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NEWS UPDATE - Wednesday, January 31, 2001

SUMMARY

In the News…

- *Associated Press* reports that Treasury Secretary Paul O'Neill claims there is "uniform agreement" in Congress for the Bush Administration's across-the-board tax cuts that skew most of the benefits to the richest sector of the population
- *The New York Times* reports that U.S. Trade Representative-designate Robert Zoellick garnered zero opposition to his nomination in the Senate, despite his free-trade zealotry and his "sidestepping the concerns of many senators about specific practices of this country's trading partners." Zoellick said the Bush Administration strongly supports efforts to pass "fast-track" authority.
- *Reuters* reports on Progressive Caucus Rep. George Miller introducing comprehensive education reform legislation that focuses on investment in school construction and infrastructure – rather than Bush's voucher proposal
- *Washington Post* reports on a new audit of California's deregulated energy system showing that Southern California Edison passed on $5 billion in net income to pay its parent company's shareholder dividends, while simultaneously asking the state for a bankruptcy bailout
- *The Wall Street Journal* examines one Michigan town to study how the shifting economic winds – and inconsistencies of a rapidly globalizing economy - affect everyday Americans

From the Editorial Pages…

- *Economist James K. Galbraith*, director of the University of Texas Inequality Project, charts the growing inequality in pay and explains why that means tax relief must be skewed to help working families – not the wealthy
- *The Washington Post* editorial board hammers the Bush Administration's "prescription drug plan" as a weak gesture at the problem that, if passed, would attempt to preclude any further reform from passing
- *The New York Times* editorial board calls on proponents of a new energy policy to focus on conservation – not simply environmentally-hazardous oil exploration.

Quote of the Day…

"The Fed should cut interest rates, sure. And Congress should cut taxes. But what taxes? Not, surely, taxes that mainly fall on creditors, savers and the wealthy. Not, surely, tax rates four, five and six years from now."

– *Economist James K. Galbraith on the ongoing tax debate (TheStreet.com, 1/30/01)*

O’Neill says tax cut plan making headway

Associated Press

WASHINGTON — Treasury Secretary Paul O'Neill said Tuesday he believes the Bush administration has close to "uniform agreement" with Congress on the need for an across-the-board tax cut. The size of the reduction is the major unresolved issue, he said.

O'Neill said the administration is intensively trying to work out the mechanics of how to make President Bush's proposed 10-year $1.6 trillion tax package retroactive to the first of the year.

Meanwhile, at the White House, President Bush met with Republican leaders of Congress on Tuesday and said the issue of how to get his tax package through Congress was a main topic of conversation.

"We did discuss the timing of the tax package, how best to move it through the House," Bush told reporters. "We are interested in success."

As far as timing for debate on the centerpiece of his economic program, Bush said he would like to see the measure dealt with "as soon as possible."

Also at issue was whether lawmakers should consider Bush's proposal in one fell swoop, or in pieces.
Bush was giving lawmakers "procedural flexibility" on how they approach his proposals, spokesman Ari Fleischer said. "The president's focus will be the bottom line," Fleischer told reporters. "He wants taxes cut (and) he'll work with the Congress on whatever procedure best gets that done."

After the meeting, Senate Majority Leader Trent Lott told reporters he believes Congress could have a major tax bill approved by July 4.

"We believe we can get to the major tax package in the Senate in May. We fully expect to have significant tax relief for Americans before the Fourth of July recess," Lott said.

A decision on whether to make the tax cut retroactive has not been made, O'Neill said in a separate meeting with reporters.

"The president hasn't decided to accelerate yet. There is only one decision-maker down here and he is over there," O'Neill said, pointing from his Treasury office to the White House next door.

One issue to resolve is how to change individual tax withholding rates to cover the full year, O'Neill said. That would make the withholding reductions larger since they would not take effect until several months had passed. However, that could result in what would appear to be a tax increase next year when withholding rates would be readjusted to be spread over a full 12 months.

"It is a complex, technical issue and it involves millions of employers and more millions of individuals and it is something that you have to attend to really carefully," O'Neill told a small group of reporters during a breakfast interview.

O'Neill, who won widespread praise for his successful turnaround of aluminum giant Alcoa, expressed a businessman's frustration about the length of time it takes in the political process to decide such issues as a tax cut.

"We now have what looks like pretty uniform agreement that we should have a tax cut and that we should have marginal rate reductions and the question about how much, which is a legitimate question. But once we have agreed to all of that, how long should it take to pass legislation, a week, two weeks, be generous, say six weeks," O'Neill said.

