The Economy in Perspective

Les Misérables ... A few decades ago, during a period of slow economic growth and high inflation, the economist Arthur Okun added together the unemployment and inflation rates and dubbed the sum the Misery Index. Okun, a keen marketer of economic concepts, recognized the communication value of having a quick and dirty indicator of economic conditions at one's disposal. In 1960, the Misery Index stood at 7.2%; in 1970 at 10.6%; in 1980 at 20.6%; in 1990 at 10.9%; and today it registers about 8.2%. With so much misery having been wrung out of the economy lately, you might think people would be fairly pleasant about the subject, if not borderline blissful.

Au contraire. Apparently, there is still plenty to be miserable about. Many people are understandably disconsolate about employment upheavals in business firms—restructurings driven by a desire to cut costs and reposition the companies. Interestingly, although widely publicized layoffs by large, well-known companies have captured the public's attention during the past several years, employment overall has been expanding fairly rapidly, and the unemployment rate stands at just 5.2%. Moreover, if corporate labor-force retrenchments are making households more cautious, why do national statistics show growing consumer confidence, lower saving rates, and increased debt finance during the past few years? Although it is clear why layoffs would affect the behavior of those directly harmed, large spillovers are not evident.

Some people are glum about what they regard as the inadequate pace of economic growth. Real GDP has been advancing at an average 2.75% rate for the past five years, a tempo that most economists regard as slightly better than what the nation should expect, considering labor force and productivity trends. The critics' impatience stems from a conviction that changes in certain national economic policies could boost the economy's growth rate considerably, to 3.5% per year or more.

Different economic policies could, possibly, lead to a faster growth track. To reach this objective, economists typically recommend policies that encourage saving, enhance capital formation, reduce regulatory taxes, and promote free trade. Consequently, many would like to see our income-based tax system replaced by a consumption-based one, and would urge reconsideration of tax preferences and other government programs that encourage spending on housing.

In discussing capital formation, most people ignore housing, although it actually forms the largest component of our capital stock. Without altering the size of that stock, the nation could develop a more productive capital base by changing the mix of housing and business capital. Nevertheless, despite the disproportionate share of housing-related tax preferences accruing to the wealthiest households, government programs that support housing expenditures remain quite popular.

Free-trade agreements, on the other hand, are difficult to sell to the public, despite their often-demonstrated ability to improve national living standards over time. Public debates over free-trade agreements tend to focus on the jobs that will be lost relative to those that will be gained in the agreement's wake. A nation is considered a winner if it gains more jobs than it loses, but this elementary arithmetic misses the real point.

Trade agreements should enable nations to compete on the basis of their comparative advantages so that both parties benefit, whatever the outcome for jobs. For example, South American countries enjoy summer when it is winter in the United States. Permitting them to export more fresh fruits and vegetables to this country gives U.S. consumers a wider food selection all year. In return, our exporters could get cheaper access to markets for manufactured products. In this example, the U.S. growing and packaging industries might lose jobs as consumers substitute fresh food for packaged, but our manufacturing sector would gain jobs. The essential point, however, is that both nations' productivity would increase.

Many economists also suggest Social Security reform. This program provided generous benefits to current and past generations of the elderly, but demographic trends and slowing productivity growth make its prognosis bleak. Even more problematic, the rate of return to contributions has been declining for some time, and currently is far below what a person could receive by investing in privately issued securities. The net effect of the program has been to boost national consumption at the expense of national saving.

Public office holders find it difficult to champion open trade agreements, consumption-based taxes, curbs on housing investment, or Social Security reform. Although movement in these directions carries the promise of higher living standards, the status quo is *de rigueur.* Misery, after all, loves company.