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Sizing Up Downsizing*

"Downsizing," a favorite bugbear of critics of profitable corporate enterprise, provides many net benefits. The genuine danger is the policy resulting from the fears it excites.

Critics of voluntary cooperation through free markets typically describe one aspect of its wealth-creating dynamic as "downsizing." They allege that such adjustments are, on balance, harmful.

The news media, as well as explicit market opponents, use "downsizing" to describe the alleged loss of millions of jobs that have been sacrificed on the altar of corporate greed. According to National Public Radio, the 1980s and 1990s witnessed "massive layoffs" by corporations that pursued short-term profits designed to increase stock values.[1] The condemnation comes from many quarters, even mainstream churches. *The Lutheran* (the publication of the Evangelical Lutheran Church in America), for example, claimed that 43 million jobs were eliminated between 1979 and 1995—and that economic instability has destroyed faith in the American dream.[2]

The job loss has taken its toll on the incomes, health, and spirit of American citizens, according to the critics and media. Last year Reuters reported a Finnish study that asserts downsizing harms employee health.[3] Individual self-confidence is supposedly torn down by the threat of job cuts. Psychologist James Campbell Quick claims that downsizing causes workers to feel mistreated and abandoned.[4] Even *Fortune* magazine used the term "executioners" to describe corporate job-cutters.[5]

But the term "downsizing" is grossly misleading. More important, the social and economic adjustments so described provide tremendous net benefits.

There is an eerie Orwellian flavor to the term "downsizing" that has much more to do with propaganda than truth. Observe, for example, that the Amazon Rain Forest is characterized by tremendous amounts of water evaporation. Indeed, it may be unrivaled in this regard. But it would be seriously misleading to emphasize the evaporation at the expense of the rain, thereby leaving the incorrect impression that one is describing a desert. Bill Gates spends millions of dollars per year. Indeed, he may be unrivaled within the United States in that regard. But it would be seriously misleading to emphasize the spending at the expense of his wealth creation, thereby leaving the incorrect impression that one is describing a net consumer.

One has an ethical duty not to present misleading half-truths. (By the way, Tiger Woods has not beaten me in golf for the last three years.)

The Whole Truth

But presenting half-truths is exactly what critics have been doing. The simple truth is that the free-market economy, on net, creates jobs and has done so since its inception. This has been the case during the 1980s and 1990s, the so-called heyday of downsizing. Even in our hampered economy, more jobs are created than cut. This is an *upsizing* economy.

According to Federal Reserve data, 1980 started with total employment at more than 99.8 million. By the beginning of 1985, it had increased to over 106.3 million. On average, job creation exceeded job cuts by almost 1.3 million jobs each year during the 1980-1985 period. By the beginning of 1990, total employment had increased again to over 119 million. From 1985 to 1990, job creation exceeded job elimination by an average of more than 2.5 million per year. By the beginning of 1998 total employment had increased again to over 131 million. From 1990 to 1998, job creation exceeded job elimination by an average of almost 1.5 million jobs per year. Over the entire 1980-1998 period, net job creation was nearly 2 million jobs per year.[6] The economic rain forest is hardly becoming an economic desert!

The U.S. experience contrasts sharply with that of the European Union (EU). During the 25-year period ending with 1995, EU countries added 8.5 million jobs while the United States added 46 million jobs, even though the EU has about one-third more people.[7]

Not only has total employment increased, but the percentage of the population in the work force (those with jobs or actively seeking jobs) has increased, rising from 64 percent in January 1980 to 67.3 percent in January of 1998.[8] The current numbers are all-time records.

Loss of Faith?

Even though the detractors of the market economy claim that workers have lost faith in the American dream, many data present a contrary view. They indicate, for example, that individuals are healthier than ever. According to the Centers for Disease Control and Prevention, 1996 U.S. life expectancy was at its all-time high of 76.1 years. Since life expectancy in 1900 was only 43.7 years, it has increased substantially during this century.[9]

Furthermore, a nationwide poll by

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[1] David Molpus, Alex Chadwick, "Downsizing," Morning Edition NPR, November 14, 1997, www.elibrary.com, April 17, 1998.

[2] Cheryl Heckler-Feltz, "Broken Promises, Economic Earthquakes Shake American Dream," *The Lutheran,* March 1997, pp. 8-9.

