exempt bonds. They'll protect so much taxable income, in fact, that government revenues will actually drop after an increase in income tax rates on the highest earners. Fortunately for believers in responsible government, history proves our critics wrong. As we demonstrate in the *Economic Report*, income tax increases in the United States have generally increased income tax revenues to the government while income tax cuts have generally reduced them.

Obviously, marginal tax rates are important factors in determining savings and investment patterns and economic growth, but so is the view of the credit markets about whether the government's fiscal policy is responsible. The Clinton Administration introduced higher tax rates on the richest 1.2% of the nation's taxpayers as a necessary part of a balanced deficit reduction program. Certainly, higher taxes by themselves, like spending cuts, exercise a contractionary effect on the economy in the short run. But as part of a credible deficit reduction program, the higher tax rates introduced by the Clinton Administration have contributed to lower long-term interest rates and the strength in interest-sensitive spending that have been the most important elements powering our current economic expansion.

Our economic strategy has created a sound macroeconomic environment and a sound foundation for future economic growth. We have made a good start. But it is only a start. Creating the framework for sustained growth is the government's first responsibility, but not its only responsibility. A second responsibility is to improve how the government itself performs its functions. In a time of budgetary austerity, inefficiencies in the government process must be eliminated. The National Performance Review, completed under the bold leadership of Vice President Gore, lays out ways to improve the way government itself performs: by reducing the size of the Federal bureaucracy, reducing the burden of government regulations, and ensuring that any new regulations carefully balance benefits and costs.

Government also has a vital role to play in providing some of the critical raw materials for continued growth--science and technology, public infrastructure, a healthy environment and an educated and well-trained work force. We need to worry about the debt we bequeath to our children, but we must also worry about the quantity and quality of the physical, financial, and human capital they will inherit.

Let me begin with investing in People. The Clinton

Administration has made increasing both the quantity and the quality of jobs its highest priority. Sound macroeconomic policies are necessary but not sufficient for the realization of this goal. They must be complemented by labor market policies to remedy a number of deep and longstanding impediments to the maintenance of high employment and to improvements in the quality of jobs.

The American workforce remains the most productive in the world. Nonetheless, as we point out in the Economic Report, turnover rates in the American labor markets are very high. And losing a jobs is often very costly, especially for those who are unlucky enough to lose a jobs they have held for many years. At the same time, modern industrial processes demand workers with higher levels of education and training; and evidence on the relative wages of college-educated and high school-educated labor bears this out. In 1981, workers with college degrees earned about 45% more than workers with only high school degrees; by 1992, this gap had reached almost 65%.

The combination of high turnover rates and rising inequality in the earnings distribution, aggravated by a slow recovery from the 1990-91 recession, has made many Americans feel increasingly uncertain and insecure about their economic future.

In response to these problems in the nation's labor market, the Administration has designed a multifaceted strategy to enhance the education, training and flexibility of the American workforce. This strategy encompasses several new programs: the Goals 200 program that sets higher performance standards for american teachers and students; the school to work transition program that will help students get hands-on, work-related training as they move between the world of school and the world of work; the National Service program that provides opportunities for community service and the acquisition of jobs-related skills but also helps send more Americans to college, the reformed student loan program that will reduce the borrowing costs of students loans and will allow loan repayments based on future income; and the new worker re-employment program that will provide training and income support for displaced workers moving from one jobs to another.

Health Care

Our health care reform proposal is also an important component of our strategy to build a flexible, high-wage American workforce. Under our current system, millions of americans are afraid to change jobs because they face the prospect of losing their health insurance coverage. Some estimates suggest that such worries may reduce job mobility by as much as 25%. In addition, America's working men and women have paid for escalating health costs by taking home smaller paychecks. Empirical research suggests that the dominant long-run response of businesses to rising health care costs has indeed been to lower the rate of increase of take home pay. Between 80 and 100 percent of increases in health care spending appear to be reflected in lower take home pay. If business spending on health care were the same share of compensation today as it was in 1975, wages pre-employee could be over $1000 higher.

