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President's Message: Modernization for the New Millennium

William Poole

On November 12, 1999, President Clinton signed into law the Gramm-Leach-Bliley Act. This historic law modernizes the way the U.S. financial services sector is regulated by tearing down old laws that stood as barriers to competition between commercial banking and the securities and insurance businesses.

Gramm-Leach-Bliley razes the Depression-era Glass-Steagall Act, which barred commercial banks and securities firms from competing on each other's turf or forging financial services conglomerates. Glass-Steagall was created because lawmakers believed the widespread bank failures that occurred during the Depression were caused by bank involvement in the securities business. This belief has now been widely discredited. Gramm-Leach-Bliley also repeals provisions of the Bank Holding Company Act, which barred affiliations between banks and insurance companies and prohibited banking organizations from engaging in the insurance business.

So who benefits by the dismantling of these outmoded laws? The answer is, just about everyone. Banks, insurance companies and securities firms now have the ability to escape their narrow market niches and compete head-to-head by selling a full range of financial products and services. Consumers benefit by having unfettered access to a wider array of products—products that will be delivered more efficiently than in the past. In fact, the U.S. Treasury estimates that consumers will save $18 billion annually because of the new law. Speaking more broadly, I believe the U.S. economy will benefit from heightened competition among financial organizations. Vigorous competition leads to greater innovation, and innovation is a critical element to our domestic financial architecture, especially in an increasingly global economy.

Another aspect of the legislative overhaul that shouldn't escape notice is the resulting reduction in certain regulatory burdens and inefficiencies. Regulators will no longer be working in silos or duplicating efforts. Rather, they will be working hand-in-hand to ensure the safety and soundness of the new financial conglomerates that will naturally evolve in response to the legislative changes. Existing banking regulators will also be joined by a new one: market forces. Large national banks, for example, will be able to underwrite securities only if they can get a national rating organization like Moody's or Standard & Poor's to give their corporate debt issue a high rating—for example, an S&P AAA.

Spurred in part by technological advances, the financial services sector has been evolving at a rapid pace—some might say a revolutionary pace. I believe this legislation is a timely, rational response to the demands of the new millennium, and I look forward to the challenges and opportunities the new, barrier-free landscape provides.

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Price Stability And The Rising Tide: How Low Inflation Lifts All Ships

William Poole , Howard J. Wall

The strong economic performance that the United States has logged over the last eight years has generated much good news. Consider the highlights: Since the beginning of 1992, quarterly real gross domestic product (GDP) growth has averaged 3.7 percent at an annualized rate, compared with an average of only 2.6 percent over the prior 20 years; the unemployment rate has fallen to its lowest level in almost 30 years; and employment has grown steadily, so that there are now over 16 million more people employed. This performance was achieved during a period in which inflation was at or below 3 percent.

Low and stable inflation—price stability, for short—has been a necessary ingredient in the current expansion. When prices are unstable, businesses and households face more uncertainty about the future, making it more difficult for them to plan efficiently. When people plan inefficiently, unavoidable mistakes are more common, which leads to greater variability in growth and employment. If inflation hadn't been kept in check over the last decade, slower growth, and possibly a recession, would have almost certainly followed soon after.

Although few would question the Federal Reserve's recent success in maintaining price stability, many are worried that gains from the resulting expansion have not been distributed broadly, and that significant segments of society are being left behind. High on the list of concerns are increases in wage equality and stagnant or falling wages for low-income groups.

The balance of the evidence, though, shows that there is less to be worried about—much less—than some believe, and that there have been strong employment and income gains for most broad categories of the population. In fact, some groups that began the period in the worst economic shape—including teen-agers and those with the lowest education and income levels—have enjoyed substantial gains. Sustained prosperity made possible by price stability has brought greater opportunities for all groups and, in the process, has transformed labor markets. Perhaps the most remarkable change has been the increased employment opportunities for blacks and women. The shares of these groups that are employed are higher than they have been for many years.

The effects of continued price stability and growth on labor markets are best illustrated by a dissection of some of the aggregate employment numbers. Doing so presents a picture of an economic expansion that, in terms of falling unemployment, greater employment opportunities, and rising incomes, has been beneficial for a broad cross section of the population.

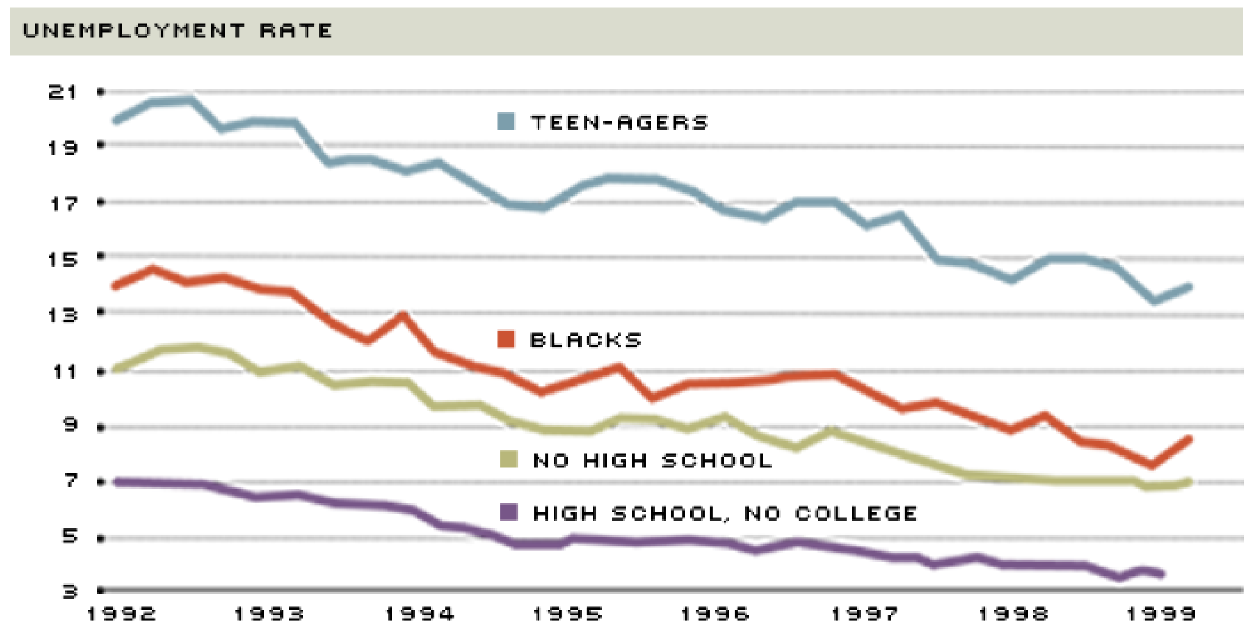
Unemployment Falling Down

Because it is the most widely used indicator of labor market performance, any analysis of the current expansion begins with the unemployment rate. Since peaking at 7.8 percent in June 1992, the unemployment rate has fallen steadily, reaching 4.3 percent in December 1998, where it has hovered ever since. When these

unemployment numbers are broken down, it becomes apparent that the expansion has been particularly beneficial for groups that began the period in the relatively worst situations—specifically, blacks, teen-agers and the less-educated.

Figure 1

The Rising Tide Lowers Unemployment



Since 1992, unemployment rates have fallen steadily for teen-agers, blacks and those with less than a college education. In fact, the unemployment rate for blacks is lower than at any time since 1972, and the rate for teen-agers is at a 30-year low.

SOURCE: Bureau of Labor Statistics

In 1992, the unemployment rate for blacks averaged 14.2 percent. That rate fell to 8.3 percent by the third quarter of 1999, and it appears that the average rate for 1999 will be even lower than for the previous year, which was lower than at any time since 1972. Continued economic growth has narrowed the unemployment gap between whites and blacks. From the first quarter of 1998 to the third quarter of 1999, the black unemployment rate has fallen considerably, from 9.3 percent to 8.3 percent. Over the same period, the unemployment rate for whites has fallen less, from 4.0 percent to 3.7 percent. Although these data show that there has been a good deal of progress in reducing the unemployment gap between whites and blacks, they also show that the gap is still large. There is certainly good reason to believe, though, that ongoing economic growth will narrow the gap even further.