The administration is expected to send its tax proposal to Congress next month along with the broad outlines of its budget proposal for 2002, the fiscal year that begins next Oct. 1.

On other matters, O'Neill said he had a "useful first meeting" Monday with Horst Koehler, managing director of the International Monetary Fund, and Deputy IMF Director Stanley Fischer.

But he suggested the Bush administration would be pushing for larger reforms at the institution, which was heavily criticized for its handling of the 1997-98 global currency crisis that engulfed a number of Asian countries, Russia and Brazil in economic turmoil.

"I will have more to say to you probably in the not-too-distant future about what I think, and more importantly what the president thinks, about the direction of these international institutions," O'Neill said.

Bush's Choice Seen Winning Trade Position

New York Times

WASHINGTON, Jan. 30 — Facing no opposition to his confirmation, Robert B. Zoellick, President Bush's choice to be United States trade representative, offered the Senate a strong defense of the new administration's free-trade policies today and sidestepped the concerns of many senators about specific practices of this country's trading partners.

"Expanded trade, imports as well as exports, improves the well-being of Americans," Mr. Zoellick declared at the outset of his confirmation hearing before the Senate Finance Committee. "It leads to better jobs, with bigger paychecks, in more competitive businesses, as well as to more choices of goods and inputs with lower prices for hard-working families and hard-driving entrepreneurs."

He promised to work with Congress to win early approval of what is called fast-track legislation, which would give the administration the authority to negotiate trade agreements that Congress could not change, but only approve or reject. This legislation is viewed as essential if President Bush is to achieve his main goal in international trade, turning the entire Western Hemisphere into a free-trade zone.

Mr. Zoellick made no concession to Democrats who insisted that labor rights and environmental protections be part of any trade agreement.

In answer to one question on the matter, he said: "When President Bush was asked about this, he said that of course he believes it's very important to try to improve environmental and working conditions. He just wants to be sure that we don't do so in a protectionist fashion. To be successful with the trade agenda, we're going to have to try to get the broadest possible support in the Congress, a bipartisan support. And that's why I am definitely committed to consulting and working with you and your colleagues on this issue."

An official in the Treasury and State Departments in the Reagan and Bush administrations, Mr. Zoellick is well known to the senators. Today, almost all those on the Finance Committee asked questions about trade matters of particular concern in their states.
Mr. Zoellick is likely to be confirmed by the Senate next week.

Key Democrats Challenge Bush's Education Plan

Reuters
WASHINGTON - Key Democrats in the House of Representatives will unveil their own education reform package Wednesday, increasing pressure on President George W. Bush to abandon contentious plans for private school vouchers.

Rep. George Miller of California, the ranking Democrat on the House Education Committee, said on Tuesday his package would increase investment in school construction and after-school programs, and reward public schools that boost academic performance.

The proposal is the latest to challenge Bush's agenda on education reform and prescription drug benefits for seniors, casting doubts on White House hopes of scoring an early legislative victory.

But key Democrats said they had hopes that Bush would eventually back off on vouchers, clearing the way for passage of his other education priorities. ''We see more chances for agreement on key education reforms this year than at any time in the past,'' a spokesman for Miller said.

Bush made education reform his first proposal to Congress, offering a multibillion-dollar plan linking federal aid to school performance. Bush's plan would also give $1,500 vouchers to the parents of students in troubled public schools, allowing them to send their children to private institutions.

While Democrats generally welcomed Bush's proposal, they said vouchers were a nonstarter because they would siphon off funds from cash-strapped public schools.

Miller's bill, co-sponsored by Michigan Democratic Rep. Dale Kildee and other lawmakers, would double over five years so-called Title 1 funding for poor children in elementary and secondary schools, and target additional resources to disadvantaged areas.

It would also require states and school districts to ensure that all children ''reach a proficient level of performance'' within 10 years. It does not include private school vouchers, which Miller and most Democrats oppose.
A similar plan was introduced by former vice presidential candidate Sen. Joseph Lieberman of Connecticut and other moderate Democrats. Lieberman's bill would boost investment in public schools and for the first time sanction states where local school districts fail to improve.

Likewise many moderate Republicans were pressing Bush to abandon vouchers, saying it could spark a partisan battle over the nation's education priorities. Moderate Republicans could hold the key to passage of Bush's legislative agenda in the narrowly divided House and 50-50 Senate.