The Economic Report distinguishes four distinct but interrelated problems in our current health care system. First, the current health care system fails to provide health security for millions of Americans--many insured Americans stay in jobs they no longer want because they cannot risk losing their insurance; meanwhile, the uninsured are sicker, receive less treatment, and suffer higher mortality rates than the insured.

Second, private insurance markets exhibit some severe shortcomings. People with preexisting conditions, or people who are simply less healthy, have to pay more, sometimes much more than other people, if they can find insurance at all. And many policies don't cover a variety of large financial risks--exactly the kinds of risks that insurance is supposed to address in the first place.

Third, our current health care system suffers from a lack of effective competition. Providers often have incentives to provide overly-sophisticated or unnecessary care, because they are reimbursed for each additional test or procedure they perform. Consumers often do not have effective choice among insurance plans, doctors, or hospitals, so market competition among providers is often weak. Moreover, effective consumer choice depends on adequate information. Yet consumers often do not know even the price of medical goods and services, and they seldom have the information they need to evaluate the quality of the services they receive. This means that providers are often in a position to influence both the supply and demand sides of their markets. In short, consumers are ill-equipped to bring strong competitive pressures to bear on providers to make cost-conscious decisions.

Nor do consumers themselves have strong incentives to exert such pressures. Given how the current health insurance system works, consumers often have few incentives to comparison shop among either health care services or health care plans, and even fewer incentives to pursue more cost-effective preventive care so they can avoid health trouble before it starts.

Finally, the fourth problem with our current system is the burden it places on public sector budgets. Public sector spending on health care grew 2 percentage points faster than private sector spending in the 1970s. and health spending is growing four times as rapidly as any other component of the federal budget. Faced with ballooning health costs, governments are forced to make painful choices involving cuts in other spending programs, revenue increases, or bigger deficits--any of which can have adverse consequences for long-term economic growth.

None of these four problems can be solved in isolation. In the absence of system-wide reforms, arbitrary caps on Federal health care programs, which some have proposed, would simply shift more of the government's program costs onto the private sector. Similarly, any attempt to provide universal coverage without complementary measures to improve competition and sharpen the incentives for more cost-conscious decisions would mean even more dramatic increases in systemwide costs. Reforms designed only to address the most glaring shortcomings of private insurance markets would not solve the problem of providing health security for all Americans or the problem of escalating government expenditures for public health.

The Administration's health care reform proposal is the only proposal currently before the Congress which addresses the four problems of the current system. As the recent CBO study argued, "The Health Security Act is unique among proposals to restructure the health care system because it is the only proposal that describes the steps that would have to be taken to accomplish its goals." The CBO study also confirmed that this proposal would significantly reduce the projected growth of national health expenditures while simultaneously providing universal coverage of comprehensive benefits for all Americans by the end of this century. And finally, the CBO study, like several studies by private sector organizations and scholars, confirms the CEA's own assessment that the net effect of health care reform on aggregate level of employment is likely to be small: at most plus or minus one half of one percent of total employment. The reason is that there are a number of offsetting factors in the plan, some of which may increase employment--like lower aggregate business spending on health care as the growth of costs slows--and some of which may decrease employment--like an increase in voluntary retirement. -- but the net effect of these offsetting factor is likely to be small.

Investing in Technology

Now let me turn to another important area of our investment agenda--investment in science and technology. A careful reading of US economic history reveals that the government has consistently played a pivotal role in the development of the nation's educational and scientific infrastructure and in the diffusion of knowledge. This has been true in areas as diverse as agriculture and biotechnology, civilian aviation and microelectronics, lasers and acute trauma care, computing and communications.

We have learned, however, especially from some conspicuous failures to promote civilian technology development in the 1970s, how government can play its part more effectively. So we argue in the *Report* that government support for technology is most effective when projects are evaluated by non-government experts, when they are designed and carried out by industry, when private firms share a significant portion of program costs, and when only the best proposals are funded after a rigorous competition for public support.

