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The Ledger

Economic Education Newsletter

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"Magnificent Seven" Seven Economic Highlights of 1991

BY THE SECOND WEEK IN JANUARY MOST PEOPLE HAVE HAD THEIR FILL OF "TOP TEN" LISTS. THAT'S WHY OUR LIST OF LAST YEAR'S ECONOMIC HIGHLIGHTS IS DIFFERENT FROM MOST OTHER LISTS. IT DOESN'T COME OUT IN JANUARY, NOR DOES IT COVER TEN POINTS.

WE HOPE OUR LIST WILL PROMPT READERS TO REVIEW LAST YEAR'S SIGNIFICANT ECONOMIC EVENTS AND TO DISCUSS EMERGING TRENDS FOR 1992. EACH SECTION OF THE ARTICLE CONCLUDES WITH AT LEAST ONE POINT INTENDED TO TRIGGER DISCUSSION.

AS ALWAYS, THE STANDARD CAVEAT APPLIES: WE MAKE NO CLAIM THAT OURS IS THE DEFINITIVE LIST, NOR DO WE PRETEND TO OFFER AN IN-DEPTH ANALYSIS OF EACH EVENT. AFTER ALL, YOU MUST REMEMBER THIS, A LIST IS JUST A LIST ...

Dissolution of the Soviet Union/ The Fall of Communism

The United States and the Soviet Union had been locked in a "Cold War" for more than 40 years. From Berlin to Angola, the two superpowers had faced one another in a life-and-death struggle between two very distinct economic and political systems – communism and capitalism. The struggle for supremacy affected every aspect of life in the two countries. Even the Olympic Games were seen as a test of which system was better.

Then, suddenly, the Cold War was over. By the end of 1991, the Soviet Union had ceased to exist. The country that Ronald Reagan had once called "The Evil Empire" had dissolved into a loose confederation of autonomous, sometimes squabbling, republics. All across the former Soviet Union and its one time client states in Eastern Europe, exuber-

ant crowds toppled statues of Lenin. Only China, Cuba, and North Korea remained faithful to communist principles.

Citizens of the United States and the Soviet Union looked forward to a brighter, more secure future as their countries stepped back from the brink of nuclear war. Americans talked of the "peace dividend" that might result from reduced defense spending. Russians hoped for an economic turnaround that would put groceries and consumer goods in their shops and stores.

By the end of 1991 neither hope had been fully realized. Cuts in American defense spending appeared inevitable, but there was still considerable disagreement over the scope of those cuts and the manner in which they might be spent. Americans were coming face to face with the undeniable reality that defense cuts would mean job losses and base closings.

In Russia, the sense of uncertainty was accompanied by widespread dissatisfaction over the economy. Soviet prime minister Gorbachev survived a coup attempt, only to see his office eliminated after the formal dissolution of the Soviet Union. Russian president Boris Yeltsin saw his popularity decline after long-awaited economic reforms failed to produce immediate economic improvement. Lines at food stores were no shorter, and the supply of consumer goods was no greater than in the bad old days of the Soviet Union. Some believed that the pace of economic reform was too slow, others thought it too fast.

Yeltsin and other Russian politicians looked to western countries for economic aid. But with the U.S. economy in recession, the Russian calls for aid generated considerable debate among Americans. Some argued that we could not afford to help the Russians or any other foreigners, others claimed that we couldn't afford to see Russian reforms fail.

Discussion Triggers:

How should we use the peace dividend?

Defense cutbacks will cause economic dislocations. What steps, if any, should the government take to ease the plight of workers and communities affected by defense cutbacks?

The Soviet Union no longer exists. Only China, Cuba, and North Korea still adhere to communist doctrine. To what extent does the fall of communism say anything about the superiority of the free market system?

The Gulf War

Operation Desert Storm was an unqualified military success. The U.S.-led coalition achieved its objective with startling speed. Invading Iraqis retreated from Kuwait in disarray.

Back home, returning U.S. troops were treated to an enthusiastic welcome. Americans felt good about themselves and their country. Flag sales soared, and consumer confidence rebounded from the lackluster levels that had



preceded the Gulf War. A period of renewed economic vigor seemed to be in the offing.

But all too soon it became apparent that Operation Desert Storm would not serve as the catalyst for economic recovery. Even before the last victory parade had stepped off, consumer confidence had begun to wane.

