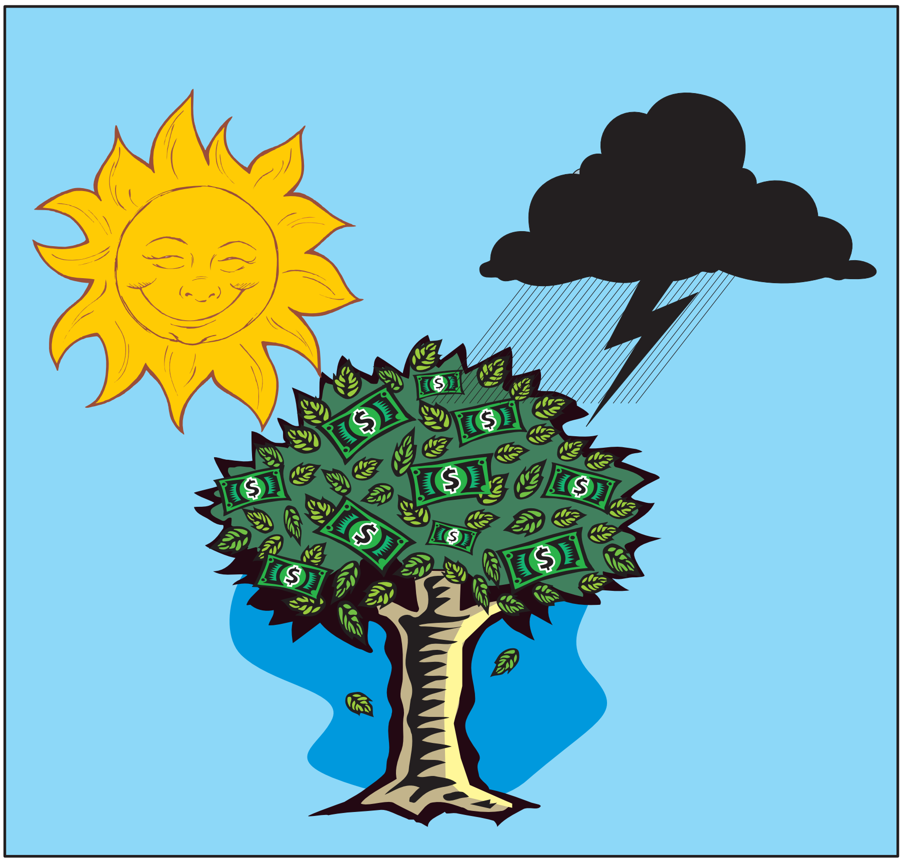
Economic Growth Matters More Than We Think



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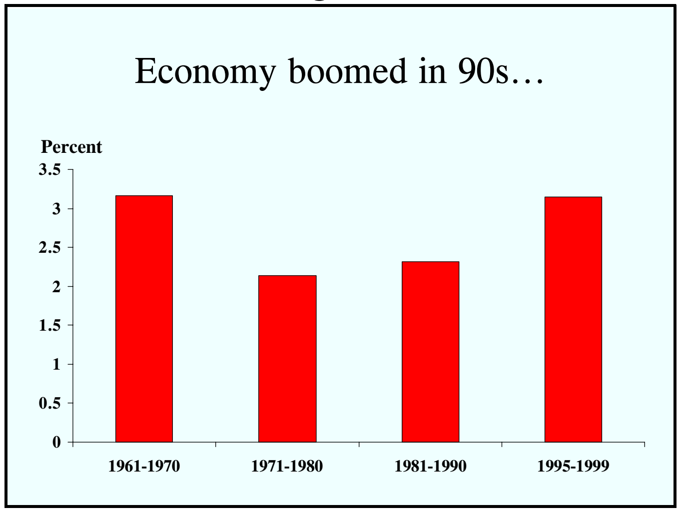
September 2002

Economic Growth Matters More Than We Think

In March of 2001, the U.S. economy entered its 120th month of economic expansion. During the latter part of that expansion, GDP grew at a rate not seen since the 1960s (**Figure 1**). This achievement is all the more remarkable given the problems many other industrialized economies experienced during the 1990s.

But all good things must eventually come to an end, and it was in that month that the U.S. economy officially entered recession. We now know that the recession was more severe than initially believed, though still mild by historical standards. We also suspect–or at least many economists believe–that the U.S. exited recession in December, though economic growth continues to be haphazard at best as the country struggles to recover its economic footing. Second-quarter GDP came in at a weaker-than-expected 1.1 percent and many analysts now believe 2002 growth will not be much higher than 2.5 percent.

