Waiting for the paradigm

To some, it must seem that they must wait forever for economists to decide if there has or has not been a structural change in the statistical relationships within the economy that merits a label such as "New Paradigm." As economic statisticians, we hope that some of the wait is due to painstaking consideration of a huge mass of relevant data and careful construction of alternate statistical models. For some economists, however, the wait is simply a matter of there not being enough evidence.

For example, Margaret K. Burke and Michael A. Kouparitsas conclude in the October *Chicago Fed Letter* that "the robust performance of the U.S. economy has been due to temporary factors that have permanently raised the level of U.S. production, but have not changed the long-run growth rate of the economy." Indeed, both an analysis using trend decomposition by unobserved components and another using spectral techniques suggest to the authors that underlying trend growth rates have increased only very slowly in the 1990's and are not any higher than they were in the 1980's.

Although she approaches the issue from a very different perspective, Susan C. Lakatos presented similar conclusions to a recent meeting of the National Association for Business Economics. Her presentation, "S&P Earnings, Corporate Profits, and Productivity," reconciled the recent above-average price-to-earnings ratio of the Standard & Poor's 500 by adjusting their reported earnings to more economically meaningful profit estimates. After that reconciliation, corporate earnings were well within their historical relationship with the profit figures in the national income and product accounts and would imply that price ratios are much more in line with historical averages. Similarly, by an analysis of the relationship of the deviation of current quarter output growth from its five-term moving average and the growth rate of domestic nonfinancial corporate productivity, Lakatos concludes that not only is the economy not outperforming history in terms of productivity growth, but may even be slightly underperforming.

America's changing well-being

The Council of Economic Advisors has published a 74-page book, *Changing America: Indicators of Social and Economic Well-Being by Race and Hispanic Origin*, "to document current differences in well-being … and to describe how such changes have evolved over the past several decades." Seven broad topics—population, education, labor markets, economic status, health, crime and criminal justice, and housing and neighborhood—are sketched in charts and talking points. The section on the labor markets includes pages on labor force participation, unemployment, earnings, occupation, and a chart of the proportion of youths who are neither employed nor in school.

The last measure is important not only for what it says about current activities, but for what it indicates for the development of future earnings power as well. While the percentage of young men who are neither enrolled in school nor employed has not changed much for any of the race and ethnic groups, the percentage of young women has fallen substantially. The most substantial declines have occurred among young black women starting in 1991 and among young Latinas since 1995. For both black and Hispanic women, much of the decrease can be accounted for by increases in school enrollment.

Why cities are important

Concentrations of economic activity, what Professor Michael Porter calls "clusters" of inter-related suppliers, producers, and consumers, suggest that density of economic activity can be beneficial. The diversity of an urban economy, be it New York, London, or Hong Kong, also suggests that these gains can cut across a wide variety of activities. Kelly Ragan and Bharat Trehan, survey some of the theory and empirical evidence supporting this view in the Federal Reserve Bank of San Francisco's *Economic Letter*.

On the theoretical side, there is the notion that the productivity of a worker with a given amount of human capital or productive skill depends in significant ways on the level of human capital present in the workers that he or she interacts with. Thus, moving a worker from a low-capital group to a high-capital group may raise the worker's productivity through the mechanism of interaction. Opportunities for interaction are not uniformly distributed in space and are much more common at the nodes we call "cities."

Empirically, researchers have found evidence that doubling a city's size or density is associated with an increase of roughly 6 percent in labor productivity. The study based on urban density in fact found that gains due to employment density can explain more than half of the labor productivity variation among States. This study, report Ragan and Bharat, also goes to great length to avoid its results being negated by reverse causality or weakened by the impact of potential intervening variables such as education and public capital, and show that the results do not reflect the influence of market size (a potential alternative hypothesis). □