Although no one doubted that Coalition troops had scored a decisive military victory in the Middle East, many problems remained. To be sure, the U.S.-led coalition had restored Kuwaiti sovereignty and had preserved international access to Persian Gulf oil. But postwar enthusiasm was dampened by the fact that Saddam Hussein had not only weathered Operation Desert Storm but had also survived a Kurdish rebellion in northern Iraq and a Shiite uprising in the south. After the dust had settled, the goal of peace and stability in the Middle East remained elusive.

The war also had an unintended and potentially far-reaching effect on U.S. relations with Japan. Barred by its constitution from engaging in overseas military operations, the Japanese government offered limited financial assistance to the Gulf War effort but declined to send a military contingent. Japan's reluctance to provide even minimal military support was not well received by Americans who believed Japan had a major stake in preserving free access to Persian Gulf oil. The heightened tension between the U.S. and Japan could have a long-term effect on economic and political relations between the two nations.

Discussion Triggers:

According to a senior U.S. government official "Jobs, jobs, jobs!" were at stake in the Persian Gulf crisis. What do you think he meant?

Based on U.S. experience in the Persian Gulf War, to what extent is military action an effective means for achieving economic and political policy objectives?

Elusive Economic Recovery

Midway through 1991, wags took to saying that the economic recovery had been sighted more times than Elvis. They were referring to the fact that economists and

policymakers had been overly optimistic in predicting an end to the stubborn recession that had begun in 1990.

In fact, 1991 offered few reasons for short-term optimism. It was a year marked by job cutbacks, business failures, a sharp decline in consumer confidence, and renewed calls for a "get tough" policy in international trade.

The weak economy put a big strain on U.S. relations with Japan. Detroit's automakers had a bad year and "Japan-bashing" became more prevalent. (The U.S. merchandise trade deficit with Japan was \$42.5 billion for 1991.) President Bush was also forced to spend a lot of time defending his plan for a free trade agreement with Mexico.

The American economy was also adversely affected by corporate "downsizing." Among the companies planning major job cutbacks were Apple Computer (1,500 jobs); Digital Equipment (9,000 to 10,000 jobs in addition to those announced earlier); Eastman Kodak (3,000 jobs); Ford (company's first white-collar layoffs since the early 1980s); General Motors (announced plans to close 21 factories and cut 74,000 jobs by the end of 1995); IBM (20,000 jobs in addition to the 20,000 it announced in 1990); Sears (9,000 in addition to those announced earlier); Unisys (10,000 jobs); and Westinghouse (4,000 jobs). What made the news even more tragic is that many of the cuts eliminated jobs that paid good wages and offered good benefits; the kinds of jobs that enabled people to buy houses and raise families.

The job losses prompted President Bush to change his mind about the need to extend unemployment benefits. In November, he agreed to a \$5.2 billion compromise measure that would allow jobless workers to collect benefits for a longer period of time. Job cutbacks also had a dramatic impact on consumer confidence. Many of those who still had jobs reassessed their spending plans, reduced their debt levels, and generally tightened their belts.

For many Americans, 1991 was not the best of years.

Discussion Triggers:

Faced with a mounting national

debt and strong opposition to tax increases, what role should the federal government play in trying to alleviate the effects of a weak economy?

According to an old axiom, "When your neighbor loses a job, that's a recession.

When you lose your job, that's a depression."

What do you think that means?

The recession of 1990-1991 was particularly severe in the Northeast. It also led to a large number of job losses among white collar workers and managers. What affect might those factors have on consumer confidence?

Harris Wofford, Earvin Johnson, and the Looming Crisis in U.S. Health Care

Just mention the name "Magic," and everyone knows who you mean. Long before 1991 began, Earvin "Magic" Johnson had established a reputation as one of the best-known and best-loved figures in American sports.

Harris Wofford, by contrast, was not one of the best-known figures in American political circles. Even though his career in government stretched all the way back to the Kennedy Administration, Wofford began 1991 in relative obscurity.

At first glance, Magic Johnson and Harris Wofford would seem to have very little in common. But by the end of 1991, both men had helped to focus public attention on the growing crisis in American health care.

On November 6, 1991, Wofford surprised nearly everyone by defeating Richard Thornburgh in a Pennsylvania race for the U.S. Senate. Thornburgh was a well-known former governor of Pennsylvania who had resigned as U.S. Attorney General in order to run for the Senate seat. Early public opinion polls indicated that he would win an easy victory over the lesser-known Wofford.