The expansion has also meant good news for young people. The teen-age unemployment rate, which in 1992 averaged 20.1 percent, has fallen steadily, to 13.7 percent for the third quarter of 1999—a 30-year low. Even during the strong growth of the 1980s, teen-age unemployment never dropped below 15 percent—a level that this expansion achieved nearly two years ago. Black and white teen-age unemployment are both at their lowest levels in 30 years, although the white teen-age unemploymet picture is still much better.

Well-educated workers continue to be highly valued by employers. Nevertheless, the less-educated have clearly benefited from the economic growth of the 1990s. In the third quarter of 1999, the unemployment rate for those older than 25 who did not have a high school diploma was 6.9 percent, having fallen from a high of 12.2 percent in mid-1992. For those with a high school diploma who never went to college, unemployment was at 3.6 percent, having fallen from 7.3 percent in mid-1992.

It appears, then, that despite the concern that an increasingly high-tech economy will leave the less-educated behind, there has been room in the U.S. economy for the relatively unskilled. What has happened, as anyone can confirm by talking to employers, is that the shortage of well-qualified workers has led firm after firm to hire less-educated workers, and those with poor employment histories, and train them. On-the-job training has assumed increasing importance in the United States, and the results are gratifying. Firms find that not everyone hired works out, but a significant proportion do. The end result is that not only is the U.S. economy generating employment for many left behind in earlier years, but these workers are also developing new skills that will undoubtedly yield opportunities for them in the future.

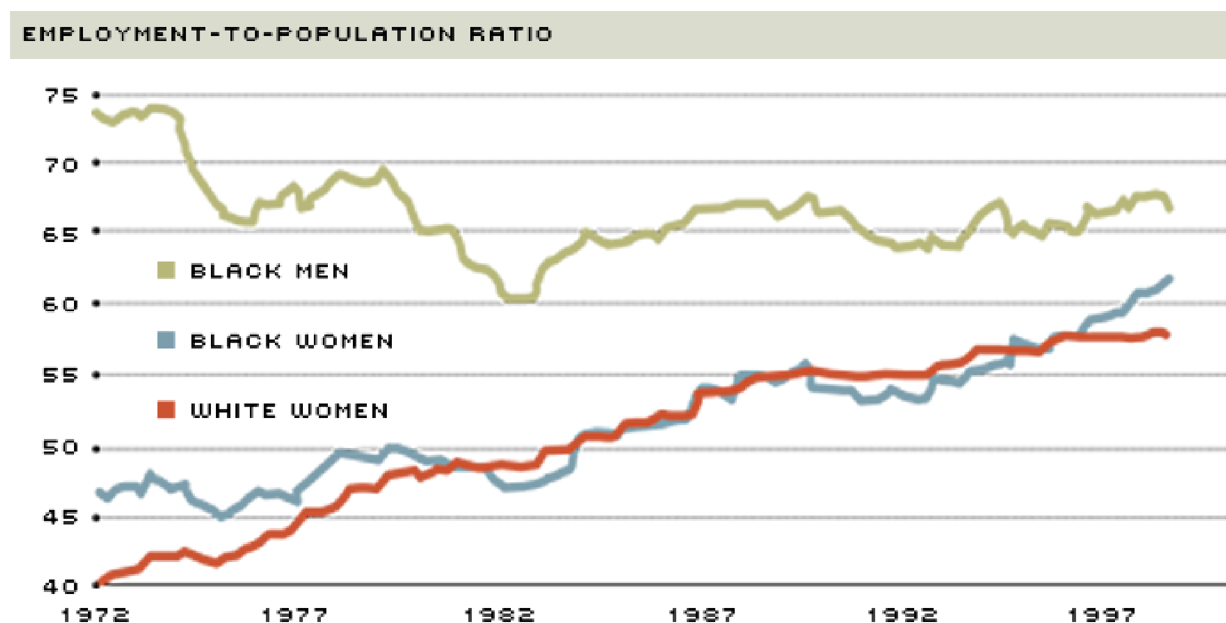
A Changing Face

Although unemployment rates are useful indicators of labor market performance, they tell only part of the story. During any period in which employment opportunities are expanding, two things happen: First, more people become employed; and, second, more people who had been choosing to stay out of the labor force decide to enter it. Although both of these effects are important, newspaper reporters and TV newscasters tend to look only at the first, and to ignore the second. This incomplete view of the current expansion misses some very dramatic changes that have been transforming the labor market—perhaps permanently—as relatively larger proportions of certain groups have been drawn into it.

One way to get an idea of how the labor market has been transformed by the current expansion is to look at the ratio of employment to population for various demographic groups. As shown in figure 2, employment-to-population ratios highlight one of the great successes of the recent expansion—rising percentages of women and blacks who are employed. Between February 1992 and November 1999, the share of adult white women who were employed rose by 3 percentage points; the share of adult black men rose by 3.8 percentage points; and the share of adult black women rose by 8.8 percentage points. Comparing these numbers for black men and women with those for the 20 previous years reveals the depth of these changes. Between 1972 and 1992, the share of black men employed actually fell by 8.7 percentage points, and the share of black women grew by 7.1 percentage points.

Figure 2

The Changing Face of the Labor Market



Since 1992, larger shares of women and black men have become employed. Historically high proportions of the female population were employed in 1999, and black men have been regaining some of the ground lost between 1972 and 1991.

SOURCE: Bureau of Labor Statistics

One of the reasons that blacks have been making such steady gains in the 1990s compared with the previous two decades is that the economy has experienced steady growth. Over the last eight years, the economy has not experienced the downturns that, in the past, have hindered or reversed gains made during upturns. Consequently, the face of the working population has changed dramatically, as women and blacks make up larger shares of employment than at any time since the end of World War II. The longer the current expansion is sustained, the more likely it is that these gains will continue and become permanent, as women and blacks become entrenched in the work force.

Fewer Poor People, More Rich People

While the evidence indicates that employment opportunities have improved for broad classes of people, it says little about their overall economic well-being. There are various ways of measuring well-being—the most common being per capita income or earnings. Based on these broad income measures, the average person has been doing better since 1992. According to the Bureau of Economic Analysis, between the third quarters of 1992 and 1999, per capita real disposable personal income rose by 15 percent.

Despite this evidence, various studies, news articles and pundits have claimed that the expansion has left behind the poorest. The argument is usually based on data showing that the average real wage has not increased very much, or that the average real wage of the poorest wage earners is not much higher—or is even lower—than before the expansion began.

Because of the inclusion into the labor force of many who were previously excluded, it is important to be wary, however, of any claims based on average wages. The wages of these newly employed persons, who tend to have less-than-average work experience and skill levels, are generally lower than for those who are already employed. As these low-wage workers are added to the ranks of the employed, the average wage for all workers can go unchanged, even if the wages of those already employed rose.

To see how this process works, consider a scenario in which there are only two groups of workers—long-term workers and newly employed workers. As in the actual economy, the newly employed workers are unskilled relative to the long-term workers; they also join the ranks of employed persons at low wages. The change in the average wage of all workers from one year to the next reflects two forces: the increase in long-term workers' wages, and the addition of newly employed workers with their lower-than-average wages.