Calif. Utility Sent Parent Firm $4.8 Billion

Washington Post

LOS ANGELES, Jan. 30 -- The first of several audits to be released by state regulators said that one of California's two nearly bankrupt utilities, Southern California Edison, legally passed along nearly $5 billion in net income to its parent, Edison International, which used the money to pay dividends to its shareholders and to repurchase its own stock.

The audit, released Monday night by the California Public Utilities Commission, also showed that Southern California Edison is now broke and so strapped for cash it cannot keep buying electricity at rates higher than it can pass along to consumers.

The $4.8 billion was, in part, proceeds from the sale of the Southern California Edison's power plants, which the utility was required to sell under California's 1996 deregulation plan. Deregulation here sought to break up the utility monopolies and open the state up to free-market forces.

Consumer advocates -- and some elected officials -- reacted angrily to the audit, accusing the utilities of pleading poverty and begging for financial assistance from the state to avoid bankruptcy.

"Basically, they took the money and ran," John Burton, a Democratic leader of the state Senate from San Francisco, told reporters. "Had they not done that they would not be in the financial problem they are in. If ratepayers bail them out, ratepayers should get something in return, like power lines or something."

But officials with the utilities said their critics are playing politics and misinterpreting their books. Tom Higgins, senior vice president at Edison International, said: "There's been no profit, no windfall. This is the recovery of capital investment."

The past profits and current solvency of the state's two struggling utilities are central to California's energy crisis. Most experts agree that the state is suffering from soaring prices and its 15th day of emergency energy rationing because of a failed and dysfunctional deregulatory plan, which allowed wholesale energy prices to soar while capping the rates utility companies could charge consumers. In the past six months, the utilities have gone bust, while wholesale power producers have reaped huge profits.

California is fast running out of time to solve its immediate energy crisis. The state already has used up the first $400 million in emergency appropriations for electricity purchases. The Legislature is considering bills to make the state a major buyer of power -- and to pass along possible steep increases in costs to consumers. Gov. Gray Davis (D) worked through the weekend trying to hammer out a longer-range plan, but so far the Legislature has passed only emergency measures and decrees -- and no long-term solutions.

Higgins, the Edison International executive, said Southern California Edison was required to sell off its plants after deregulation in 1996, and that it did so -- mostly to out-of-state companies that are now the wholesale suppliers of California's electricity. The utility sold off its gas and coal-fired plants, but retained its nuclear and hydroelectric facilities.

The money they got from plant sales, Higgins said, went to pay off the banks that loaned them the cash to build the generating stations and to repay investors and shareholders who also put money into plant construction. The transfer of money occurred from 1996 through last November.

"It's like you have a house and mortgage and you sell the house and you recover your initial investment and then pay off the mortgage," Higgins said.

Another audit of Pacific Gas and Electric Co., the other struggling utility, will be released within days. That results are expected to be similar.

"The only reason this would be controversial is that the consumer groups are trying to rewrite history," said John Nelson, a spokesman for PG&E.

Nelson said his utility did the same thing as Southern California Edison -- it sold plants, paid off loans and sent the rest to its holding company, PG&E Corp. He would not disclose exactly how much was transferred, but said it is safe to assume a figure of several billion dollars.

Consumer advocates around California, however, said it did not matter that the utilities were returning investments to their shareholders, a practice that no one has asserted is financially improper or illegal. Today, they began lobbying state lawmakers to scrap an emerging legislative plan that would cover much of the utilities' purported debts with billions of dollars in publicly financed bonds.

"This confirms what we've been saying all along," said Matt Freedman, a director of the Utility Reform Network. "Edison is not being straight with the public or the Legislature about the extent of its debt."

Freedman also said that the audit shows that in recent months Edison has been selling some of its own generating power back to itself at high prices on the open market, then claiming both profit and debt.

"It's like a laundering scheme," he said.

Michael Shames of the Utility Consumers Action Network said the audit could significantly influence the fast-moving legislative debate on the state's energy crisis. He said that while it was not illegal for the utilities to transfer money to their parent companies, "the question is, 'Was it prudent?' "

But Paul Hefner, a spokesman for Assembly Speaker Robert Hertzberg (D), said there are no substantive new revelations in the Edison audit and that the Legislature is proceeding with a plan outlined last Friday that would cover much of the utilities' debts in exchange for the state receiving warrants to buy stock in the companies.