[3] Reuters, "Downsizing Threatens Worker Health," October 17, 1997.

[4] Nathan Seppa, staff writers, *APA Monitor,* May 1996, www.apa.org, April 17,1998.

[5] Kenneth Labich and Erin M. Davies, "Managing: How to Fire People and Still Sleep at Night," *Fortune,* June 10, 1996, pp. 64ff.

[6] St. Louis Federal Reserve, www.stls.frb.org/fred/data.

[7] Peter Lynch, "The Upsizing of America," *Wall Street Journal,* September 20, 1996, p. A14.

[8] St. Louis Federal Reserve, www.stls.frb.org/fred/data/employ/civpart.

[9] U.S. Bureau of the Census, U.S. Life Tables 1890 and 1901-1910, and Centers for Disease Control and Prevention, Vital Statistics Rates in the United States, 1940-1960, cited in MedAccess Corporation Table 27. Data are located at website http://www.medaccess.com/health93/TABLE027.htm.

Money magazine reveals that individuals generally feel more secure about their jobs.[10] Consumer confidence numbers reveal a similar picture. The Conference Board reported that the December 1997 index of consumer confidence jumped to 134.5, a 28-year high. Indeed, consumers should be confident because income has generally increased for all groups of Americans.

We are witnessing the continuing restructuring of the American economy in response to consumer dollar votes. The downsizing in mature industries is what permits growth industries to acquire workers. If downsizing had been prohibited, we would still be using the Pony Express instead of e-mail!

Change characterizes free-market economies. A review of the 1994 *Forbes* 400 reveals that opportunity still characterizes the American economy. Four-fifths of the richest Americans earned rather than inherited their wealth. This represented an increase from three-fifths in 1984. They earned their wealth in technology, retailing, and finance. Those dropped from the list got their money from inherited wealth, real estate, oil and gas, heavy manufacturing, media, and agriculture.[11]

While the people on the *Forbes* list represent spectacular examples of economic success, it is also true that the gains have been spread throughout the American economy. This rising tide indeed has lifted all boats. All income groups, including the poor, have improved their position over time.

Who Are the "Poor"?

It is important to remember that the "poor" is not a fixed group of individuals. Defining the poor as those in the bottom 20 percent in income means that poverty will never be eliminated. There will always be a lowest 20 percent! But this does not mean that those who were previously the poor are still poor. They have generally moved up to higher incomes, and their places have been taken in part by those who were previously in higher income groups. More typically, they are replaced by new entrants into the labor market, essentially young individuals and immigrants.

To understand how the poor fare over time, one needs a longitudinal sample that tracks the success of the same individuals over time; otherwise, one is measuring an ever-changing group. The University of Michigan has collected such a sample, which is the subject of a Federal Reserve Bank of Dallas study.

This study stands in sharp contrast to the view of people who claim that the American dream has been shattered. Over the period 1975 to 1991, the poor did not get poorer; instead, they generally got richer! Only 5 percent of those in the bottom 20 percent in 1975 remained there in 1991. The other 95 percent had moved up the ladder. By 1991 roughly 80 percent of those in the bottom 20 percent in 1975 had moved up to the top 60 percent—middle class or above. Indeed, nearly a third had moved up to the top 20 percent. A poor person in 1975 was six times more likely to be rich in 1991 than still to be poor.[12]

All income groups increased their real purchasing power over the period 1975 to 1991. But the bottom 20 percent had larger gains than the top 20 percent. Measured in 1993 dollars, the "poor" had an average gain in income of $25,322 from 1975 to 1991, while the top 20 percent had an average gain of only $3,974 during the same period. Every group increased its real income, but the poor had much larger increases than the rich.

These findings are confirmed by a separate and independent U.S. Treasury longitudinal sample covering 1979 to 1988. The study found that 86 percent of the individuals in the lowest income group moved up during that period, with 67 percent moving up to the middle class or above. The slightly lower values for the Treasury study are explained by the fact that it covered a shorter period.

Both the Federal Reserve and Treasury studies confirm that a fixed sample of individuals improved their relative income position. Assuming that the free market is allowed to work, there is every reason to believe that the individuals now in the bottom 20 percent will also move up the income ladder. The American dream is indeed alive and well.