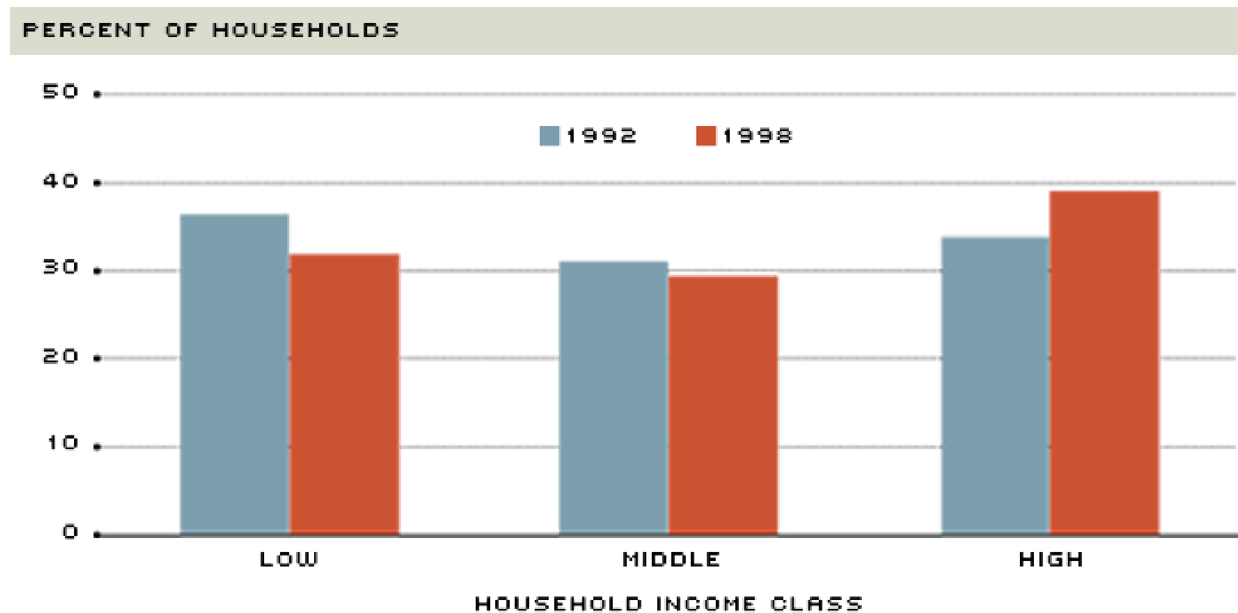
In this scenario, suppose that there were 10 long-term workers last year, each of whom earned $20 an hour. In the new year, each of these workers received a 10 percent pay increase—to $22 per hour—and two new workers were hired at $10 an hour. The average wage for the 12 workers is, therefore, $20 an hour—10 workers at $22 each ($220), plus two workers at $10 each ($20), equals $240, for an average wage of $20.

In this illustration, there has been no change at all in the average wage, despite the fact that 10 of the workers enjoyed wage increases of 10 percent, and two workers went from being unemployed to jobs that pay $10 an hour. This illustration helps explain why most workers feel, and in fact are, better off, even though the average wage may be growing slowly. Those who continue to be employed are receiving wage increases, and the newly employed are finding jobs that bring more income and, presumably, greater personal satisfaction than before.

To measure how the economic well-being of low-wage earners has changed, it is necessary to look at the entire population. One relatively straightforward approach, illustrated by figure 3, is to look at recent Census Bureau data on the percentages of households in three constant-dollar income classes—Low, Middle and High—for 1992 and 1998. Those in the Low group have incomes below $25,000, those in the Middle group have incomes between $25,000 and $50,000, and those in the High group have incomes above $50,000. In 1992, 36 percent of households were in the Low group, but by 1998, only 32 percent were. Further, over the same period, the share of households in the Middle group fell from 31 percent to 29 percent. This means that the only income group that has grown during the current expansion has been the High group, which increased from 34 percent to 39 percent of all households. This mobility likely continued into 1999, pushing even larger shares of the population into the higher income groups. Although these numbers are by no means definitive, they do illustrate the positive effect that the current expansion has had on the economic well-being of all income groups.

Figure 3

The Rich Get Richer ... Along With the Rest of Us



Between 1992 and 1998, the percent of households in the low (less than $25,000) and middle ($25,000 to $50,000) income groups fell. At the same time, the percent of households in the high ($50,000 and above) income group rose.

SOURCE: Bureau of the Census

Price Stability Has Been Good for Everyone

The strength and endurance of the current economic expansion in the United States is largely due to the Federal Reserve's success in maintaining price stability. As a result of the expansion, many groups of people who were marginalized or excluded from employment have been drawn into it: The unemployment rates for blacks, teen-agers and the less-educated have fallen steadily; more and more women and blacks have been drawn into the work force; and large numbers of households have been earning more. In short, price stability has been good for everyone.

Ling Wang provided research assistance. This paper is based on a speech by William Poole titled, "Prosperity: Just How Good Has It Been for the Labor Market?" given on Sept. 27, 1999. It can be viewed on this web site at https://fraser.stlouisfed.org/scribd/?item_id=18841&filepath=/docs/historical/frbsl_history/presidents/poole/19990927.pdf

Endnotes

1. Growth data are from the Bureau of Economic Analysis. Employment and unemployment data are from the Bureau of Labor Statistics Household Survey. [back to text]
2. Due to rounding errors, the shares for 1992 add up to 101 percent. [back to text]

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National and District Overview: New Millennium: Same Vibrant Economy?

Kevin L. Kliesen

With few exceptions, U.S. economic performance remains exceptional at the turn of this millennium. As evident by the upbeat tone of recent *Beige Books*, this would also be an apt characterization of economic conditions in the Eighth Federal Reserve District. To get a sense of just where the District economy might be headed in 2000, it's helpful to gauge the likely strength of the national economy next year, as well as the outlook for inflation.

Century Closes with a Boom

CPI inflation through the first 11 months of 1999 ran about a percentage point above 1998's 1.6 percent rate. The bulk of this acceleration reflects the doubling of crude oil prices between February and November. Once the direct effects of higher energy prices are removed from the calculation, however, CPI inflation is actually running a bit lower (2 percent) over this period than it did in 1998 (2.4 percent). On the output side, real GDP increased at a 3.7 percent annual rate through the first three quarters of 1999. Although this is appreciably slower than 1998's 4.6 percent rate, output growth has been strong enough to pare the civilian unemployment rate to 4.1 percent in November—its lowest level in nearly 30 years.

Evidence from statistical reports available through December suggests that real GDP could expand rapidly during the final three months of 1999. In particular, fairly strong retail sales figures in October, November and—according to anecdotal reports from retailers—December, suggest that real consumer spending was quite brisk during the fourth quarter. Despite rising mortgage interest rates, which have put a damper on construction activity recently, the number of new and existing houses sold in 1999 will likely be the highest on record. Optimism abounds in the manufacturing sector as well, as business spending on capital goods remains quite strong. In particular, new orders and shipments of computers and office equipment advanced at their second-strongest pace in about 3½ years in October. U.S. manufacturers may see further gains if the widespread predictions of faster worldwide growth ring true.

Will Forecasters Be on the Money in 2000?

For the past few years, most forecasters have regularly underpredicted the strength of real GDP and overpredicted the rate of CPI inflation. One of the main surprises that has tripped up forecasters is the faster-than-expected growth of labor productivity (output per hour), which now appears to be growing about a percentage point faster than the 1 to 1.5 percent that most had assumed. In short, many forecasters now assume that the economy's potential rate of real GDP growth—that is, the economy's noninflationary rate of growth—is around 3.5 percent. This also happens to be its average for the current expansion.

What about the prospects for 2000? Well, assuming next year's growth of labor input (a combination of employment growth and hours worked) and labor productivity in the *private, nonfarm* business sector will

match their average rates for this expansion—roughly 2 percent growth of each factor—nonfarm business output should grow by about 4 percent in 2000. Adding back in the government and farming sectors (to get total GDP) suggests real GDP growth of around 3.5 percent. Basically, the economy is expected to grow at its potential until some unforeseen shock causes a significant change in aggregate demand or supply. Given the poor record of forecasters stated earlier, however, the possibility of another year of above-trend growth should not be discounted.

In terms of the inflation outlook, most forecasters anticipate a modest deceleration in CPI growth in 2000, perhaps to around 2¼ percent. This forecast depends significantly on a lower trajectory of oil prices—an expectation also apparent in crude oil futures prices. Continued strong productivity gains, which will temper product price pressures, as well as moderating rates of money growth, also factor into the equation. In any case, forecasters generally agree that if aggregate demand continues to expand at a rate that exceeds growth of aggregate supply, it would not be surprising to see somewhat faster price inflation.