We also know that science, technology, and the economic growth they generate cannot help but be greatly affected by the current defense retrenchment, because nearly 60 percent of Federal support for domestic R&D comes from the Defense Department or defense-related parts of NASA and the Department of Energy, and because nearly one-fifth of the Nation's scientists and engineers work in defense-related areas. That is why, with the help of the Congress, we have funded several new technology programs, including the Technology Reinvestment Project, which is designed to help defense contractors retool to serve civilian markets. We have also increased funding for successful examples of public-private partnership in civilian science and technology research, such as the Advanced Technology Program of the National Institute of Standards and Technology.

We have also begun to shift the Federal R&D portfolio from defense to other national needs. For example, we were able to increase funding for research into new environmental technologies. As we discuss in the *Economic Report*, improvements in technologies for preventing and treating pollution, and improvements in regulatory mechanisms, can improve the tradeoff between our interest in regulating environmental hazards and our interest in promoting economic growth. Given the worldwide explosion in environmental regulatory activity, the development of more effective and lower cost pollution control technology can also contributed to our high-wage job base and our exports. The US is now the world leader in exports of environmental equipment. Our trade surplus in pollution control equipment has been increasing and was $1.1 billion in 1991. Our support for environmental technology R&D programs will maintain our competitiveness in this important growing marketplace.,

The issue of international competitiveness brings me to another important dimension of the Administration's economic strategy--its trade policy. Whatever we accomplish at home, must be complemented by an expansion of America's trade opportunities abroad. We live in an increasingly integrated world economy populated by increasingly tough and sophisticated competitors. In response, we believe that the United States has to expand our export promotion efforts--so we have streamlined the Nation's export control programs, and we've significantly eased Cold War-era export controls on producers of high tech products like computers and communications equipment.

We also believe--we know--that America's markets are already among the most open in the world. So last year we moved to ensure access for American products to markets abroad. The Administration vigorously supported the North American Free Trade Agreement. We continue to work through bilateral negotiations to open the Japanese market. And we have worked hard to complete the Uruguay Round of the General Agreement on Tariffs and Trade.

As we argue in the *Economic Report*, the liberalization of global trade resulting from successful completion of the Uruguay Round will raise real incomes in the United States by billions of dollars annually in the coming years. In fact, the total gain 10 years after implementation of the agreement begins is likely to be between $100 billion and $200 billion annually. This is because U.S. negotiators have not only reduced existing barriers; they've also brought areas of trade that had been largely outside of the GATT system, such as agriculture, textiles, intellectual property, and services, into the GATT framework.

We focus on expanding trade because we know that jobs in export industries pay better wages--about 22 percent above the economy-wide average. We know that American companies that compete successfully both at home and abroad offer the best opportunities for American workers. But this is not a mercantilist strategy--in fact, it's a strategy for avoiding mercantilism. We expect trade liberalization to increase both U.S. exports and U.S. imports. And we welcome both.

Summation. Together, all of the initiatives I've described--

continued deficit reduction, increased public investment, a reformed health care system, expanded exports, and a reinvented government--comprise an economic strategy. The goal of that strategy is as clear as it is ambitious: to sustain a high and rising standard of living for the average American family. Because this is a strategy for the long run, its full effects will not be felt overnight. But as we demonstrate with a wealth of detail in the *Economic Report*, there are already many signs that the strategy is beginning to pay off.

We expect the economy to continue to grow in 1994, at 3 percent. Consumer spending should remain healthy, due to continued steady gains in output and employment. Investment spending will also remain strong, because of low long-term interest rates and increased levels of demand. And the economy remains on track to produce 8 million new jobs over a four year period.

At the same time, and every bit as important, the economic outlook of the American people will continue to improve. In our one year together, this Administration and the American people have accomplished much. We have learned that the secret to economic success is making change our friend, not our enemy--coming to view change as the opportunity for advancement it is, not as the threat that it sometimes appears to be. And so the two largest living generations of Americans--the baby boomers and their parents--and a whole new generation that has since come of age in an era of deficits and diminished expectations, can now look ahead with renewed hope and confidence to the future we all share. We can be proud of that. But there's much more to be done. We'll stay to answer some of your questions about this year's *Economic Report*. Then it's time to get back to work on making next year's *Report* even better.