But polls are not the same as elections. Wofford won.

Health care proved to be the pivotal issue in the race. Voters were concerned over the rising cost of health care and frightened by the prospect of not being able to afford or obtain adequate health insurance coverage.

Multi-Media

Striking Gold and Silver

Energy, the Economy and Monetary Policy, booklet, published by the Federal Reserve Bank of Dallas, 13 pages.

Energy, the Economy and Monetary Policy succinctly outlines the importance of energy, the cause of energy "price shocks," and how those price shocks affect the economy. It also clearly explains how the Federal Reserve's monetary policy decisions affect the use, production, and price of energy. For a free copy of *Energy, the Economy and Monetary Policy*, write to:

**Public Affairs Department,
Federal Reserve Bank of Dallas,
Station K, Dallas, TX 75222.**

Preparation and Redemption of Mutilated U.S. Paper Currency, pamphlet, published by the Department of the Treasury.

Perhaps you were remodeling your house and you found a wad of old, deteriorating \$50 bills stashed in the walls. Or maybe you've lost some cash to fire or water damage. Take heart! You may be able to recover part, or all, of your loss. The Bureau of Engraving and Printing redeems partially destroyed or badly damaged currency as a free public service, and a new pamphlet published by the Treasury Department explains how the service works. For a free copy of *Preparation and Redemption of Mutilated U.S. Paper Currency*, write to:

**Public and Community Affairs
Federal Reserve Bank of Boston
P.O. Box 2076
Boston, MA 02106-2076.**

Fundamental Facts About Money, pamphlet, published by the Federal Reserve Bank of Atlanta, 16 pages.

Fundamental Facts About Money is true to its title. The 16-page pamphlet clearly and concisely gives basic information about U.S. currency and coin: how they are made, their design and distinctive features, and how they circulate. To order copies, write to:

**Public and Community Affairs
Federal Reserve Bank of Boston
P.O. Box 2076
Boston, MA 02106-2076.**

THE UNITED STATES MINT INTRODUCED AMERICAN EAGLE GOLD AND SILVER BULLION COINS IN 1986. THE FOLLOWING QUESTIONS AND ANSWERS ABOUT THE BULLION COIN PROGRAM ARE REPRINTED COURTESY OF THE U.S. MINT OFFICE OF MARKETING.

What is a bullion coin?

A bullion coin is one that is valued by its weight in a specific precious metal. A bullion coin is not a commemorative or a numismatic coin, which is valued by limited mintage, rarity, condition and age. Bullion coins are purchased by investors seeking a simple means to own gold and silver.

What are the American Eagle Bullion Coins?

The American Eagles are legal tender bullion coins produced by the United States Mint, by act of Congress. There are four gold coin sizes available: one ounce, half-ounce, quarter-ounce, and tenth-ounce. There is also a one ounce silver Eagle.

Why is the United States minting bullion coins?

The United States is minting its own bullion coins to give gold and silver purchasers the world over the opportunity to buy an American coin backed by the United States Government.

Where are American Eagles sold?

The American Eagles are sold at thousands of coin shops, banks, financial institutions, brokerage firms and other retail locations. The United States Mint sells American Eagle Bullion Coins directly to 32 gold purchasers and 36 silver purchasers, who then distribute the coins to various retail outlets. Call the U.S. Mint Office of Marketing at (202) 874-6468 for a free list of competitive American Eagle dealers.

How are American Eagles priced?

The gold and silver American Eagle can both be purchased and resold based on the current world market prices of gold and silver, plus a slight premium. The American Eagles are priced competitively with all other bullion coins.

Are American Eagle Gold Bullion Coins pure gold?

No, and for a good reason. Each American Eagle Gold Bullion Coin contains its stated weight of gold, which is combined with small amounts of silver and copper. This alloy provides the coin with superior strength and durability. Unlike a "pure" gold coin, the American Eagle will resist damaging scratches and dents. So, a one ounce American Eagle Gold Bullion Coin contains one full ounce of gold bullion plus additional amounts of copper and silver.

Are sales of the American Eagles limited in any way?

No. American Eagles are minted to meet public demand, and there are no legal limits to the number of coins that may be minted in any given year.

Are American Eagle Bullion Coins legal tender?