Thomas A. Pollmann provided research assistance.

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The Crisis That Wasn't: Asia and the Eighth District

Cletus C. Coughlin , Patricia S. Pollard

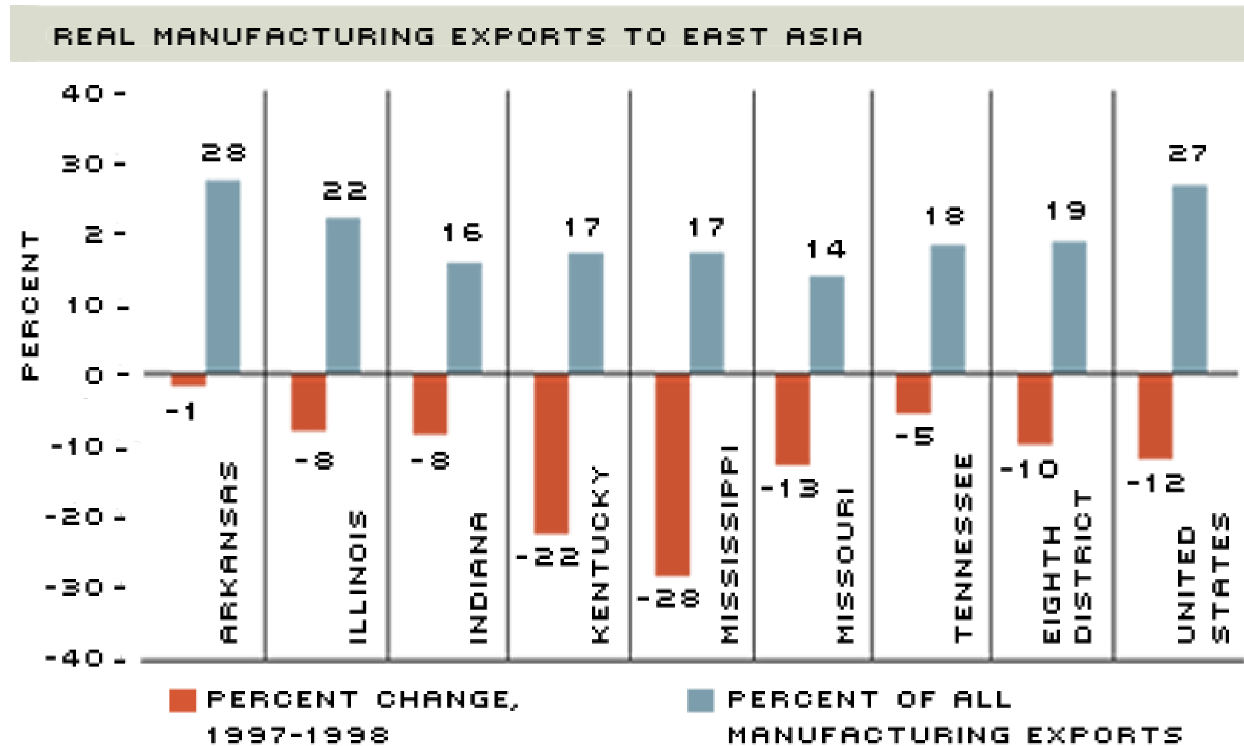
In 1998, U.S. real merchandise exports to East Asia fell by 12 percent as the Asian economic and financial crisis reduced demand throughout the region for goods produced in the United States.1 Many forecasters predicted that the fallout from the Asian crisis would severely reduce U.S. growth. Despite the decline in these exports, however, the U.S. economy continued to expand, as domestic demand remained strong. Did the Eighth District mimic the U.S. experience?

Asia Major or Minor?

The markets of East Asia are, on average, less important to Eighth District exporters than they are to exporters in the United States, overall. As shown in the top panel of the accompanying figure, in 1997, the District sent 19 percent of its manufacturing exports to East Asia, which is less than the 27 percent average for the United States. This difference is not surprising because western states tend to have stronger trade links with Asia than do other states. Arkansas was the only District state whose manufacturers sent a higher share of their exports to East Asia than the national average.

Figure 1

Asian Crisis Reduces Eighth District Exports



Not only are East Asian markets less important for Eighth District exporters in other parts of the United States, but the District's exports to the region also fell by less than the national average. Nevertheless, some states—like Kentucky and Mississippi—experienced sharp declines in exports to the region during 1998.

SOURCES: U.S. Department of Commerce, Bureau of the Census; Department of Labor, Bureau of Labor Statistics

Within East Asia, some markets are more important to District states than others. Japan is the most important export destination in East Asia for each state in the District, with 35 percent of the District's manufacturing exports shipped to Japan in 1997. Over half of Kentucky's manufacturing exports headed for East Asia went to Japan. All other District states sent at least 29 percent of their exports to Japan.

Korea and Hong Kong are the next most important export destinations, accounting for 14 and 13 percent of the District's exports to Asia, respectively. Missouri sent the largest share of its exports to Korea—16 percent in 1997—while Arkansas sent the lowest share to Korea—10 percent. In contrast, Arkansas sent 30 percent of its manufacturing exports to Hong Kong—the highest of any District state—while Missouri sent only 6 percent—the lowest of any District state. The remaining seven countries represent much smaller export markets for the District states. Only Mississippi sent more than 10 percent of its East Asian manufacturing exports to any of these countries. China was Mississippi's second most important market, receiving 15 percent of the state's manufacturing exports to the region in 1997.

District exports to East Asia are highly concentrated in a few product categories. Two-thirds of Eighth District manufacturing exports to the region fall into one of three categories: machinery (both electrical and nonelectrical), chemicals and transportation equipment. Arkansas is the only District state whose major export

product to East Asia does not fall into one of these categories; 43 percent of its manufacturing exports to the region consisted of food products, such as chicken. This was well above the District average of 8 percent.

Falling Exports

In the wake of the East Asian crisis, Eighth District manufacturing exports to the region fell by 10 percent between 1997 and 1998, slightly lower than the 12 percent drop for the United States overall. Although exports from all District states decreased, there was much variation across states, as shown in the bottom panel of the figure. Arkansas' manufacturing exports to East Asia fell by only 0.7 percent—the smallest decrease among District states—while Mississippi's exports fell by 28 percent—the largest District decrease.

The importance of the preceding declines in exports on a state's manufacturing output depends on the importance of the East Asian markets to manufacturing output. In 1997, 2 percent of the District's manufacturing shipments went to East Asia, which was well below the 4.2 percent U.S. figure. Moreover, no District state ranked above the national average. The leading District state, Illinois, sent 3.3 percent of its manufacturing shipments to East Asia. The shares of the remaining District states were: 1.8 percent for Tennessee, 1.5 percent each for Indiana and Kentucky, 1.4 percent for Arkansas, and 0.9 percent each for Mississippi and Missouri. These low shares indicate that the direct effect of the East Asian crisis on District manufacturing was relatively minor.

Eighth District Effect

The change in manufacturing exports, along with the share of these exports in manufacturing shipments, suggests that the trade shock reduced the District growth rate of manufacturing output by 0.19 percentage points.2 In contrast, the trade shock lowered U.S. output growth by 0.50 percentage points. Generally speaking, then, District states suffered only minor reductions in their manufacturing output growth rates. Given the small drop in its exports, it's not surprising that Arkansas was the least affected, with an estimated 0.01 percentage point decline in its manufacturing sector's growth rate. Kentucky was the most adversely affected. Its decline in East Asian exports lowered the manufacturing growth rate by 0.33 percentage points. Although Illinois' exports fell by far less than Mississippi's, the growth rate of manufacturing output in these two states fell by the same amount, 0.26 percentage points. This is because Illinois manufacturers are much more dependent on East Asian markets.