"I don't know that it changes the landscape at all," Hefner said, referring to the audits. "All along we've been saying we're not going to do this and get nothing back. We're driving as hard a bargain as we can."

Michigan Town Feels Crunch Of Shifting Economic Trends

Wall Street Journal

HOLLAND, Mich. -- A few hours before his shift starts, Ray Modrak drops by the Barber Ford dealership to get a closer look at the Econoline van shimmering on the showroom floor.

Mr. Modrak works full time in the warehouse of an automotive supplier. He made $35,000 last year. Lately, he has been thinking about trading in his 1996 Ford pickup truck for something more practical, with better gas mileage and room for a bed he can sleep in when he is on long fishing trips. He can afford the van, but he isn't ready to buy it.

"I'm watching the economy real close before I make a decision," says the 59-year-old, as he strolls around the showroom with a cup of coffee in his hand.

Such is the delicate state of the economy, at least as seen through the tall, well-cleaned windows of Barber Ford. A sense of caution has begun to drift through this town, like the little gusts of cold air that accompany each customer into the showroom.

For months now, economists and politicians have been warning that the nation could be headed for a recession. Weak retail sales, bitter winter weather, soaring energy prices and wilting consumer confidence have hurt manufacturing and slowed the economy, the experts say. Tuesday, the Conference Board reported that its January index of consumer confidence had dropped 14.2 points to 114.4, the fourth consecutive monthly drop and the lowest absolute level the index has hit since 1996. The sharp decline sparked speculation that the Federal Reserve could slash its benchmark interest rate by three-quarters of a percentage point today, bigger than any single move since 1982.

But what's often missed by such economic indicators is the way that even a perceived slowdown can ripple through people's lives. The customers and employees here at Barber Ford still have jobs and spare cash. They say they aren't afraid to spend. But anxiety, however slight, has begun to creep in, often in ways they are reluctant to admit.

Janet Hall, who is looking at sport-utility vehicles, says she's concerned because donations have been down lately at the church where she works. Matt Terpstra, a 21-year-old new-car salesman, has noticed that the ratio of browsers to buyers is increasing. That could have a big effect on his income in this, his first full year of employment. But he runs on high-octane optimism and scarcely even remembers a time when the economy wasn't booming. He keeps telling himself that hard work overcomes hard times and that browsers will turn to buyers before long.
And then there's Mr. Modrak and the Econoline, a demo model left over from the 2000 line. It's now marked down about $1,000 to $21,988. As much as Mr. Modrak would like to have it, he finds himself hampered by a vague, uneasy sense that the economy is cooling.

It's a cold Friday morning, with the sun trying to break through a cardboard-gray sky, when Mr. Modrak visits Barber Ford. The dealership sits at a busy intersection on the south side of Holland, surrounded by a McDonald's, a Banc One, a Shell station and a Chevy dealer. He has always bought his vehicles here, and he's particularly fond of a salesman named Pete Shearer.

Mr. Shearer isn't around at the moment, so another salesman, Mike De Vree, takes Mr. Modrak to see the van. Mr. Modrak explains that he has been working in the automotive industry for 35 years -- the last 12 at the automotive supplier Donnelly Corp. -- and he thinks it's time to begin preparing for retirement. He wants a van so he can take long fishing trips and not have to rent a motel room. And he wants to buy it soon so he can pay it off while he's still employed.

But Mr. Modrak says he's concerned because his health-insurance premiums were raised late last year at about the same time his employer announced an end to overtime pay. He did receive a raise, but it was barely enough to compensate for the higher insurance payments. He also knows that several of the town's big manufacturers in recent months have asked employees to agree to take time off without pay, in what the companies call voluntary layoffs.

"I'm getting everything lined up," he says, "and if it looks like there's going to be a future, I'll go ahead" and buy the van, Mr. Modrak says.

The salesman senses that there will be no deal today. Mr. Modrak drives home, exchanges his brown-leather jacket for an olive-drab army jacket and gets ready to go to work. Before backing his truck out of the driveway, he carefully lays two reels and two collapsed rods on the passenger seat. Ever since the ban on overtime, he's been bringing some of his old fishing gear to the warehouse and selling it to co-workers. It's not that he's broke; it's just that he can't justify buying fancy new equipment without the extra income. Economists would see his purchase of the new gear as good news, no doubt, but no statistical analysis would pick up on his mood.