Yes, the Eagles are legal tender at their face values of \$50 for the one ounce gold, \$25 for the half-ounce gold, \$10 for the quarter-ounce gold and \$5 for the tenth-ounce gold. The silver coin has a face value of one dollar.

What designs appear on the coins?

The obverse (front) of each gold coin bears a modified Augustus Saint-Gaudens design of Liberty, which was originally used on U.S. gold coins from 1907 through 1933. On the reverse is a "family of eagles," a new design created by Mrs. Miley Busiek. On the silver coin obverse is a depiction of the historic "Walking Liberty" design by Adolph A. Weinman. John Mercanti's version of the traditional "Heraldic Eagle with Shield" is on the reverse of the silver coin.

Does the government make a profit from sales of the American Eagle Bullion Coins?

Yes. All net profits from the program contribute to the reduction of the national debt. The American Eagle Bullion Coin Program operates at **no net cost** to American taxpayers.

New England Update

Ledger Award Goes to David Grenier

David Grenier, lead teacher in banking and retailing at Assabet Valley Regional Vocational High School in Marlboro (MA), was selected as this year's recipient of The Ledger Award. The honor is presented annually in recognition of "long-standing commitment to high quality economic education" in the First Federal Reserve District. It is named for *The Ledger*, a quarterly economic education newsletter published since 1974 by the Federal Reserve Bank of Boston's Public and Community Affairs Department.

Mr. Grenier began at Assabet Valley more than 13 years ago. In 1982, he and Gene Carlo, the school's business manager, established Massachusetts' first full-service, chartered school bank. For the past six years, it has operated as a branch of Hudson National Bank. Approximately 25 to 30 customers a day use the bank to cash checks, deposit savings, and process applications for consumer loans, home equity loans, and auto loans. The school branch trains more than 20 students a semester under the guidance of a Hudson National Bank staff member.



Photo by Ralph Ragsdale

Ledger Award winner David Grenier receives congratulations from Assabet Valley Regional Vocational High School principal Steve Pronovost (L) and the school's business manager Gene Carlo (R).

After graduation, many of the students go on to work in the financial services industry. (Students from Assabet Valley's carpentry and electrical departments helped to build the branch.)

In addition to teaching, Mr. Grenier is president and co-founder of the Massachusetts School Bank Association,

which now has a membership of 20 schools. The Association hosts an annual spring conference for its members and other interested parties. To learn more about the Massachusetts School Bank Association, write to: David Grenier, Assabet Valley Regional Vocational High School, Fitchburg Street, Marlboro, MA 01752.

Sterling Bank Opens Branch at Lexington High School

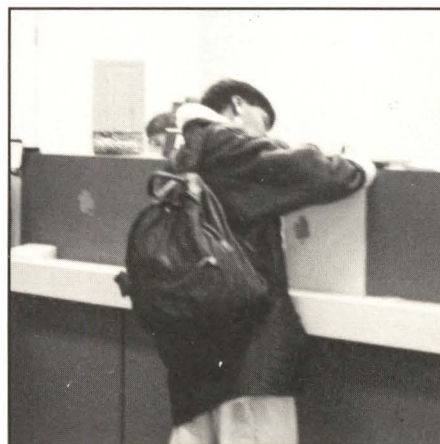
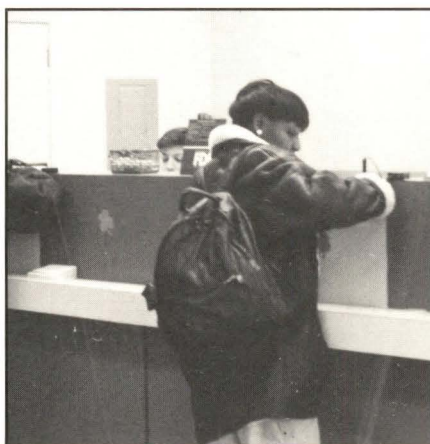


Photo courtesy of Lexington High School

Students and staff members at Lexington High School in Lexington, Massachusetts can now conduct their banking right on campus. The LHS Bank of Opportunity, which opened its doors in February, offers savings accounts, checking accounts, installment loans, certificates of deposits, and a variety of other services.

LHS Bank of Opportunity holds a charter from the Massachusetts Commissioner of Banks and is a limited service educational branch of Waltham-based Sterling Bank. Student staff members work under the supervision of Lexington High School's Business Department and a Sterling Bank branch manager.