Based on these numbers, it appears that the Asian crisis had a negative effect on District manufacturing output growth. These results do not, however, imply that District manufacturing output fell in 1998. The negative export effect on growth from the Asian crisis may have been offset by strong domestic demand or other countervailing factors. Although 1998 state level manufacturing output data are not yet available to confirm this suspicion, manufacturing employment growth may provide some insight into the overall effect on output.

Eighth District manufacturing employment rose by 0.55 percent in 1998—an increase of 18,700 jobs. This change mirrors the national economy, which showed an increase of 0.52 percent. Given the continued rapid increases in U.S. manufacturing productivity during 1998, the uptick in District manufacturing employment undoubtedly indicates an upturn in District manufacturing output. Despite the negative effect the trade shock has had on the manufacturing sector, Tennessee was the only District state in which manufacturing employment fell in 1998. Manufacturing jobs there declined by 0.56 percent. Moreover, among District states with increases in manufacturing employment, Arkansas—whose manufacturing sector took the smallest hit from the Asian crisis—had the smallest gain in manufacturing jobs, at 0.44 percent. Meanwhile, Mississippi, which was one of the hardest hit states, enjoyed one of the largest increases in manufacturing jobs—1.1 percent.

Crisis—What Crisis?

Why didn't the Asian crisis have a noticeable effect on manufacturing employment in the Eighth District? The simple answer is that, as in the United States as a whole, domestic demand offset the drop in exports. Many of the goods that were not bought by Asian consumers were bought by U.S. consumers and firms. But what caused the increased demand by U.S. consumers? Ironically, the Asian crisis itself may have played a role since it set in motion numerous economic changes that affected not only international trade flows, but also commodity prices and interest rates. A reduction in demand for commodities by the East Asian countries helped to lower prices for these products on world markets. The price of crude oil, for example, fell by 34 percent in 1998. The resulting savings in energy expenditures enabled consumers to spend more on other goods. In addition, the Asian crisis led investors worldwide to seek safe assets, such as U.S. Treasury securities. This resulted in reductions in interest rates on these securities, as well as on a range of consumer debt instruments. Lower interest rates then stimulated spending on goods, such as automobiles. These indirect effects of the Asian crisis likely had a greater influence on the Eighth District economy than did the direct trade effect. As a result, Eighth District manufacturers were relatively unaffected because demand by U.S. consumers replaced demand by Asian consumers. So, for Eighth District manufacturers at least, the Asian crisis appears to have been the crisis that wasn't.

Heidi Beyer provided research assistance.

Endnotes

1. In this article, East Asia refers to: China, Hong Kong, Indonesia, Japan, Korea, Malaysia, Philippines, Singapore, Taiwan and Thailand. An overview of the Asian crisis appears in Neely (1999). [back to text]
2. For an analysis of all 50 states, see Coughlin and Pollard (2000). [back to text]

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Community Profile: Foreign Residents Fill Local Needs in Bowling Green, Ky.

Stephen P. Greene

In the movie "Back to the Future," Michael J. Fox's character hops in a DeLorean time machine, speeds for his life, and winds up in a quintessential 1955 version of his hometown. If, by mistake, he had crashed into downtown Bowling Green, Ky., circa 2000, he may have thought he had reached his destination. The statues and greenery of Fountain Square Park, the rows of small businesses, the city hall building on the corner...Bowling Green appears to be as typically mid-American as the fictional Eisenhower-era Hill Valley.

Closer scrutiny, however, reveals an unusual phenomenon in this city of fewer than 50,000 residents. In recent years, Bowling Green has witnessed a steady influx of immigrants, many of whom are refugees looking for a life free of political, racial or religious persecution. This trend has helped to fill job vacancies and add a cosmopolitan flavor to this unassuming southwest Kentucky town.

Why is Bowling Green suddenly home for people who historically have settled in large urban centers like New York, Chicago or Los Angeles? And what effect is their presence having on the local economy?

"Very Much in Demand"

Businesses thrive alongside Bowling Green's Fountain Square Park.

Hovering around 2 percent, the unemployment rate in Bowling Green is extremely low by any standard. In Warren County, where Bowling Green is located, the unemployment rate is 3 percent. Each figure sits well below the state unemployment rate of 4.1 percent. Plentiful jobs, along with affordable housing and a low cost of living, have made Bowling Green a prime resettlement area for immigration.

"Even for a person who speaks no English, there are jobs available all over the place right now because times are so good," says Martha Deputy, director of the Western Kentucky Refugee Mutual Assistance Association (WKRMAA), part of a network of 30 agencies that resettles refugees. "These people are very much in demand."

When incorporated in 1981, the WKRMAA began resettling refugees from Vietnam, but has since worked with people from many different countries, including Cambodia, Laos, Mexico, El Salvador, Honduras, Armenia and Russia. The majority of refugees over the past three years have come from Bosnia and Croatia.

Deputy estimates that since June of 1998, she and her staff have brought about 500 refugees into town, compared with about 125 in 1993. There are, she says, currently about 3,000 refugees in all of Warren County. In addition, there is a growing population of nonrefugee immigrants--those who leave their native land not to escape persecution but to seek greater economic prosperity elsewhere.

A Variety of Jobs

Although immigrants make up only a small percentage of the overall population in Bowling Green and Warren County (accurate counts won't be available until the 2000 census is completed), they are quickly filling niches in several industries.

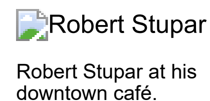
Immigrants are frequently hired at two woodwork companies, Woodwork of Mid-America and Eagle Industries Inc., and also at Trace Die Cast Inc. Restaurants and taverns also offer job opportunities: Because a bulk of the counties surrounding Warren County prohibit alcohol sales, many establishments have sprung up on the south side of town, offering an oasis to travelers along Interstate 65.

Then there are immigrants who have decided to go into business for themselves. Two such men are Roman Safarov, who escaped religious persecution in Armenia seven years ago and now operates his own tool repair business in Bowling Green, and Robert Stupar, a Croatian who is co-owner of The Brickyard Café downtown.

Safarov operated his own automotive repair shop in Armenia and, upon arriving in Bowling Green, set his sights on once again running his own business. He says that living in a smaller town has allowed him to fulfill his dream more quickly.

"What I hear from friends of mine who are in bigger cities is that it took them longer to open their own business," Safarov says.

Stupar, who came to Bowling Green five years ago after his brother-in-law moved here from Vermont, says, "I never would have thought a place like Bowling Green would be where I would end up in America, but now that I am here, I know I am in the right place."



Robert Stupar at his downtown café.

If the economy remains strong, even more people from other nations may be beckoned to Bowling Green to rejoin friends and families.

"When jobs are available, word travels," Deputy says.

And indications are that jobs will indeed continue to be available. A diverse group of companies maintain a presence in Bowling Green. General Motors has produced all of its Corvettes in Bowling Green since 1981, and Fruit of the Loom's world headquarters is here. According to the Chamber of Commerce, Bowling Green has attracted 82 corporate facility investments since 1989, though those gains have been offset somewhat by recent plant closings. Holly Performance Products, which is headquartered in Bowling Green and still employs more than 700 people, has closed three plants in town over the past 15 years.

Richard Cantrell, an associate professor of economics at Western Kentucky University in Bowling Green, has closely followed the city's progress over the past two decades. He says that Bowling Green is well positioned to reap the benefits spilling over from the economically potent Nashville market, 60 miles to the south.

"We lie on a large artery that links us to Nashville--I-65," Cantrell says. "Nashville is growing north because most of the land and facilities to the southeast and west have been absorbed. Bowling Green is growing south. By being in the sphere of influence of the tremendous development taking place in Nashville, that is where our best opportunities lie. And that is not a bad place to be."

Blending Together

The proliferation of residents from many different foreign countries in Bowling Green has affected even more than the economy. One illustration of this is the city's International Festival, which began as the Japan Festival in 1989 before conditions required an expanded name. Every October, about 5,000 people attend the celebration in Fountain Square Park. One of the festival's goals is to promote a smoother cultural blend in the town.