"Yeah, the '90s might have been great," he says. "But people put in a lot of overtime to get that kind of money. Now there's so much tension. Something's not right."

Later, when Mr. Shearer returns to the dealership, he says he isn't worried about customers such as Mr. Modrak. It has been a tough winter in western Michigan, he says. The uncertain outcome of the presidential election seemed to make everyone edgy, and the slow Christmas retail season only added to the sense of uncertainty about the economy. Then came huge snowstorms in December. On top of all that, Ford dealers have had to wrestle with problems connected to the recall of Firestone tires on its Explorer models. "The buyers are still out there," Mr. Shearer says. "People still have a pretty decent peace of mind."

Mr. Shearer, 33, has a dimpled chin and a boyishly handsome face. Spend five minutes with him, and you'll feel as though you've made a friend. Buy a car, and you will have made a friend. He's the sort of salesman who goes fishing with his customers and attends their families' big celebrations. Like many salesmen, he thrives on optimism, and he strongly believes that if Americans tell themselves that there will be no recession, there will be none.

A 'Special Area'

"That's why we tend not to watch the news in our house," he says. "I find if I'm in a good mood and I'm positive, it spreads. If you smile, you get a smile back. In Holland, we're pretty blessed. I don't want to call it an economic bubble, but it's a pretty special area. We're paid pretty well, and we spend."

It's true that Holland has almost no unemployment. In addition to automotive-supply companies, it is home to several big furniture manufacturers. Its residents, many of them of Dutch descent, pride themselves on their thrift. The median family income in town is about $56,000. Many customers still pay cash or make large down payments for their vehicles. Only under duress does Mr. Shearer acknowledge that a few of his customers have expressed nervousness about the economy in recent days. "Maybe 5%," he says. Then he perks up instantly, suggesting that those customers who are nervous might wait a year, but they will eventually buy.

"Let's say in the next month the gloom and doom starts and we get a thousand layoffs at Johnson Controls," Mr. Shearer says, referring to the automotive-seat manufacturer. "The only thing I'd do differently is work harder. I'll call more customers, write more letters. I keep pictures of my kids up there for that reason," he says, pointing to the bulletin board next to his desk. "It keeps me going. I'd just turn it up a little."

Car salesmen talk a lot about needs and wants. Anyone can sell a car to someone who needs one. No matter what the economy, a customer whose car breaks down and can't be repaired needs a new one. But does he really need a

$40,000 Ford Expedition when a $15,000 Focus will get him to work just the same? No, but he wants the Expedition. And when the economy is going strong, wages are rising and the stock market is rising, a want can feel an awful lot like a need.

What Keeps Us Spending

"It's important to understand consumer attitudes," says Diane Swonk, chief economist for Bank One Corp. in Chicago. "Do you have a job? Does your neighbor have a job? Do you have money in your wallet? As long as those things are there, you'll keep spending."

All those conditions still exist in Holland, as they do in much of the nation. That's one reason Ms. Swonk is one of the economists predicting that the current economic slowdown needn't become a full-bore recession. She notes that sales at many big retailers were stronger than expected in January. Mortgage applications and home purchases have rebounded. When consumers begin to realize that the slowdown isn't going to turn into a collapse, they'll begin spending again. "Psychology is ultimately dominated by what people see in their wallets," she says.

The same subject was debated one day in the service department of Barber Ford. Dave Cook, Bob Wright and Gary Alpers work back near the garage, where they act as liaisons between customers and mechanics.

"I don't get too concerned because I consider my job pretty recession-proof," says Mr. Cook, 33, who writes up mechanics' reports for customers. "Bob's been affected, though. He had to stop supersizing his lunch at the Hot-n-Now."

The men all laugh. But, in fact, Mr. Wright has been affected in a more profound way. After eight years of investing a portion of his savings in the stock market, he has been hit by his first significant losses, in the low tens of thousands. He keeps telling himself they're only paper losses, but they feel real -- real enough that he and his wife have canceled their Australian vacation, their first overseas trip and one they had been talking about ever since they got married 10 years ago.

The Snowball Effect

But Mr. Cook worries that the economy could get worse if more people react as Mr. Wright did. "Isn't it all group psychology?" Mr. Cook asks. "Some company holds off on hiring somebody, then that person holds off on buying the new washer and dryer, and then it all snowballs?" Mr. Wright says he understands that, but it doesn't bring back his money.