Figure 1



At a time of economic uncertainty, it is important to understand why economic growth matters. And the answer is not that a number we call GDP rises. The answer, simply put, is that economic growth benefits the lives of ordinary Americans. Economic growth typically goes hand-in-hand with strong job growth. It frequently goes hand-in-hand with strong productivity growth and a lower federal budget deficit. And it sometimes even goes hand-in-hand with weaker inflationary pressures. While not every period of economic growth will necessarily produce each of these factors, all appear to have been operating in the United States during the 1990s. Jobs were relatively easy to come by, productivity growth was relatively strong–if not as strong as once thought–and inflationary pressures were relatively well-contained. And all of these things made the lives of ordinary Americans better than they otherwise would be.

But the importance of economic growth does not stop here. There are many other ways, less celebrated though no less important, in which a strong economy can improve the lives of ordinary people. Among the areas of life affected by a strong economy are minority well-being, crime, welfare, and charity. Once this is understood, the stakes of economic growth are much higher than is generally realized. Economic growth is quite literally the driving force not only of salaries but also of the quality of life you and I enjoy. This presentation discusses how and why these factors are affected by the economy–and what this means for the future.

Minority Well-Being

Historically, minorities have fared worse than whites on standard measures of economic well-being. They have also been disproportionately affected by changing economic conditions. Did the boom of the 1990s reduce the gap between minorities and whites? And did the bad times of 2001 eliminate those gains?

The answer to the first question is yes (**Figure 2**). In fact, it can actually be said that minorities found jobs at a faster rate than whites during the 1990s. In the decade before the 2001 recession, the unemployment rate gap between blacks and whites fell from 6.7 percent to 4 percent and the gap between Hispanics and whites fell from 3.3 percent to 2.3 percent. Even more importantly, the black poverty rate fell to its lowest rate in recorded history (**Figure 3**).

The answer to the second question is: only partially. Unfortunately we do not yet have minority poverty statistics for 2001 or 2002. But we do have unemployment rate data, and they are not encouraging: the gap between blacks and whites widened from 4 percent to 5.5 percent while the Hispanic-white gap stopped narrowing (**Figure 4**). While this represents only a partial take-back of the dramatic gains of the 1990s, further economic hard times could widen the gap to where it stood at the dawn of the 90s boom. But if a burgeoning recovery should take hold, there is every reason to believe the gap will continue to narrow in the same way it did in the 1990s.