One particular area where amalgamating different cultures poses a challenge is in the city's public schools. Of the 3,500 students, 12 percent are enrolled in English as a Second Language courses, the highest percentage of any school district in the state. Only four years ago, that percentage was about 2. More than 20 languages are represented in the district.

"Many of these refugees in our schools have seen war and may never have been in a classroom setting, so meeting their needs is definitely a challenge," says Deborah Williams, chairman of the Bowling Green Board of Education. "If our teachers were not so flexible, I don't know what we would do."

Because Bowling Green is not large enough to be considered a Metropolitan Statistical Area, many forms of federal funding for the school district are unavailable.

"I think we have done as well as we can do with limited funding," Williams says.

The increasing variety of cultures in Bowling Green has also changed the restaurant landscape.

"Twenty years ago, you never would have been able to find a burrito in Bowling Green," Deputy says.

Now, residents can sample foods from around the world at area Mexican, Thai, Japanese, Chinese or Cambodian restaurants.

In general, new residents like Safarov and Stupar say the native citizens of Bowling Green have made them feel welcome. Part of this receptiveness stems from the fact that they are seen as an asset in the effort to fill open jobs. But what if the economy were to turn south again?

Rick Horn, who as director of the Kentucky Small Business Development Center helps to generate additional jobs, fears the atmosphere would change.

"The attitudes of the citizens toward immigrants have been very welcoming, but I think it could be a whole different story if everyone was fighting for the same jobs," he says.

But as long as the economy continues on a vigorous pace, Bowling Green will not have to worry about such conflict between its increasingly diverse mix of residents.

Bowling Green, Ky., by the numbers

Population	48,300
Labor Force	25,427
Unemployment Rate	1.9%
Per Capita Personal Income	$21,264
Top Five Employers	
Western Kentucky University	2,500
The Medical Center/CHC	2,195
Warren Co. Board of Education	1,493
General Motors Corvette Plant	1,000
DESA International	800

NOTES: Statistics are from June 1999 except for per capita personal income, which is from 1998. The population for all of Warren County in 1998 was 87,323.

REGIONAL ECONOMIST | JANUARY 2000
https://www.stlouisfed.org/publications/regional-economist/january-2000/working-in-the-golden-years-and-paying-for-it-the-retirement-earnings-test

Working In The Golden Years And Paying For It: The Retirement Earnings Test

Adam M. Zaretsky

In October of last year, the U.S. unemployment rate hit 4.1 percent—its lowest since January 1970. This low unemployment rate just continued a trend of declining rates that has been one of the identifying characteristics of the ongoing economic expansion. All the while, lots of firms and industries continue to clamor for qualified workers to fill vacant jobs. But with the national economy experiencing such a tight labor market, this has not been an easy task, especially as the U.S. economy approaches its tenth year of expansion.

The length and strength of this expansion has pushed labor markets to new extremes and drawn in large numbers of workers who previously had not been in the labor force. As Poole and Wall describe in the lead article of this issue, the face of the labor force has changed dramatically over the past few decades—but especially in the 1990s. Many more women over 20 are not only in the labor force, but employed. And the share of black men employed has nearly recovered from the blows suffered in the 1970s and early 1980s. The teen-age population has made similar strides, as Poole and Wall also note. But even with all of these new workers, vacant positions abound.

There is a population, however, that contains a sizable pool of workers that remains somewhat untapped: those near or at retirement age. In 1998, an estimated 19.5 million people—or more than 11 percent of the population 25 years and older—in the country were between the ages of 60 and 69.1 Of these people, 35 percent (about 6.8 million) were labor force participants; that is, they were either employed or actively looking for work. Of these, about 6.6 million were employed, implying an unemployment rate of just 2.9 percent. Clearly, people in this age bracket who choose to enter the labor force are very likely to be working. The big question, then, is why do so few choose to be in the labor force in the first place?

When Earning Too Much at Work Hurts

The obvious answer, of course, is that most are retired. Even though mandatory retirement was eliminated in the mid-1980s, workers still tend to retire when they reach 65 years of age. In fact, if the labor force number just given is divided into two groups—those between 60 and 64 years old and those between 65 and 69—nearly 70 percent are in the younger age bracket. Indeed, the number of people in the older group who participated in the labor market in 1998 was less than half that of the younger group. Despite appearances, however, there is nothing magical about the age of 65. Rather, this is the age that has been institutionalized because it is when a person is able to begin collecting full Social Security benefits (reduced benefits are available at age 62).2 By itself, receiving full benefits might seem like enough of an incentive to encourage someone to withdraw from the labor force. But the Social Security system provides another powerful, but less obvious, retirement incentive: the retirement earnings test.

The earnings test is basically a tax on earnings for those who are between 62 and 70 years old and receive Social Security benefits.3 Its intent is to move people out of the labor force and into retirement. In 1998, the

test worked as follows (see accompanying table):

- Those under 65 years of age could earn up to $9,120 a year without any reduction in Social Security benefits. For each $2 earned above $9,120, benefits would be reduced by $1, until all benefits were gone. This amounts to a 50 percent tax on earnings above $9,120 for those in this age group. (The benefits are not forfeited, however, because future benefits will be raised to compensate for the loss today.)
- Those between 65 and 69 years of age could earn up to $14,500 a year without any reduction in Social Security benefits. For earnings above this threshold, benefits would be reduced $1 for every $3 in earnings until all benefits were gone. This group effectively faces a 33 percent tax on earnings above $14,500.
- Those 70 and older face no benefit reduction, regardless of earnings.

Table 1

The Cost of Working: The Earnings Test Thresholds

	Exempt Income Thresholds	
	Under Age 65	**Age 65-69**
1998	$9,120	$14,500
1999	9,600	15,500
2000	10,080	17,000
	Effective Tax rate	
All Years	50%	33%

NOTE: For those under 65, the threshold adjusts automatically with increases in the national average wage index. For those 65 to 69, the threshold has been legislated.

SOURCE: Social Security Administration

These are extremely large penalties for continuing to work while collecting Social Security benefits—particularly for the younger age group. And these benefit reductions occur at low income levels—levels that under normal circumstances would, at most, be subject to a 15 percent income tax. Thus, it's easy to see how the earnings test could work to push someone out of the labor force. If one chose to stay in, however, the number of hours worked would likely be limited to avoid the penalty. Until just recently, though, the evidence in the literature did not support these assertions.

On the One Hand...

Virtually all earlier studies that examined the effect of the earnings test on the labor supply of older workers concluded that the effect is small.4 The studies found that eliminating the earnings test would have, at most, a minor effect on the work activity of older Americans, especially those 65 and over, because many factors play a role in the retirement decision. In fact, according to the studies, some of these factors—such as private pensions and health status—have much more influence on retirement decisions than the earnings test. Furthermore, the studies also found that over time the earnings test has been relaxed—that is, exempt income thresholds have been raised and penalty rates have been lowered—without much effect on the labor supply decisions of older Americans.

...But on the Other Hand

In a June 1999 study, however, economist Leora Friedberg contradicts the findings of the previous literature. Friedberg asserts that the earnings test's predicted effects are apparent in the data, particularly the expected adjustment of work hours to keep earnings just below the exempt income thresholds. In her study, Friedberg shows that not only have workers adjusted their hours to avoid the earnings test penalty, but they have actually shifted their hours as the thresholds have increased. This type of clustering just below the exempt income threshold amounts, Friedberg argues, is evidence that the earnings test has indeed led many workers to limit their labor supply.

All told, Friedberg predicts that eliminating the earnings test would bolster the labor supply of those at or above the current exempt amount, raising their working hours by 5.3 percent, and it would do this at a small cost to the government. That said, Friedberg also projects that in 2002, when the exempt amount for those 65 and older rises to $30,000, the labor supply of those with earnings in this neighborhood will actually fall as they adjust to the penalty. On top of this, more people over time will be facing the more restrictive 50 percent tax penalty (currently affecting those between ages 62 and 64), as the retirement age gradually increases to 67.