In 1971, Americans spent \$82 billion (7.5 percent of GNP) on health care. By 1991, the cost had soared to \$650 billion (approximately 12 percent of GNP). If the current trend continues, the total outlay for health care will top \$1 trillion by 1995.

In 1990, the average annual health insurance premium ranged from \$2,700 to \$3,500 per employee, and employers picked up most of the tab. But soaring premiums have prompted employers to look for ways to limit their costs, and some of the cost control measures have created friction between management and labor.

Self-employed people and others who aren't eligible for group health insurance plans face a tremendous financial burden. They pay staggering premiums for less comprehensive coverage. (In 1991, the average non-group premium exceeded \$5,000 a year.)

But the prospect of facing medical bills without health insurance coverage is even more alarming than the soaring cost of health care premiums. A brief hospital stay can easily run into the thousands of dollars, and a protracted illness can lead to financial ruin. According to a Congressional Budget Office report, 16 percent of the nonelderly population in the United States was without health insurance in 1989. More than half of the uninsured worked for small firms that couldn't afford to provide health coverage for their employees.

Some political observers attributed Harris Wofford's unexpected victory to the fact that he addressed the health care concerns of Pennsylvania voters. All across the country, politicians took notice.

Two days after Wofford's upset victory in Pennsylvania, Magic Johnson focused public attention on health care issues in a very different way when he announced his retirement from professional basketball after testing positive for the AIDS virus. His announcement stunned the nation. When asked their reaction, most people shook their heads in disbelief or shuddered as they came to the realization that, "If Magic can get AIDS, anyone can."

Public health officials and AIDS activists had been trying for years to convey the magnitude of the AIDS epidemic.

The cost figures alone told an alarming story. In 1990, the nation's life and health insurance firms paid approximately \$1.2 billion in AIDS-related claims, a four-fold increase over the amount paid in 1986. But the figures were almost too incomprehensible, too impersonal.

Magic Johnson put a very human face on the problem. His battle with the AIDS virus and Harris Wofford's upset victory in the Pennsylvania senate race had shocked Americans into confronting the crisis in health care.

Discussion Triggers:

What makes health care different from other services we buy, and what are some of the factors that make health care so costly?

Certain drugs such as AZT often have a beneficial effect on those afflicted with the AIDS virus. But the drugs are very expensive. Should everyone have access to these treatments? Who should pick up the cost?

Scandal and Continued Uncertainty in Financial Services

Nineteen ninety-one saw little let up in the difficulty and uncertainty that have plagued the financial services sector in recent years. The year began with the closing of 45 Rhode Island banks and credit unions due to the bankruptcy of that state's deposit insurance fund. Some of the institutions never reopened. A few days later, Bank of New England, one of the largest banks in the New England area, was taken over by the FDIC.

The insurance industry also had its share of problems. In April California regulators seized Executive Life Insurance, and in November Metropolitan Life reduced its dividend to policyholders by 8 percent. Most insurance industry woes were the result of troubled real estate loans or junk bond investments gone sour.

Two major scandals rocked the financial industry in 1991. One involved the Bank of Credit & Commerce International (BCCI); the other centered on Salomon Brothers, Inc., a dominant firm in the U.S. Treasury securities market.

BCCI made headlines when international regulators shut it down in early July. According to investigators' reports, the owners and founders of BCCI had engaged in a variety of questionable practices such as making huge loans to wealthy investors without securing sufficient collateral. In some cases, there was little or no documentation to support loans that totaled tens of millions of dollars. There were also reports of money laundering, connections to drug traffickers, and ties to international intelligence operations.

The Salomon Brothers scandal revolved around the charge that the government securities dealer had violated Treasury Department rules by attempting to corner the market on certain issues of Treasury securities. In an attempt to circumvent a Treasury Department regulation that prohibited individual buyers from purchasing more than a 35 percent share during a single auction, the firm reportedly submitted bids in the names of buyers who hadn't authorized it to do so. In one instance Salomon Brothers is thought to have purchased as much as 85 percent of two-year Treasury notes sold during a May auction. The Salomon Brothers scandal prompted widespread calls for changes in the way government securities are auctioned.

Discussion Triggers:

In the past, certain banks were said to have been "too big to fail." What do you think that means?

The Federal Deposit Insurance Corporation has insured bank deposits since 1933. The government does not extend similar protection to other types of financial investments. Why do you think that is the case?