The men agree, at least, that their jobs are secure. If the economy slows, people will spend more to repair their old cars rather than buy new ones. "I even heard some of the new-car salesmen saying it wasn't so bad, they'll just sell used," Mr. Cook says.

The owners at Barber Ford -- Ed Bosch and Doug Wierda -- say the business has survived recessions before, thanks in part to the fact that they do sell both new and used vehicles. But both men worry that many of their 58 employees are too young to have ever worked through a recession. They are concerned that some of them might have acquired too much debt during the 1990s and won't be prepared if their annual incomes drop in 2001.

"A lot of us older people knew we were going to get a dip," says Mr. Bosch, 56. "I can't tell my employees how they're supposed to live and how they're supposed to budget their income. I hope there's some common sense out there and they've budgeted themselves." He says he has tried to keep the operation lean during the good years so he wouldn't have to lay off employees during the bad.

Mr. Bosch remains optimistic that the economy, especially in Holland, will remain somewhat strong. But his accountant, who also audits the books for a lot of manufacturers in the region, has been telling him that many clients are "feeling the crunch." That could mean a lot of belt-tightening in Holland.

'Kind of Wait-and-See'

For now, though, even with Barber's sales slumping a bit, there is a sense that the belt-tightening hasn't begun. As salesmen spring from behind their desks and step across the carpet to greet new customers, they say they believe that

Holland residents aren't yet operating as if they were in a downturn. The buying has stopped -- temporarily, they insist -- because people are waiting. They want to see whether George W. Bush will push ahead on his proposed tax cut. And they are watching whether manufacturers are going to announce layoffs that aren't voluntary.

"I think it's kind of wait-and-see with the economy," says Ms. Hall, 50, who has come to Barber to see about renewing the short-term lease on her Expedition. Ms. Hall is leaning toward an Explorer this time, however, because it's less expensive than the Expedition. "I'd feel more comfortable knowing that the fixed costs I have won't increase," she says.

The salesmen at Barber are getting used to such concerns, and they are happy to oblige. A sale is a sale, they say. A few days after his first look at the Econoliner, in fact, Mr. Modrak returns to the showroom to see the van again. This time, Pete Shearer is there to greet him.

Mr. Modrak says he was thinking it might be wiser to buy a small car rather than a van, what with gas prices being so high. Then he could buy an inexpensive, used truck to haul his fishing boat.

But Mr. Shearer recommends against it, reminding him that the cost of insuring two vehicles would gobble up any savings. Mr. Modrak seems to agree.

"I'm going to look and wait and think yet," he says. "I'm in a toss-up right now."

That's fine, says Mr. Shearer, sensing, he says later, that he'll make the sale in a few days -- one week, tops -- if he doesn't push. He tells Mr. Modrak to come back whenever he's ready.

Inequality Ticks Up, Bringing Bad News for the Economy

TheStreet.com

By James K. Galbraith

Readers of *TheStreet.com* know me mainly as a Fed basher . But I have another life entirely. In it, I pursue, for the pure pleasure of discovery, the measurement of economic inequalities. There are many different kinds: inequalities of pay, of income, across industries and economic sectors, across regions, in the U.S. and around the globe. I measure them, graph them, map them and compare them to measures of other economic variables, like unemployment, gross domestic product and other people's inequality measurements.

This work -- on display at the University of Texas Inequality Project Web site -- has been well received by professional economists, giving rise to papers with impossibly long titles, dissertation topics for my students and a small career for myself as a traveling evangelist for certain statistical techniques. But it also produces, on occasion, information of larger importance.

In particular, the monthly employment and earnings data sets produced by the Bureau of Labor Statistics can be used to measure inequality in pay in the U.S. manufacturing sector, and this calculation can be made just as soon as the data are released. Because employment and earnings data come out every month, monthly inequality measurements can be just as up to date as unemployment measurements, one of the most sensitive indicators of current economic performance that we have.

An Early Warning?

This measure of inequality has been very closely related to unemployment and to economic performance in general over a very long time; month to month, inequality and unemployment match as far back as 1939. The inequality measure may actually lead unemployment by a bit, giving an early warning of downturns. When the economy slows and unemployment is about to rise, firms first cut the hours and overtime of their hourly workers. This shows up as a fall in relative pay (monthly earnings) for the lowest-paid, and the inequality measure ticks up. Unemployment itself tends to rise a bit later, when firms are (as a rule, reluctantly) forced to eliminate whole shifts, shut factories and let workers go.