Thank you.

**Women Business Owners and the U.S. Economy**
**Dr. Laura Tyson**
**Women's Economic Summit**
**Northwestern University**
**May 30, 1996**

Four years ago I was an economics professor at UC, Berkeley. I was finishing a book on the problems of U.S. trade and competitiveness in high technology. I was also concerned both about the increasing federal deficit -- which was a threat to federal investment in education and technology -- and about the economy's slow recovery.

A friend called and asked me to help out on the Clinton presidential campaign. I agreed to, because I felt Bill Clinton had the right agenda. His goals were to restore economic growth and to provide opportunity for every American to share in the prosperity that is possible in this period of profound technological and economic change. The President's goals embodied our Nation's core values: to reward individual responsibility and hard work; to preserve families; and to invest in the future of our children and our country.

I was convinced that Bill Clinton's approach was the right one in part because it rested on a few common-sense fundamentals.

First, we live in a market economy, and firms such as yours are the major source of economic growth and job creation In particular, small business is the solid foundation upon which our nation builds its economic strength.

Second, the era of big government is over. In this period of rapid technological and economic change, we have to alter fundamentally the way our government works. It has to be smaller. It has to be less bureaucratic. It has to be oriented toward partnerships and results, rather than toward telling people precisely what to do.

Third, even a smaller government has several key roles to play in our economy, including providing a sound macroeconomic environment for sustained economic growth by billion, compared to the FY92 deficit of $290 billion. The federal deficit now represents the lowest percentage of GDP since 1979. Moreover, the U.S. has the best record of any industrial country, as measured by deficit as a percentage of GDP. In fact, our federal budget would be in surplus today, were it not for the billions of dollars in interest payments we are paying on deficits accumulated during the previous two Administrations.

In sum, this country's fiscal condition is much improved, and the President and Congressional Republicans both have put forth plans to fully balance the federal budget by 2002. The trillion-dollar decrease in the deficit as a result of the 1993 economic plan -- and the prospect of additional deficit reduction -- have led to lower interest rates and a freeing up of capital for investment by businesses such as yours. Inotherwords, deficit reduction has not been an end in itself but a means to an end. The end is economic growth and opportunity.

The results -- as measured by the economy's performance -- are extremely positive. During the last three years, the nation has experienced a broad-based, investment-led economic expansion, accompanied by low inflation:

- The economy has created 8.5 million net new jobs, nearly all of them in the private sector -- exceeding the President's promise of 8 million new jobs during his first term.

  Moreover, these are good jobs. According to a recent study by the Council of Economic Advisers, in the last two years, 68 percent of the new jobs have been in industries and occupation groups that pay more than the median wage.

- More than 2 million new business have been created -- an all-time record.

- Business investment in productive equipment has grown at double-digit rates for three years in a row -- for the first time since the 1960s.

- Home ownership is at its highest level in 15 years.

- The unemployment rate has been below 6 percent for 20 consecutive months. The latest unemployment figure was 5.4 percent -- down from over 7 percent when President Clinton took office.

- Inflation has remained low and stable, averaging 2.7 percent since 1993.

- And the combined rate of inflation and unemployment -- the so-called misery index -- is at a 27-year low.

Women-owned businesses have both contributed to and benefited from the recent strength of the economy. Women entrepreneurs like yourselves are starting new businesses and creating new jobs at <u>twice</u> the national rate. That's a remarkable statistic, isn't it? Let me share some other remarkable statistics with you:

- In January, the U.S. Census Bureau reported that, as of 1992, there were 6.4 million women-owned businesses. Using the Census numbers, the National Foundation for Women Business Owners recently released an analysis showing that today, there are nearly <u>8 million</u> businesses owned and operated by women. That's a <u>25 increase</u> in the number of women-owned businesses just in the last four years. Women-owned firms now account for fully <u>36 percent</u> of all U.S. businesses.

Women-owned business are growing in economic power as well as sheer numbers.