Absolute Improvement

But these studies underestimate the gains. Individuals in the 1975 sample improved their position relative to others. But the entire constellation of incomes was shifting upward as well. Thus, most people's purchasing power would have improved in absolute terms even if their relative position had not changed. Using a constant benchmark, such as the living standards prevailing in 1975, we find that 98 percent of the individuals in the bottom 20 percent in 1975 had improved their living standards by 1991! About two-thirds of those in the lowest 20 percent that year had by 1991 achieved a living standard that exceeded what the middle class had in 1975.

Since all income groups have witnessed increases, it follows that today's poorest 20 percent are better off than the poorest 20 percent earlier in our history. Consumption patterns confirm this conclusion. It is widely acknowledged that individuals give priority to life's "necessities" and use additional, discretionary income to purchase less essential items. Food, clothing, and shelter are widely considered essentials. In 1920 the poorest 20 percent used 75 percent of their income to purchase those necessities. By 1950 the income percentage had decreased to 57 percent. And by 1993 that percentage had dropped to 45 percent of total consumption.

This is true even though the homes are larger and have better climate control, the food is more varied and safer, and clothing comes in more variety and in higher quality. That today's poorest individuals spend a smaller percentage of their total income on necessities implies that they are better off than their earlier counterparts. Simply put, if one must be in the poorest 20 percent (or in any other income group for that matter), it is better to be there today than in 1975. These are the good old days!

Growth and Change

The free market's creative restructuring in response to consumer preferences is not properly characterized as "downsizing." Growth and change characterize free markets. It is something of an enigma, to me at least, to see so-called progressive "liberals" propose reactionary policies designed to preserve old modes of exchange and production. Policies that prevent firms from responding to changing consumer wants will serve only to impoverish Americans. The freer an economy, the greater is its average income growth. When government intervenes in the workings of the free market, income growth slows. (See, for example, the Heritage Foundation's 1998 *Index of Economic Freedom.*)

The view that the market economy has killed the American dream is simply false. Individuals are healthier than ever. They live longer than ever. More jobs are being created than cut. Individual incomes are rising over time. There is great mobility up the income ladder. The market economy is the greatest institution for social cooperation ever developed. Capitalism has accomplished fantastic feats in spite of the dead weight of government. Imagine what it would do if freed from that burden. ❑

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[10] Lesley Alderman and Karen Cheney, "Your Worklife: Here's the Good News about Jobs," *Money* magazine, May 5, 1996, p. 110. The data was obtained at website http://www.elibrary. com/ getdoc.cg...burl=htlp*C*//pathfinder.com/money.

[11] W. Michael Cox and Richard Alm, "By Our Own Bootstraps," Federal Reserve Bank of Dallas, *Annual Repart,* 1995, pp. 23-23.

[12] Ibid., p. 13. Subsequent income data come from this study.

BUSINESS-CYCLE CONDITIONS

Much of the doubt that dominated our recent reviews of business-cycle conditions has been resolved. Overall, the statistical indicators suggest that continued expansion is likely, at least for the next few months. However, many potential threats remain, notably a decrease in corporate profits.

According to the latest round of economic data, four of the twelve primary leading indicators reached new highs: *new orders for consumer goods*, *new housing permits*, *initial claims for state unemployment insurance* (inverted), and *M2 money supply* (M2 money supply and all other dollar-denominated series are reported in constant dollars). Although the latest base data for both housing permits and initial claims are down, the decreases were insufficient to reverse their upward trends and all four remain appraised as clearly expanding.

Despite an increase in its base data this month, changes in the moving average of the *ratio of manufacturing and trade sales to inventories* raised some doubt about the direction of the series. Appraised as clearly expanding last month, it was downgraded this month to probably expanding. *Contracts and orders for plant and equipment*, which came close to reaching a new high last month, reported a second consecutive monthly decrease in its base data. Although the moving average of this series has deteriorated somewhat, it remains appraised as probably expanding.

The *3-month percent change in consumer debt,* primarily credit card debt and automobile loans, steadily slowed from late 1994 until late 1997. That trend subsequently reversed, and although consumer debt still is well below its peak for the cycle, the series now is appraised, as it has been for some months, as probably expanding.