Here's the headline: This particular inequality measure had been falling smartly since 1994, pretty much in line with the unemployment rate. But it stopped falling in early 1999. Since June 2000, the measure has started rising sharply, with particularly large jumps in October and November of last year. A chart showing the entire series, all the way back to 1947, illustrates this. Just last week, Vidal Garza Cantu, a UTIP veteran who is now an assistant professor at the Monterrey Institute of Technology in Monterrey, Mexico, produced this chart.

As you can see, the start of recessions in 1957, 1960, 1970, 1974, 1980 and 1990 were all marked by distinct upturns in this series. It's a sensitive indicator, in other words, of larger economic conditions. And, given what it has started to do over the past year, this is not good news.

It is risky to lean heavily on a single measure -- particularly in this case, when the weight of manufacturing in employment has been falling over the decades, as it has been. But on the other hand, it would be foolish to ignore a bit of evidence, when a lot of other evidence also points the same way.

The Politics of Policy

Policy implications? Let's concede a point to Dick Cheney. The risk of recession is a serious one, as he said in December. But let's also face the implications. The Fed should cut interest rates, sure. And Congress should cut taxes (as well as increase spending on public services, like education). But what taxes? Not, surely, taxes that mainly fall on creditors, savers and the wealthy. Not, surely, tax rates four, five and six years from now. So leave the income tax, the capital gains tax and the estate tax alone. We are seeing a fall in income, relatively speaking, of the working American families with the *lowest* incomes, not the *highest*. That is what our inequality measure shows. And we are seeing it *today*. In fact, it has been going on for more than a year.

So, let's cut taxes on *working* Americans *now*. How? The best idea I've seen so far has been proposed by Randall Wray of the University of Missouri at Kansas City and my fellow fellow at the Jerome Levy Economics Institute.

Wray points out that Social Security payroll taxes now exceed benefits, this year, by around $150 billion. A cut in payroll tax rates, sufficient to bring the trust fund into balance for a year or two, would usefully put money directly into the pockets of working Americans this year where it is most needed. If the measure stabilizes the economy, the long-term net effect on the Social Security trust fund would likely be quite small.

Obviously some Republicans, determined to cut taxes for the wealthy and to privatize Social Security over their own dead political bodies, will oppose this simple, effective proposal. But others, who may recognize what a long and steep recession will do to them politically in any event, might just line up with public-spirited Democrats and, for once, save the country. Or am I dreaming?

Wrong Rx for Medicare

Washington Post

THE MOST efficient way to add a prescription drug benefit to Medicare is probably . . . just to add it. The president's interim proposal to give the states $48 billion over four years to help only lower-income recipients purchase drugs sounds like a reasonable first step. But other experience with such grants suggests that the measure would produce a ragged and unsatisfactory result. The problem isn't that hard; the parties don't need four years to figure out a long-term program; and $48 billion, uncertainly spent, is too high a price to pay for their indecision.

The drug companies are opposed to merely adding a prescription benefit to Medicare, and their views are likely to carry great weight within the new administration, just as they already do in the Republican Congress. The companies fear price controls or the equivalent if the government becomes the sole buyer of drugs for the elderly and disabled -- the seventh of the population enrolled in Medicare. They say the price controls will reduce the money they have available for the research on which so much progress in modern medicine has been based. It is not a trifling argument, but if Congress believes it, surely it can come up with an alternative method of buying the drugs that will leave the companies bargaining room while protecting the taxpayers from being ripped off.

Most Republicans and some Democrats have a further objective with regard to a drug benefit. They don't want to confer it without at the same time achieving what they call Medicare reform. In return for the liberalization, they want a restructuring. That issue too should be soluble if the two sides are serious and not just trying to score ideological points.

The Republicans want to convert Medicare into something closer to a voucher program. Rather than have the government act as insurer and payer of bills, they would have it give people the equivalent of chits with which to buy private insurance. In the current system, the government defines and largely determines the price of eligible services. The critics want to ease that regulation, which they say impedes innovation and stands in the way of the greater efficiency that a competitive system could be expected to produce. That's not a trifling argument, either. A competitive system might well be more efficient in some respects, though we doubt it would confer all the benefits supporters claim. We doubt, for example, that in the long run it would save all that much money. Unless benefits are cut much more than they should be, and more than either party is prepared to countenance, Medicare is going to require a major tax increase when the baby boomers retire.