Falling Interest Rates

Interest rates dropped sharply last year. In December, the Federal Reserve cut its discount rate from 4.5 to 3.5 percent.

The discount rate is the rate banks pay when they borrow from the Fed, and a drop in the discount rate does not translate automatically into lower rates for consumers. But December's full percentage point drop clearly indicated the Federal Reserve's concern over persistent weakness in the U.S. economy. It also signaled that the nation's central bank stood ready

to pursue a monetary policy that would help restore strong economic performance.

Partly as a result of the Federal Reserve's easier monetary policy, many consumers found it cheaper to borrow money last year. By the end of 1991, home mortgage rates had dipped below 8.5 percent, their lowest level since the 1970s. Banks, thrifts, and mortgage companies were swamped with applications from homeowners hoping to refinance their double-digit mortgages. And over the course of the year, the prime rate fell from 9.5 to 6.5 percent; good news for business borrowers and for homeowners whose variable home equity loans were tied to the prime.

Not everyone, however, was thrilled with lower interest rates. Many individual investors were deeply dismayed by the low yields on their savings. Indeed, some analysts attributed the stock market's high-flying performance to the fact that investors were unwilling to keep their money parked in low-yielding certificates of deposit and fixed-income mutual funds.

Finally, not all interest rates dropped in 1991. Credit card rates remained stubbornly high, with some cardholders still paying as much as 22 percent a year. Legislative proposals to cap credit card rates generated considerable controversy and sent bank stocks tumbling.

Discussion Triggers:

Who is helped by high interest rates?

Who is helped by low interest rates?

As the population bulge known as the "Baby Boom" ages, what are the possible implications for policies that affect interest rate levels?

**South Africa Ends
Race Classification/
Coup Topples Haitian President/
Congress Threatens
China Trade Sanctions**

South Africa, Haiti, and China are continents apart, separated by vast expanses of ocean. Yet last year, events in all three countries reignited a long-running debate over the use of economic sanctions as instruments of foreign policy.

Years ago, the United States instituted economic sanctions against South Africa in an effort to pressure that country into ending apartheid, a body of laws that rigidly separated racial groups and excluded people of color from the government. In February 1991, South Africa's white government announced it would free all political prisoners after the black opposition African National Congress agreed to end its 30-year armed struggle to end apartheid. Four months later, the South African government took a major step toward dismantling apartheid when it stopped officially classifying South Africans by race.

In light of these developments, a number of people in the U.S. government began to wonder aloud if the time had come to end economic sanctions against South Africa. African National Congress leader Nelson Mandela restated his unequivocal opposition to ending sanctions, but President Bush and several members of Congress expressed their willingness to take a closer look at easing sanctions.

Economic sanctions also became an issue in August after a military coup toppled the government of Haiti's President Aristide. Aristide was the first freely elected president in a country that had long suffered under the rule of brutal and corrupt dictators. To protest Aristide's ouster, the United States adopted economic sanctions against the new military dictatorship. Some observers wondered, however, if the sanctions would only make life worse for those who lived in the Western Hemisphere's poorest nation. At year's end the issue was unresolved. Sanctions were still in place and so were Haiti's military dictators.

On the other side of the world, the possible use of economic sanctions threatened to strain relations between the U.S. and China. Upset by persistent reports that the Chinese government was continuing its harsh crackdown against dissidents, members of Congress pushed for legislation that would strip China of its most-favored-nation trading status. They argued that the Chinese government should be treated no differently than the repressive regimes of the former Soviet Union. But opponents contended that sanctions would have a disastrous effect on China's effort to modernize its economy and might be equally devastating to American companies that do business there.

The Bush Administration feared that revoking China's most-favored-nation status would do irreparable harm to Sino-U.S. relations. They pointed to China's role on the United Nations Security Council and noted that a Chinese veto would have seriously complicated U.S. efforts to build an international coalition against Iraq prior to the Gulf War. Nineteen ninety-one ended with the issue still unresolved.

Discussion Triggers:

How do economic sanctions work? Why do you think sanctions against South Africa took so long to have an effect?

Why might economic sanctions aimed at pressuring Haiti's military government also create considerable hardship for Haitian citizens?

China is a major U.S. trading partner and a world power. Do you think economic relations with a country such as China should affect political considerations?

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Editor: Robert Jabaily
Graphic Designer: Kristen Taylor

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