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Remarks

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I'd like to thank Ev Ehrlich and Carol Carson for the invitation to speak here today. As one who has spent much of his career scrutinizing macroeconomic data and ruminating about their meaning, I welcome the opportunity to applaud the BEA for its current efforts and to share some of my thoughts with you on where I would like to see the federal statistical system headed. Looking around the room, I fear that I may be one of the least knowledgeable on the subject because this audience clearly represents some of the most sophisticated users of economic statistics in the country. But central bankers are rarely cowed by such fears. So I will proceed.

You and I--as economic analysts, forecasters, and policymakers---all have important stakes in the output of federal statistical agencies. And when those agencies ask for our comments on how to improve economic statistics--as the Commerce Department has done--we have a responsibility to respond. We need to let them know what we think is wrong; and I suspect that most of us have been doing that for some time. But that, it seems to me, is the easy part. The greater challenge is to get involved in helping make things right--in helping to sort out the priorities and in speaking out on the need to make speedy progress on those priorities. Beyond that, we should also be willing to extend a technical helping-hand, if need be, on the issues that must be addressed.

Before outlining my ideas, I would like to note one other responsibility that I believe we, as experienced users of federal economic statistics, have. It's simple: When we see that the agencies are doing a good job, we should say so publicly. So I'd like to commend the BEA for its effort to move ahead aggressively in developing a Mid-Decade Strategy for its statistics. Carol, Ev, and others at Commerce should be applauded for their leadership in seeking to keep the methodology and concepts underlying our national economic accounts up-to-date. Significant innovations, like those that will be involved in moving toward compatibility with the international guidelines found in the *System of National Accounts* and the *Balance of Payments Manual*, have been occurring in recent years. The publication of monthly data on goods and services on a balance of payments basis, the use of Canadian import data to better capture northbound shipments, the new Annual Capital Expenditure Survey, and supplementing the PPI with some service industry price indexes are just a few examples. Each of these has been or will become a useful tool in our policy analysis and forecasting kits. But improvements in our data systems clearly have not been occurring as frequently or as extensively as we all might like. What can we do to accelerate progress?

Let me begin with a reality check. We all know that the federal budget is tight and, in the current environment of deficit reduction, it is safe to say that the statistical agencies are not likely to see any big increases in their budgets. OMB estimates that we will spend just over $2-1/2 billion dollars in direct funding of major government statistical programs this fiscal year, if the President's budget request is fully funded; about half of that funding is allocated to economic statistics. The budgets of the agencies that produce our major macroeconomic statistics show little change in real terms over the past 10 years. In recent years, the Bureau of Labor Statistics, the Bureau of the Census, and the Bureau of Economic Analysis have regularly failed to realize their initial Presidential budget requests. Given the overall budget situation today, I suspect that this track record is not likely to be reversed soon.

Can we expect our statistical programs to live on a fixed income and still achieve improvements in our statistical standard of living? If there is to be any chance at all, we must take a serious look at how funding for economic statistics is allocated. OMB's figures show, for example, that roughly 15 percent of the funding for economic statistics is used for agriculture and another 10 percent goes for energy and mining. In an economy in which agriculture and mining each represent only 2 percent of real GDP, I believe that we should ask whether a reallocation of funds is in order--a reallocation that could, for example, help fill in some huge gaps in our understanding of the service-producing sector and in the coverage of international transactions.

Such a shift probably means increased funding for areas now underrepresented coupled with downsizings of programs elsewhere. To some extent, that is already occurring. Agencies have demonstrated that they can set priorities, drop or delay some lower priority activities, and make incremental progress over time. At BEA, for example, in recent years such difficult decisions have helped make room for work on international trade in services and to support a benchmark survey of portfolio investment abroad.

Here is one place where users of government statistics need to get more involved in making the case for sensible resource allocation. If we avoid making the hard choices, we run the risk that changes in the functioning of our dynamic economy will grotesquely outpace changes in our statistical programs. Not only that, we will also incur the continued costs of struggling with data problems for which solutions are fairly well understood. The plea for better funding of statistical programs, or for resetting priorities for statistical agencies, is not simply asking to fund knowledge for the sake of knowledge. There are very real social costs, particularly to policymaking, of delaying or forgoing improvements.

Another reason to make a more effective statement of our priorities for statistical programs is what appears to be a growing public resistance to participation in government statistical programs. Recently, when our staff was looking into some puzzling developments in the data on manufacturers' orders and shipments, they were told that response rates for certain industries had dropped sharply.

My personal perspective on priorities for improving economic statistics is now heavily influenced by my current job as a monetary policymaker. That makes me keenly interested in whether our measures of the performance and potential of the real economy and our readings on inflation are timely, accurate, and comprehensive enough to allow monetary policy decisions to be made with as little error as possible. Under that rubric, my specific concerns fall into three categories: the size of revisions to the data; the inadequate coverage of economic activity in certain sectors, such as services; and a number of unresolved conceptual problems in defining real output and prices.

Revisions:

Revisions to the NIPA data were one of my continuing frustrations even before I came to the Federal Reserve. I recall writing an article about the 1990-91 recession shortly after it was declared over in which I described it as having been a relatively mild one. Two years later, I had to change my story to say it had been an average recession--as the data then showed. More recently, I found out that I had it right the first time. According to the current data, the recession was mild after all!

Another glaring example is our experience with the drop in the personal saving rate during the late 1970s. Those figures raised serious concerns about our ability to supply funds for investment and contributed to passage of the Economic Recovery Tax Act of 1981. But after data revisions, those saving rates turned out to be several percentage points higher than everyone thought.