Figure 2

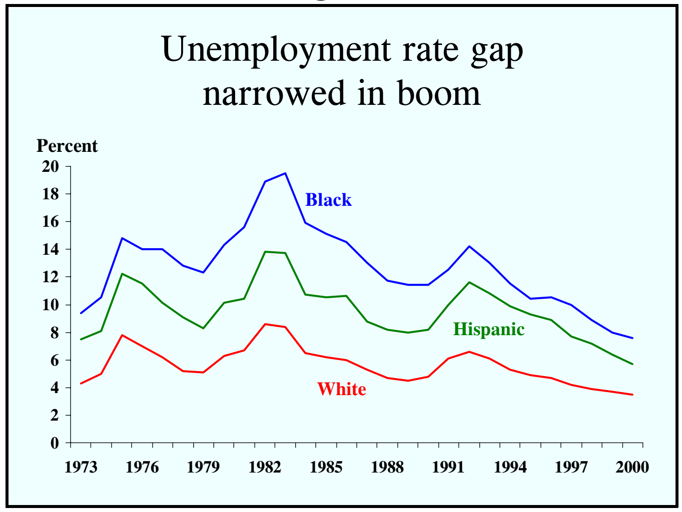


Figure 3

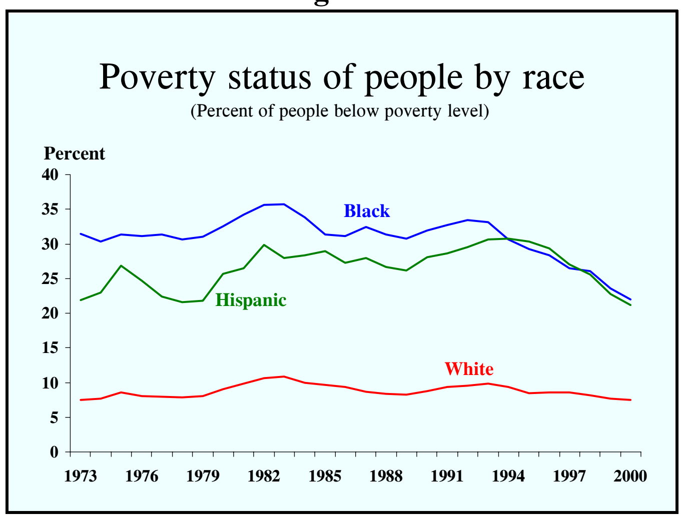
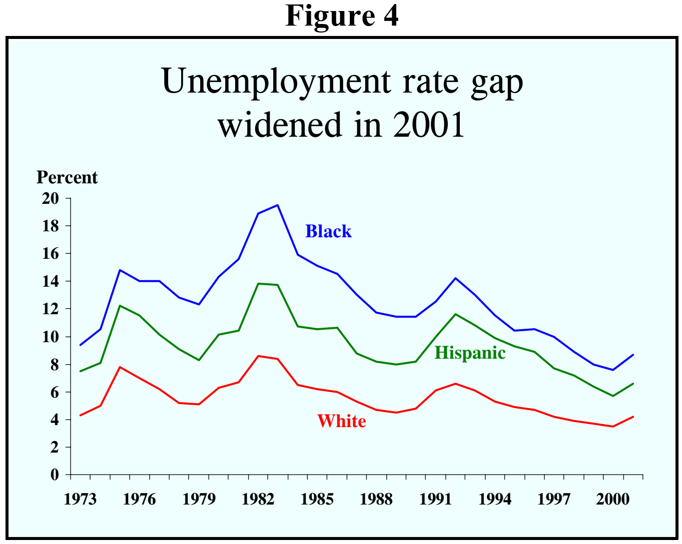
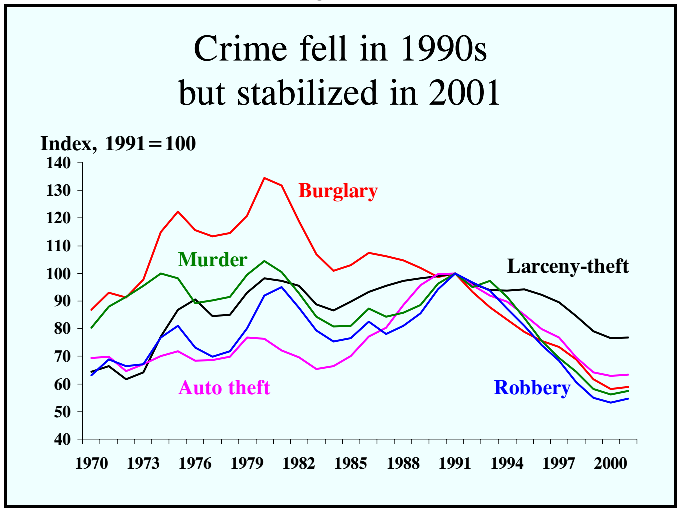


Figure 4



Crime

Figure 5



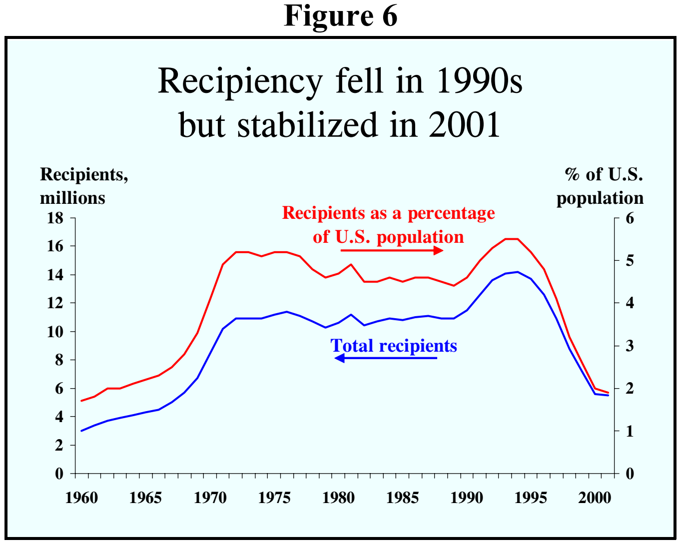
Estimates of the annual cost of crime and crime prevention in the United States range as high as $1 trillion. Many factors influence an individual's decision to commit crimes, including his age, the likelihood of being caught, and the severity of punishment. But high on the list are the job and income prospects one faces in pursuing lawful work. Research shows that economic incentives play a key role in influencing crime, just as they do in many other decisions in life. So it makes sense that crime rates, especially those economically linked—robbery, burglary, larceny and motor vehicle theft, for example—would fall in the 1990s. And they did (**Figure 5**).

Moreover, they fell sharply–by up to 50 percent in some cases. While non-economic factors such as demographic changes and more prisons can gradually reduce crime rates over time, what's remarkable about the 1990s is the sharp decline in virtually all major types of crime. Declines have been so substantial that most types of crime are less prevalent now than they were in 1970. And this reduction in crime has had a very strong effect on the quality of life in America.