Two leaders that were indeterminate last month—*vendor performance*, the percentage of purchasing managers reporting slower deliveries from suppliers, and the *average workweek in manufacturing*—deteriorated this month. Vendor performance dropped slightly to a level of 50.1, and the average workweek fell to 41.6 hours per week. Both series now are appraised as probably contracting.

The cyclical trends of only three leading indicators now remain unidentifiable: *M1 money supply*, the *index of common stock prices,* and *the 3-month change in sensitive materials prices*. Although insufficient to establish a trend, M1 money supply increased for the second consecutive month. The constant-dollar index of common stock prices also increased, but remains below its June peak. The volatile sensitive materials prices series decreased too little to establish a downward trend.

Overall, 78 percent (seven out of nine) of the primary leading indicators with apparent cyclical trends are expanding. At this level, continued expansion remains statistically more probable than contraction. Moreover, our purely mathematical cyclical score remains unchanged this month at 74, and now tends to confirm the statistical indication provided by the percentage of leaders expanding.

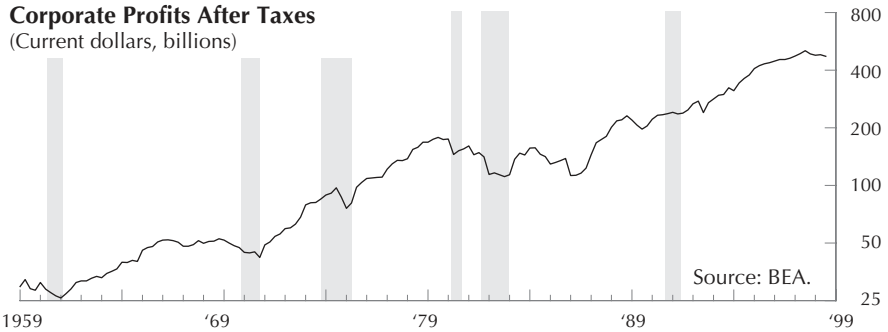
Although the outlook still could deteriorate rapidly, the uncertainty among the leaders that prevailed as recently as September has diminished markedly. In September, nine of our twelve leading indicators had no apparent trend. Our confidence in the percentage of leaders expanding, which ignores all indeterminate series, was correspondingly weak, and this circumstance was aggravated by a marked divergence between the percentage of leaders expanding and the cyclical score. Since then, six of the nine indeterminate series have established trends: two series deteriorated and are contracting—but four strengthened and now are expanding. Only three leaders remain indeterminate, and the two leading diffusion indexes have converged. In short, the current AIER leading index captures significantly more data than it did a few months back. Although that index has dropped from 100 in September to 78 this month, it is the latter number that provides greater statistical warrant for an outlook of continued expansion.

There was little change among the six primary roughly coincident indicators. *Nonagricultural employment*, *manufacturing and trade sales*, and *gross domestic product* all reached new highs and all three are appraised as clearly expanding. The *index of industrial production,* now three months off its most recent high, was downgraded from clearly expanding to probably expanding. There are still no identifiable trends in either *personal income in manufacturing* or the *civilian employment as a percentage of the working age population*. Personal income fell while the ratio of employment to population rose. However, neither movement revealed a cyclical trend. Overall, 100 percent (four out of four) of the roughly coincident in-

Statistical Indicators of Business-Cycle Changes

Change in Base Data					*Cyclical Status*		
Aug.	*Sep.*	*Oct.*	*Nov.*	***Primary Leading Indicators***	*Oct.*	*Nov.*	*Dec.*
-	+	+		M1 money supply	?	?	?
+	+	+		M2 money supply	+	+	+
-	-	+		Change in sensitive materials prices	?	?	?
-	+	+		New orders for consumer goods	?	+	+
+	-	-		Contracts and orders for plant and equipment	?	+?	+?
+	-	+	-	Index of new housing permits	+?	+?	+
-	+			Ratio of manufacturing and trade sales to inventories	+	+	+?
+	+	-	+	Vendor performance	?	?	-?
-	-	+	+	Index of common stock prices (constant purchasing power)	?	?	?
nc	-	+	-	Average workweek in manufacturing	?	?	-?
+	+	-		Initial claims for unemployment insurance (inverted)	+?	+	+
+	-	+		Change in consumer debt	+?	+?	+?
				Percentage expanding cyclically	100	100	78
				Primary Roughly Coincident Indicators			
+	+	+	+	Nonagricultural employment	+	+	+
+	-	+[r]	-	Index of industrial production	+	+	+?
+	+	-		Personal income in manufacturing	?	?	?
+	+			Manufacturing and trade sales	+	+	+
-	+	-	+	Civilian employment to population ratio	?	?	?
+	+			Gross domestic product (quarterly)	+	+	+
				Percentage expanding cyclically	100	100	100
				Primary Lagging Indicators			
+	-	nc	-	Average duration of unemployment (inverted)	+	+	+?
+	+			Manufacturing and trade inventories	+	+	+
+	+	+		Commercial and industrial loans	+	+	+
-	+	+		Ratio of consumer debt to personal income	-	?	?
-	+	-		Change in labor cost per unit of output, manufacturing	+	+	+?
-	-	-	-	Composite of short-term interest rates	?	-	-
nc No change.		[r]Revised.		*Percentage expanding cyclically*	80	80	80