Now that I am no longer just writing articles about the economy, but am a policymaker, I feel the need to reduce those sorts of revisions acutely. In that regard, I believe that BEA is right on target in giving priority to a set of proposed improvements in the components of the current GDP estimates that have proven the most unreliable. Improvements that yield better quarterly estimates of GDP--along with those aimed at obtaining more accurate and complete estimates of longer-term trends in output, investment, and saving--could reduce the uncertainty we face in conducting policy. And I can tell you that any help we get in that regard is welcome!

As I looked at the timetable for BEA's program, I was encouraged to see that a number of improvements important for policymaking may be only a few years away. These include a number of technical areas that might benefit from some assistance from the user community--such as seasonal adjustment, improved extrapolation methods, further work on hedonic price measures, and development of empirically based depreciation patterns. Other changes that look promising in the near term include plans for more frequent updating of sample frames and surveys of key components of GDP and national income. In a similar vein, the Bureau of Labor Statistics has been discussing improvements in the CPI that would give us a more up-to-date picture of price developments--changes such as more frequent updates of the consumer market basket and the use of alternative weighting methods to address the problem of substitution bias.

Sectoral coverage:

Let me turn next to the issue of coverage. By its nature, monetary policymaking does not depend on any single set of economic indicators. Rather it depends on our ability to understand the complex matrix of forces that are influencing the behavior of aggregate output, employment, and inflation. In distilling the information in that matrix, we have extensive, and generally timely, detail on real activity and pricing for some areas of the economy, such as the manufacturing sector. Given the proven cyclicality of goods-producing industries, we have come to rely on fluctuations in those industries as our principal indicators of macroeconomic fluctuations.

I am not convinced, however, that this reliance is entirely well-founded. Less than a third of our real output originates in goods-producing industries. With service-producing industries accounting for so much economic activity, we might be misled by extrapolating to the whole economy developments we observe in the goods-producing industries.

As I survey the macroeconomic landscape and try to discern where real activity and inflation have been and are headed, I am often frustrated by our limited knowledge of what is going on in the service sector. After all, private services, finance, and trade, together, now account for two-thirds of all jobs; and prices of services account for more than half of the CPI. Indeed, these two series--employment and retail prices--constitute our principal sources of timely economic information on the service sector. While certainly useful, they fail to tell the whole story. Other data sources clearly are inadequate. Because the retail sales survey covers only goods, BEA is forced to use a combination of indicator series and a large dose of judgment to estimate consumer spending on services--which is now more than a third of real spending. In addition, we have good reason to believe that BEA's current sources are missing a significant volume of trade in international financial services. Similarly, the BLS has only scratched the surface of measuring the prices producers pay for services.

As currently measured, output of the service-producing sector shows relatively stable trends over the long term and minimal business cycle fluctuations. But we have little way of knowing whether this stability is real or results from mismeasurement--that is, whether our available data sources truly capture the variation in service-sector output and spending. Since the recession trough, for instance, real spending on durable goods has been booming at a 10.1% annual rate; we feel fairly confident about that. But the BEA's estimates of spending on services says that those outlays have been rising at a mere 1.7% annual rate. Is it true? Or are the source data lagging?

Moreover, I wonder if we have as good a fix as we should on the size of the service-producing sector and, thus, on the overall level and growth rate of potential GDP. I am uncomfortable with having to back out our best guess of the capacity of the service sector from the available data on employment and income, and would prefer to see more direct measures of activity in important areas such as health, business, and financial services. These are among the things policymakers need to know more about when we confront questions such as how fast the economy can grow and how much economic slack exists.

The BEA report lays out several important steps in cracking the code on the service sector. The work now under way to revamp the SIC system promises, among other things, a more consistent and detailed picture of the relationship of the service sector to the rest of the economy. Once that foundation is laid, an even more difficult set of tasks lies ahead--incorporating the changes into our data collection system and into our input-output structure. As that occurs, we will need to explore whether our surveys and censuses are asking the right questions to capture what we need to know to measure output and prices in an expanded set of industries.

<u>Conceptual problems</u>:

I would list the job of tackling some conceptual problems in measuring output and prices as a my third priority--after improving reliability and expanding coverage. This is an area where simply throwing more money at the problem by rushing to collect more data is not the answer. Defining output in many parts of the services sector, or in high tech industries, constitutes basic research. The BEA report targets banking, financial and legal services, and management consulting activities; those are certainly important areas. But I continue to have doubts that we fully understand how to characterize computing equipment and software, and would be interested in hearing more about the pros and cons of hedonic price indexes for these items.

I am certain that everyone here would agree that this type of research--as difficult as it may be--has a potentially large payoff in terms of its quantitative effect on our ability to improve estimates of real GDP and, thus, on policymaking. If I were to take issue with the BEA report--or, for that matter, with the BLS program for CPI improvement--I would urge these agencies to try to be more aggressive in bolstering the basic research components of their programs.

Let me be clear. I would be the last to claim that inadequacies in the data are the biggest barrier standing between us and better economic policy. On the contrary, it is painfully clear that economic science rarely delivers the crisp answers that policymakers might like--even conceptually. And uncertainties multiply when we try to fill our theories with numbers. Furthermore, as everyone in this town knows, it sometimes looks like America's highly political democracy is ill-suited to making rational economic decisions.

Compared with the inadequacies in economic science, and with the inevitable--and proper--dominance of politics over economics in decisionmaking, data problems are probably a very minor source of poor economic policy. But they are also the easiest to fix.

So society should be eager to do so. The Commerce Department's Mid-Decade Strategy is a fine step in the right direction. The Federal Reserve staff looks forward to cooperating in this effort, and I hope other agencies will, too.