And the Medicare the critics envision would still require a great degree of regulation, just of a different kind. The government, if it creates a competitive market for the delivery of Medicare, will still have to police that market. If it doesn't, the record makes all too clear that the competing insurers and providers -- not all, but too many -- will profiteer at public expense, trying to cherry-pick the healthy, strand the sick and less well-off and otherwise exploit the system. The would-be reformers, and the insurers and other interest groups that are cheering them on, have to accept that continued need for policing, or there won't be reform. Nor should there be.

If Congress can't agree, who should pay the price? Not the lowest-income elderly, the president argues. But his plan would have limited effect. More than half the elderly who lack drug coverage would be ineligible; their incomes, though mostly modest, would nonetheless be enough to take them out of range. Nor is it clear, to judge by the way the states have administered similar programs in the past, that even that many lower-income people would end up benefiting. The states don't want even partial responsibility for Medicare; it's a bad precedent to hand it to them. It's probably a bad idea as well to means-test the program as the president proposes; better to keep the benefit universal and charge the better-off higher premiums.

If Congress were to enact a stopgap bill, it seems to us it would be less likely, not more, to turn any time soon to the structural questions, including the painful long-term funding question, that Medicare poses.

Wrong Way on Energy

New York Times

In his opening days in office, President Bush has taken on a number of issues such as taxes and education with discipline and an appearance of growing confidence. Perhaps for that reason he believes that California's energy crisis has given him the hot hand for rolling back environmental standards and pressing his shortsighted campaign to open the 1.5-million-acre coastal plain of the Arctic National Wildlife Refuge to oil exploration. It hardly signals a balanced approach to put Vice President Dick Cheney, also an oil man, in charge of a task force aimed at developing an energy strategy to reduce America's "reliance on foreign oil" and "bring more energy into the marketplace." Mr. Bush made clear that legislation asking Congress to open the refuge would be an essential component of that strategy.

The president is certainly right on one point. The country needs a rational energy strategy that, as he also noted, encourages energy conservation as well as responsible exploration. But the first step in that strategy should not be to start punching holes in the Arctic Refuge. Even with improved drilling technologies, Mr. Bush's plan to open the refuge is as environmentally unsound and intellectually shaky as it was when Ronald Reagan suggested it 20 years ago and when Mr. Bush's father suggested it a decade ago.

For starters, it is wholly specious to suggest, as Mr. Bush does, a connection between opening the refuge and California's energy problems. Less than 1 percent of California's electricity comes from oil. California's fuel of choice is natural gas, and if Mr. Bush wants to find natural gas, there are far better places than the coastal plain to look for it. One such place is Alaska's North Slope, which includes far bigger proven natural gas reserves than even the most optimistic estimates for the coastal plain. Another is the National Petroleum Reserve, to the west of Prudhoe Bay, where former Secretary of the Interior Bruce Babbitt made available over four million acres for leasing.

To date, the oil and gas companies have shown little interest in the reserve and no interest in investing in the necessary infrastructure to transport natural gas from the North Slope. So it is outrageous for them to clamor for access to the pristine lands of the refuge at a time when they have barely begun to tap the significant resources in areas of far less ecological value.

Finally, as this page has noted many times before, the relatively trivial amounts of recoverable oil in the refuge cannot possibly justify the potential corruption of a unique and irreplaceable natural area. While government estimates of "technically recoverable" oil in the coastal plain run as high as 14 billion barrels, the amount of "economically recoverable" oil at today's prices — the only figure the oil industry itself pays any attention to — is a little over three million barrels. That is about six months' supply for the nation. A much larger amount, in conjunction with a grave national-security emergency, would be needed to consider even the environmentally sensitive drilling of which Mr. Bush speaks.

Before the California energy crisis blew up, the environmental community was reasonably confident that a coalition of Democrats and moderate Republicans in both the Senate and House could defeat, albeit narrowly, any effort to open the refuge to drilling. These calculations could change if, as now seems possible, Mr. Bush and Mr. Cheney decide to make opening the refuge a matter of party loyalty.

If they do, Congress, particularly the moderate Republicans, should turn a deaf ear. What Congress should insist on instead is a comprehensive energy strategy that emphasizes conservation as well as exploration and does not rely on old clichés like "freeing America" from foreign oil — an impossibility under any circumstances — or on unnecessary invasions of fragile public lands.

It should not be impossible to fashion a plausible exploration program that satisfies both environmental and energy needs. But the Bush administration is plainly going to need guidance from an energized environmental community to get there.