Under "Change in Base Data," plus and minus signs indicate increases and decreases from the previous month or quarter and blank spaces indicate data not yet available. Under "Cyclical Status," plus and minus signs indicate expansions or contractions of each series as currently appraised; question marks indicate doubtful status when shown with another sign and indeterminate status when standing alone.



dicators with apparent cyclical trends are expanding.

Two primary lagging indicators were downgraded this month: the *average duration of unemployment* (inverted) and the *percent change from a year earlier in manufacturing labor cost per unit of output*. At 14.5 weeks in November, the average duration of unemployment now is two months off its peak; and the labor-cost series, which dropped in October, is three months off its peak. The downturns in both the base data and the moving averages for both series, which were appraised as clearly expanding last month, shed doubt on their trends, and both were downgraded to probably expanding.

Two lagging indicators, *manufacturing and trade sales* and *commercial and industrial loans*, reached new highs and both are appraised as clearly expanding. The *ratio of consumer debt to personal income,* which has fluctuated narrowly for many months, remains indeterminate. And at 5.09 percent, the *composite of short-term interest rates* remains appraised as clearly contracting. Overall, 80 percent (four out of five) of the primary lagging indicators with apparent cyclical trends are expanding.

Our review of the primary indicators of business-cycle change suggests that the economic expansion is likely to continue for the next several months, at least. Much of the doubt that dominated our recent reviews of the indicators has been resolved, yet many potential threats to continued expansion remain. Most of these remain in the realm of conjecture. For example, currently distressed steel producers could spearhead a major return to protectionism or a major unexpected bankruptcy here or abroad could cast a renewed chill on the money and capital markets. A more concrete development that warrants examination is the decreasing trend of corporate profits.

A Slowdown in Corporate Profits

As shown in the chart, corporate profits in current dollars have usually turned down before recessions. (The exception in the 1973-75 recession reflected large "phantom" inventory profits resulting from soaring commodity prices, especially the price of crude oil then). Indeed, until 1975 corporate profits was one of our primary leading indicators. The series was dropped from the list because it lacks timeliness—it is published quarterly (45 days after the end of the quarter) and often revised substantially.

During the current expansion, corporate profits increased steadily (with only 3 one-quarter decreases) until reaching a peak in the third quarter of 1997. However, the preliminary estimate for the third quarter of this year was 8 percent below its year-earlier peak. The decrease in corporate profits during the past 12 months is usually attributed to the strong dollar and to weakness in Asian and Latin American markets, which have adversely affected exports, made imports more competitive in the United States, and put pressure on the profit margins of domestic producers. Moreover, a strong dollar depresses the reported earnings of U.S. multinational corporations—foreign earnings translate to fewer dollar profits.

A strong dollar was clearly a factor in the "false signal" of recession given by the trend of corporate profits in the mid-1980s and it remains to be seen how much of the recent downtrend of profits reflects cyclical developments (such as "tight" labor markets). In any event, continued decreases in corporate profits may be expected to be reflected in a further weakening of at least two of the primary leaders: common stock prices and contracts and orders for plant and equipment. ❑

PRICE OF GOLD

	1996	*1997*	*—— 1998 ——*	
	Dec. 23	*Dec. 23*	*Dec. 17*	*Dec. 22*
Final fixing in London	$368.75	$292.50	$293.30	$297.25

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