- They <u>generate sales of $2.3 trillion</u> a year, which is more than the GDP of all but a few countries in the world.

- And women-owned businesses now <u>employ 18.5 million people</u> -- that's <u>one out of every five</u> American workers.

In fact, using Census and NFWBO numbers, I have calculated that of the 8.5 million new jobs created since the President took office, half of them are in women-owned firms.

Now, although the economy is the strongest it has been in decades -- with women-owned businesses playing a major role -- many Americans feel a tremendous disconnect between their own lives and the positive numbers I've cited today. Millions of working Americans aren't sure what they're going to get out of the new, high-tech, global economy. The President believes we need to find a way to maintain the dynamism of this increasingly global economy and yet still allow people who are working hard to achieve a measure of security for themselves, their families and their children. We want to avoid a winner-take-all society in favor of a society in which everyone who works hard can be a winner.

The Clinton Administration believes there is an appropriate role for government in areas that would provide greater security to working Americans. Let me cite three specific examples.

The first area is employability security, as distinct from "employment security." This is the security that you will have access to the education and training you will need to get your next jobs. For some individuals, training for self-employment -- creating and operating a small business -- may be the goal.

To help Americans achieve employability security, the Administration has proposed a G.I. Bill for America's workers, so that workers who lose their jobs can get a voucher that will cover their training costs for up to two years. The President has also proposed to make the cost of college tuition tax deductible, and to extend the deductibility of employer-financed education and training.

To be sure, education and skills have always mattered in this country. But today they are the fundamental fault line running through the American workforce. The demand for highly-skilled workers is growing at the same time that the demand for workers without a high level of education of skills is shrinking. Fifteen years ago, the typical college graduate earned 38 percent more than the typical worker with only a high school degree. By 1994, this gap had doubled to 74 percent.

Formal education is not the only investment in skills that pays off. For workers, a year of either on-the-job or formal training raises wages almost as much as a year of college education. That's good news for the roughly 70 percent of the American workforce who do not currently have college degrees. America's business leaders also know that training is good business. Several weeks ago, the National Association of Manufacturers issued a whitepaper challenging industry to double its investment in worker training.

Finally, investment in education and training contributes significantly to overall economic growth. Economists estimate that improvement in the educational attainment of the American workforce has accounted for about 20 percent of per capita income growth over the last two decades.

The second type of security is <u>access to health insurance and pension</u> benefits. Toward this end, the President has called upon Congress to pass the Kassebaum-Kennedy bill, which would allow workers to keep their health insurance even if they change jobs or get sick. And with small business owners in mind, the President last year signed legislation to increase to 30 percent the share of health insurance premiums that self-employed individuals can deduct on their tax returns -- and we're working to increase that amount.

Pensions are no less important. Small firms are less likely than their larger counterparts to be able to provide retirement plans. While 75 percent of workers in businesses with more than 1,000 employees have pension plans, only 24 percent of workers in businesses with fewer than 100 employees have them. At last year's White House Conference on Small Business, the President proposed a new pension plan targeted to the needs of small businesses--the National Employee Savings Trust (NEST). The NEST would provide benefits similar to those of a 401(k) pension plan and would be simple to create and operate.

The Administration has endorsed other improvements that make existing pension plans safer and more beneficial for business owners and employees alike. For example, we have proposed to eliminate the "family aggregation" restrictions on pensions for family members, so that spouses or children who work in the same or related businesses can earn their own retirement benefits. Repealing the family aggregation rule will allow all family members to earn their own retirement benefits.

By the way, these pension reforms would be especially beneficial for American women. Fewer than one-third of all women retirees age 55 and over receive pension benefits, compared to 55 percent of male retirees. And two-thirds of American women work in the three sectors -- services, retail and construction -- with the lowest pension coverage. Finally, the NEST plan would cover many part-time workers, who are disproportionately women.

The third type of security is the security that an American worker can make a living wage. The minimum wage is currently approaching a 40-year low. The President has called for a 90 cent increase, to be phased in over two years. This would benefit 10 million minimum-wage workers, 60 percent of them women, and many of them single parents. Last week, the House of Representatives approved a 90 cent minimum wage increase and we expect the Senate to follow suit.