Retiring the Earnings Test

The earnings test, introduced in 1939, was meant to induce retirement. Since the 1950s, the test has been gradually relaxed, as the focus has shifted toward encouraging work and saving. Given today's strong market conditions, a continually declining median retirement age, and an increasing life expectancy, the earnings test seems an anachronism. Eliminating the earnings test would likely increase the available pool of qualified workers, enabling firms to fill vacancies. Friedberg's findings could, therefore, be just the catalyst needed to launch the serious discussion this issue truly deserves.

Paige M. Skiba provided research assistance.

Endnotes

1. This and other population figures stated do not include those in the armed services or those who are institutionalized (in prisons, nursing homes, mental institutions and the like). [back to text]
2. The "official" retirement age will gradually rise from 65 to 67 between 2003 and 2027. [back to text]
3. The earnings test affects only earned income, such as wages and salaries. It does not affect unearned income, such as dividends and pensions. This tax on earnings is separate from income taxes owed to the government. The term "tax" is used because the benefit reduction is basically an amount of money a person must pay the government. [back to text]
4. See, for example, Leonesio (1990) and Packard (1990). [back to text]

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Leonesio, Michael V. "The Effects of the Social Security Earnings Test on the Labor-Market Activity of Older Americans: A Review of the Evidence," *Social Security Bulletin* (May 1990), pp. 2-21.

Packard, Michael D. "The Earnings Test and the Short-Run Work Response to its Elimination," *Social Security Bulletin* (September 1990), pp. 2-16.

Poole, William, and Howard J. Wall. "Price Stability and the Rising Tide," *The Regional Economist,* Federal Reserve Bank of St. Louis (January 2000), pp. 5-9.

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National and District Data

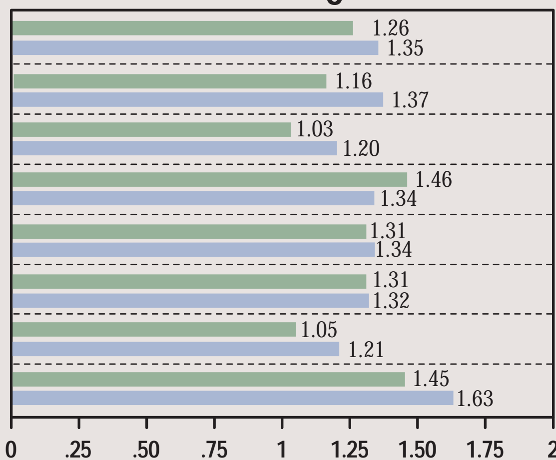
Selected indicators of the national economy and banking, agricultural and business conditions in the Eighth Federal Reserve District

Commercial Bank Performance Ratios

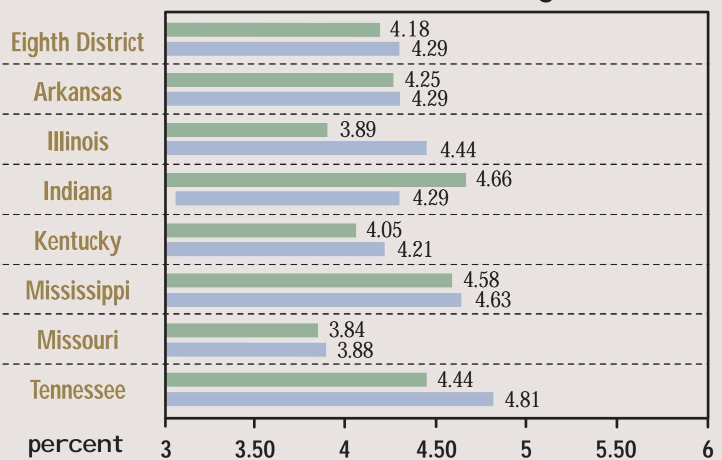
third quarter 1999

U.S. Banks by Asset Size	ALL	$100 million-$300 million	less than $300 million	$300 million-$1 billion	less than $1 billion	$1billion-$15 billion	less than $15 billion	More than $15 billion
Return on Average Assets*	1.38	1.27	1.20	1.38	1.26	1.83	1.56	1.27
Net Interest Margin*	4.14	4.68	4.61	4.60	4.61	4.78	4.70	3.77
Nonperforming Loan Ratio	0.96	0.89	0.93	0.78	0.87	1.06	0.97	0.95
Loan Loss Reserve Ratio	1.72	1.39	1.40	1.52	1.44	2.00	1.75	1.71

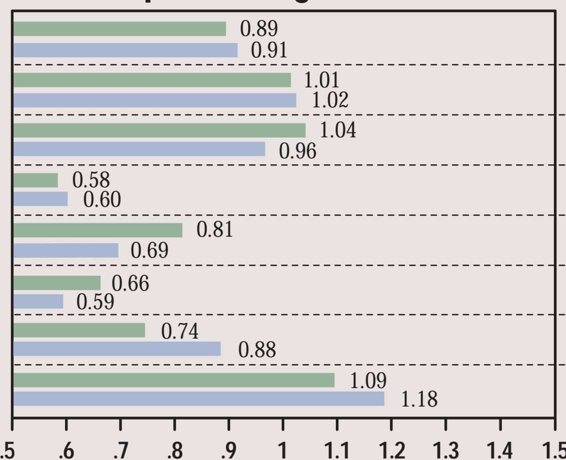
Return on Average Assets*



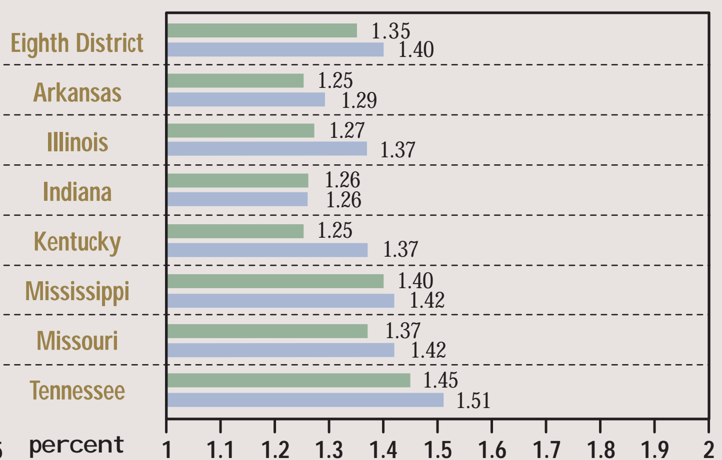
Net Interest Margin*



Nonperforming Loan Ratio



Loan Loss Reserve Ratio



Third Quarter 1999   Third Quarter 1998

NOTE: Data include only that portion of the state within Eighth District boundaries.
SOURCE: FFIEC Reports of Condition and Income for all Insured U.S. Commercial Banks
*Annualized data

For additional banking and regional data, visit our web site at:
http://www.stls.frb.org/fred/data/regional.html.