As the economy slid into recession in 2001, the crime rate stabilized and then rose in all regions of the country except the northeast. Should economic growth remain tepid for the remainder of 2002, this unwelcome trend is unlikely to abate.

Welfare

Figure 6



Since the social safety net was created in 1936, numerous programs have been established to assist out-of-work Americans. As conceived, the nation's welfare system would rescue unfortunate but well-intended citizens from occasional hard times. But the system also created incentives for able-bodied and otherwise competent individuals to opt out of the labor market in return for welfare benefits. In either case, the welfare rolls should fall when the economy improves because more jobs–and more attractive jobs–are available.

And this is exactly what happened in the 1990s (**Figure 6**). After reaching an all-time high of 14 million recipients in 1993, welfare recipiency flattened out and then began a steep decline. The welfare rolls ultimately fell by almost 60 percent between 1994 and 2000.

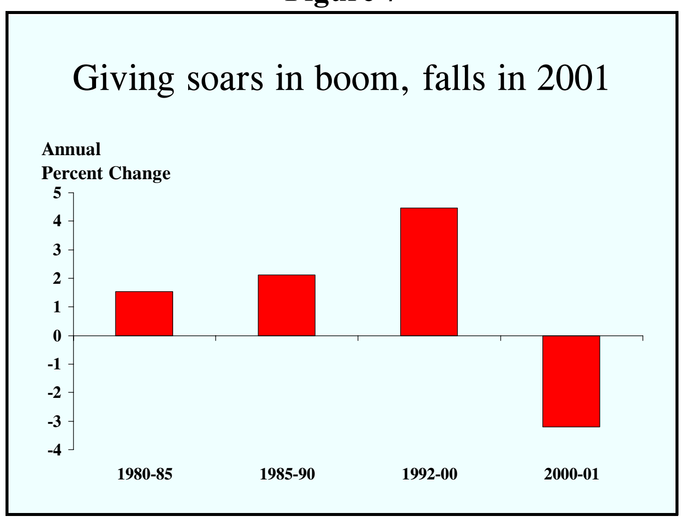
To be sure, the landmark welfare reform law enacted in 1996 played an important role in the decline. But the fact that people began to leave the welfare rolls before the law was signed suggests that the increased job opportunities provided by strong economic growth was also important. Even more evidence on this point is provided by the fact that the states where recipiency fell fastest were also the states with the greatest percentage growth in real per capita income.

With the recession of 2001 came a dramatic slowdown in the rate at which people left the welfare rolls. Indeed, the welfare rolls stabilized by the end of that year, and most states actually gained welfare recipients during the first quarter of 2002. If economic growth–and the labor market–remains weak for the remainder of 2002, there is every reason to believe the welfare rolls will not decline in the near future.

Charity

Private charity steps in–to the tune of about $213 billion last year–when the government safety net does not help everyone in need. In recent years, stories of self-absorbed millionaires and Internet billionaires have convinced many that Americans lost their commitment to charity during the recent economic boom. Yet theory predicts that individuals whose earnings increase will give more to charity–and will give less as their earnings decline. Did charitable giving fall during the boom, or did it rise until the 2001 recession?

Figure 7



In the first half of the 1980s, real charitable contributions per person rose at an annual rate of 1.5 percent. In the second half of the 1980s, contributions rose at a 2 percent rate. But during the boom of the 1990s, giving rose at a whopping rate of 4.5 percent per year as New Economy workers shared their prosperity with the less fortunate.

In contrast to this explosive growth, contributions actually declined by 3.2 percent in 2001 (**Figure 7**). With the economy in recession at that time and personal income growth sluggish, this shouldn't be surprising–people simply couldn't afford to give in the way they had previously been giving. But until the strong economic growth of the 1990s returns, the charitable renaissance begun in the 1990s will be only a memory.

Conclusion

Everyone knows that economic growth matters. Almost everyone knows that economic growth can give them a job or cause them to receive a higher wage. But few people know how much economic growth affects other aspects of their lives that are just as important but aren't usually thought of as being related to the economy.

Taken together, this evidence supports the idea that economic growth has a substantial impact on the areas of crime, welfare, charity, and minority well-being. It also underlines the importance of Fed policymaking at this vital point in time. Should U.S. economic growth accelerate in the quarters to come, Americans would reap benefits in the form of less crime, less welfare recipiency, more charity, smaller deficits, and greater earning power for minorities. But if the U.S. should fall back into recession, Americans would suffer the consequences of higher crime, more welfare recipiency, less charity, and the other unpleasant side effects of a weak economy discussed in this paper. Economic growth matters more than most people think.

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