Raising the minimum wage to $5.15 an hour can help make work pay. The extra $1,800 a year, combined with the Earned Income Tax Credit, is enough to lift a family out of poverty. This modest rise in the minimum wage will not derail the sustained economic recovery we're experiencing. Instead, it will help to keep all firms moving forward on the path of higher wages, higher skills and higher productivity.

In talking about the issue of economic security with small business owners and others over the past year, I have noticed two things.

First, women across the board are more concerned about the issue of economic security. Because women are the dominant care-givers -- taking care of elderly parents as well as their children -- concerns about education and training, as well pensions and health insurance, strike a responsive and compassionate chord. I was pleased to see that the statement by Rosabeth Moss Kanter, which appears as the lead-in to the program for this conference, calls for an "economic security agenda that is credible."

Second, women entrepreneurs tend to manage their businesses in a way that reflects this concern with economic security. Women-owned businesses are more likely to offer child-care, flex-time, tuition reimbursement and job-sharing programs than other U.S. businesses. I have noticed this emphasis on flexible, "family-friendly" work environments in my own conversations with women business owners, and it is borne out by research done by the NFWBO. Some people call this "good corporate citizenship" or "corporate responsibility." Women entrepreneurs know that this common-sense approach to the workplace is simply good business.

In part, because of these practices, the work force in a women-owned company is typically about two-thirds female. As one writer put it, "women-owned businesses become the training grounds for female employees to leave and launch their own businesses, which creates an ever-widening circle of women hiring women...." This employment record is good not only for women themselves, but for all of America.

<u>Conclusion</u>

I started with the observation that it was President Clinton's economic vision for growth and opportunity that lured me into the White House. Personally, of course, there has been plenty of growth and opportunity for me. But more important is the growth of the economy and the performance of the women's business sector in recent years. Not only has it outstripped the performance of U.S. business overall on major dimensions, but women entrepreneurs, in the process, are redefining how business is conducted.

I believe more strongly than ever that the President has found the right path for economic growth and opportunity: steady progress toward a balanced budget; targeted tax cuts to lift working families in America out of poverty; and investment in our future and our children's future. This is not always the easiest path to follow, politically speaking. But, as an economist, I am confident it is the correct path.

As we move into the knowledge-based economy of the 21st century, we are poised for success with a President who understands the profound economic changes that are transforming our lives and reordering the way we work and live. We are presented with a challenge that emerges perhaps once in a hundred years: to harness economic change to our advantage and help propel this Nation and its people forward with confidence.

Women entrepreneurs such as yourselves are especially well poised for growth and success, in a strong economy that is expected to continue to expand. You have been very good for the American economy, and the economy -- assuming we stay on President's chosen path -- should continue to be very good to you. This sustained economic growth -- of which you are both cause and consequence -- is the ultimate source of economic security for us all.

# Clinton Library Transfer Form

| | | | |
|---|---|---|---|
| Case #, if applicable | | Accession # | |
| Collection/Record Group | Clinton Administration History Project | Series/Staff Name | |
| Subgroup/Office of Origin | | Subseries | |
| Folder Title | | OA Number | 23860 |
| | | Box Number | |

| | |
|---|---|
| Description of Item(s) | sixteen computer diskettes - sixteen OA's in all - 23860, 23870, 23877, 40510, 23856, 23861, 24099, 23867, 23869, 23857, 23858, 24112, 23255, 24123, 23850, & 40514 - these diskettes were transferred as result of policy set by Supervisory Archivist |

**Donor Information**

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| Last Name: | | First Name: | | Middle Name: | | Title: | |
| Affiliation: | | Phone (Wk): | | Phone (Hm): | | | |
| Street: | | City: | | State (or Country): | | Zip: | |

| | |
|---|---|
| Transferred to: | Audio/Visual Department |
| Other (Specify): | |

| | |
|---|---|
| Transferred by: | Jimmie Purvis |
| Transfer Point | After Processing |
| Date of Tranfer | 4/10/2006 |