Regional Economic Indicators

Nonfarm Employment Growth

year-over-year percent change

third quarter 1999

		Goods Producing		Service Producing				
	total	mfg	cons[1]	govt	tpu[2]	fire[3]	services	trade
United States	2.2%	–1.7%	4.5%	1.7%	2.9%	2.7%	4.0%	2.4%
Arkansas	1.2	–0.6	3.2	0.6	2.2	1.0	2.6	1.5
Illinois	1.6	–0.8	4.6	–0.3	1.5	1.6	3.2	2.0
Indiana	1.4	0.1	–0.2	1.8	1.0	4.5	2.7	0.9
Kentucky	2.1	–1.3	4.4	2.0	3.3	2.1	3.6	2.7
Mississippi	0.1	–2.1	5.1	1.7	0.9	–0.6	–0.6	0.7
Missouri	0.8	–2.0	8.1	0.9	–0.5	3.1	0.3	1.3
Tennessee	1.2	–2.2	5.4	0.7	2.0	1.6	2.1	2.2

[1] Construction [2] Transportation and Public Utilities [3] Finance, Insurance and Real Estate

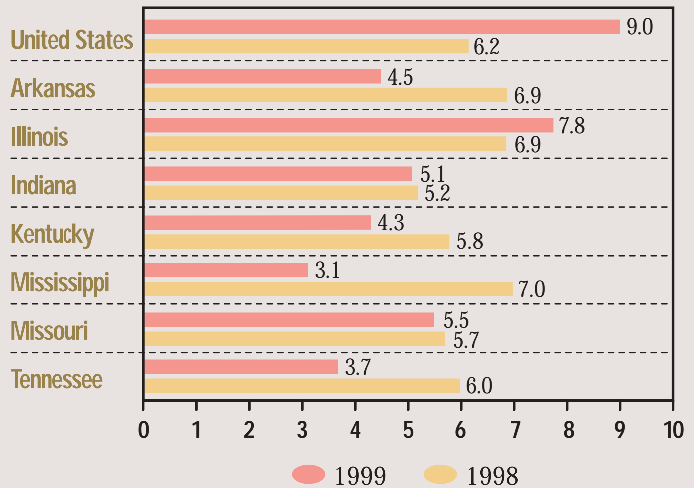
Unemployment Rates

percent

	III/1999	II/1999	III/1998
United States	4.2%	4.3%	4.5%
Arkansas	4.5	4.7	5.1
Illinois	4.3	3.9	4.2
Indiana	2.9	2.9	2.8
Kentucky	4.4	4.2	4.2
Mississippi	4.6	4.9	5.0
Missouri	3.5	2.7	4.4
Tennessee	3.7	4.3	4.3

Total State Revenue

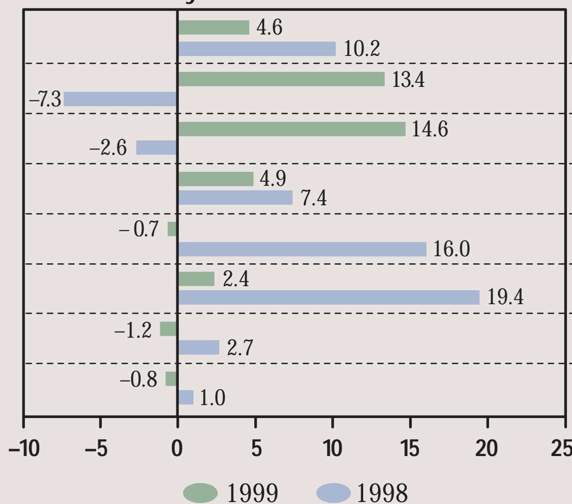
year-over-year percent change



third quarter

Housing Permits

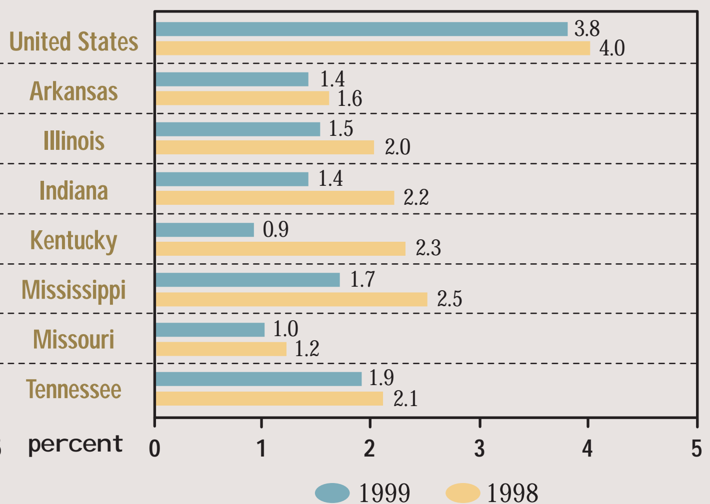
year-over-year percent change in year-to-date levels



second quarter

Real Personal Income

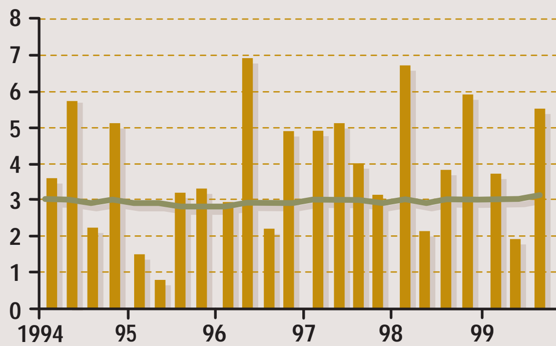
year-over-year percent change



All data are seasonally adjusted.

Major Macroeconomic Indicators

Real GDP Growth
percent

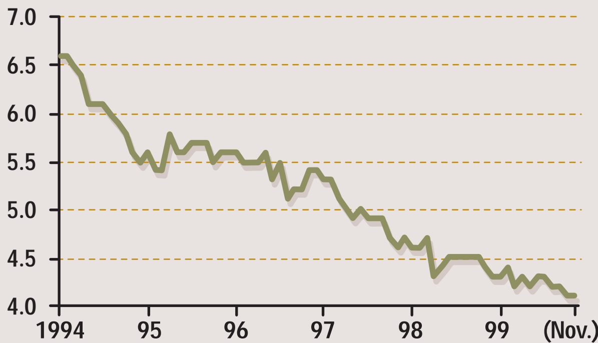


NOTE: Each bar is a one-quarter growth rate (annualized); the green line is the 10-year growth rate.

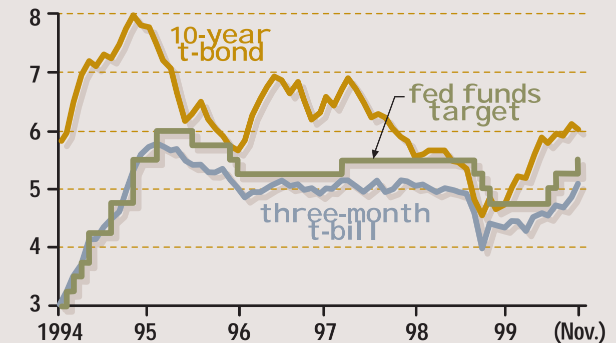
Consumer Price Inflation
percent

NOTE: Percent change from a year earlier

Civilian Unemployment Rate
percent



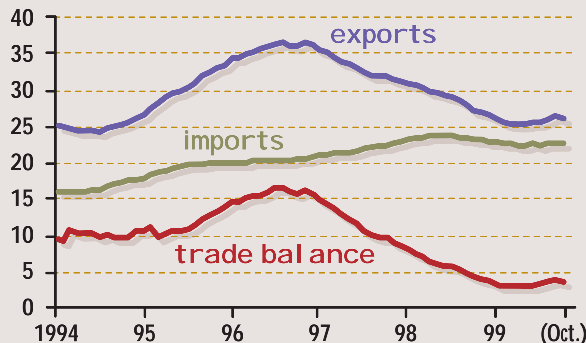
Interest Rates
percent



NOTE: Except for the fed funds target, which is end-of-period, data are monthly averages of daily data.

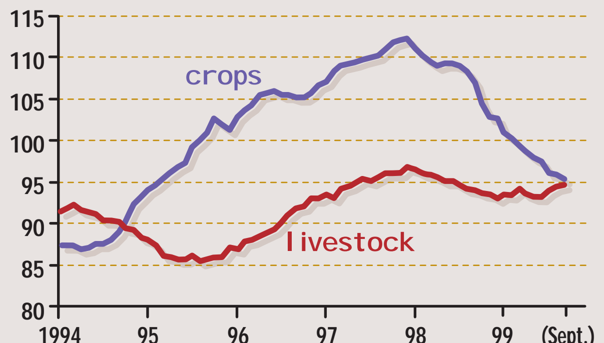
Farm Sector Indicators

U.S. Agricultural Trade
billions of dollars



NOTE: Data are aggregated over the past 12 months.

Farming Cash Receipts
billions of dollars



NOTE: Data are aggregated over the past 12 months.

U.S. Crop and Livestock Prices
index 1990-92=100