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# New Year, New Economy: The 2001 Economic Report of the President

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In 2001, the so-called “New Economy” had emerged as a part of an unprecedented period economic demand-side growth. This temporarily raised Americans’ real wages to record-highs, decreased unemployment to 4.9% (at the time, an all-time low) and created opportunities for groups that had long been left behind, such as ethnic minorities. The name “New Economy” described its new structure and nature, being more high technology-intensive than ever before while yielding higher productivity growth rates than in previous years. The “New Economy” was allowed to arise due to the macroeconomic policies of the prior eight years. This consisted of fiscal and monetary policies as well as government investment in technology and education. While appearing as a flourishing economy, the “New Economy” implied a great deal of issues as well, such as an increase in income inequality between whites and ethnic minority groups, an increase in urban sprawl, and the creation of the conditions for a devastating economic crash due to an overinvestment in risky businesses.

One challenge which arose would be the abandonment of fiscal discipline in the form of large tax cuts, which would lead to an increase in interest rates and therefore a likely decrease in overall growth and investment. Another issue at the time was the control of health care expenditures. Health care, at the time, was not affordable to all, leaving many Americans unable to reap the benefits of the high-quality care available. Additionally, an unforeseen side-effect of the “New Economy” was that, as a result of the incredible growth during the 1990s, there had been a large increase in population and jobs, especially in the perimeters of some of the nation’s larger cities, leading to the exacerbation of a pre-existing issue known as sprawl, which can result in swift and severe environmental consequences.

Another issue was the severe cooling of the stock market. In 2000, after explosive growth across the board, technology stocks, specifically for the internet, fell sharply after having peaked earlier in the spring. At the conclusion of the year, they were at their lowest point in two years. This severe cooling lead to a decrease in consumer spending as well as business investment, all else constant. Additionally, an increase in energy prices slowed the economy overall, which was further compounded by the monetary tightening of the Federal Reserve in the form of increased interest rates.

Though many Americans enjoyed the benefits of the booming "New Economy", the benefits were not equally shared among all Americans. For example, the incomes of ethnic minority groups were significantly below those of whites. Similarly, the poverty rates of ethnic minority groups were significantly higher than those of whites. As a result, one of the goals of the policy-makers was to emphasize employment and investment in the skills of the economically disadvantaged. The ultimate goal was to help those low-income families leave welfare and enter the labor market in an effort to distribute the gains of the "New Economy" more equally.

Though certain areas had seen a significant increase in both jobs and population, the opposite was true in other areas such as in central cities as well as rural areas where extreme poverty was present. According to a survey conducted in 1999, the poverty rate for central cities stood at 16.4%, and for rural areas 14.3%. Both were significantly higher than the national average of 11.8%. As a result, the Administration made an objective to make 'work pay' and decrease these poverty rates by doing away with the old Aid to Families with Dependent Children (AFDC) "Welfare" system in order to accomplish the goal of eradicating poverty from the areas in which it had become entrenched.

As education is an integral part in the intellectual development of children as well as their future, the Administration had invested significantly in a high-quality public education system.

In an effort to resolve this issue and improve public education as a whole, the Administration made it a goal to decrease the size of classes, raise the quality of teachers, fix and modernize the physical condition of classrooms, improve educational technology and internet access, improve accountability and educational outcomes, increase the number of public schools, as well as help students make the transition from secondary school to college.

Though, as a result of the "New Economy" and other pre-existing programs, Americans enjoyed a wide variety of benefits related to healthcare, there still were issues which needed to be addressed, such as health insurance coverage. In 2001, due to the high price of health care, there were approximately 42.6 million Americans, about 15% of the US population at the time, without health insurance coverage. To solve this issue, the Administration set goals to improve the technological innovations and improved organizational innovations to control healthcare costs.

As mentioned earlier, as a result of the "New Economy" there had been a rapid increase in the number of jobs available in the rural perimeter surrounding large American cities, which resulted in an increase in the population of the rural areas overall. These local communities which were experiencing rapid growth needed to find a way to channel this growth so as to avoid issues which can arise in a rapidly increasing population. The resulting sprawl causes a significant amount of challenges which must be dealt with, forcing policymakers to aim to restructure regional coordination.

In order to resolve many of the issues mentioned above, the government made an effort to implement policies which would foster innovation and entrepreneurship. In an effort to reform the welfare system, the government ended the AFDC program and instead implemented the Temporary Assistance for Needy Families (TANF) program. This program gave states much more discretion in using Federal funds, thus allowing states the flexibility to use funds to serve their particular demands and viewpoints, such as allocating more funds for childcare subsidies or allowing welfare recipients to keep a greater percentage of their earnings. Additionally, the TANF program imposed time limits and work requirements on welfare recipients. Specifically; no state was allowed to use Federal Funds to pay benefits to recipients for a time span of longer than 60 months. The TANF program also allowed states to design the parameters of their particular programs to best meet the needs of their residents, which many states used to decrease the implicit tax on earnings.

In order to decrease the implicit taxes on income and increase the potential benefit, the Administration implemented policies which increased the minimum wage as well as the Earned Income Tax Credit (EITC) through increased subsidies on child care as well as through expanded health insurance coverage.

In an effort to reduce the persistently high poverty levels in central cities, the Administration implemented policies such as the Empowerment Zone/ Enterprise Community initiative. This aimed to aid communities by encouraging investment from private businesses through wage credits, tax credits, and improved access to credit markets. To eliminate high poverty rates in rural communities, the Administration implemented policies such as Rural Utilities Service, which offered grants, technical assistance, and loans to those in these communities.

To improve the quality of schools available for low-income families, the Administration implemented policies such as the Elementary and Secondary Education Act, which allocated funds to educational institutions based on the number of poor children and the child poverty rate in the area. To reduce class sizes, the Administration implemented policies such as a 7-year initiative to reduce class sizes in grades 1-3, with the goal average class size being 18 students or less. Regarding the issue of improving the quality of teachers, the Administration implemented the Teacher Quality Enhancement Grant, which aimed to professionally develop teachers across the nation and improve education nationwide. To improve the access to new technology and internet for schools nationwide, the government implemented the E-rate program, which provides up to $2.25 billion to libraries as well as schools so as to offset the cost telecommunication services as well as internet access. To resolve the issue of the number of public schools, the Administration implemented the Public School Charter Act, as well as the Charter School Expansion Act, which allowed schools to provide a variety of educational methods while remaining publicly accountable. In an effort to ease the transition of students from secondary schools to university, the administration implemented policies such as The Gaining Early Awareness and Readiness for Undergraduate Programs (GEAR UP) which partnered middle schools with a large population of poor students with universities in the area and provided scholarships for the high achieving students of those schools.

In an effort to deal with the issue of expanding health care coverage, the government implemented three different types of subsidies. The first type, tax deductions, allowed those who purchase health insurance to their health insurance premiums thereby decreasing their taxes. The second kind, tax credits, allowed those who purchase health care to reduce their taxes by the full amount of the credit. The third kind provided government-provided insurance to lower-income families.

In response to the issue of ‘sprawl’ and the many smaller issues which result from ‘sprawl’, the Administration implemented the 30-Point Livable Communities initiative. The initiative aimed to align Federal policies with smart growth priorities and encourage planning and coordination of the areas affected by sprawl. Essentially, it provided government funds to restructure and reorganize many of these affected communities.

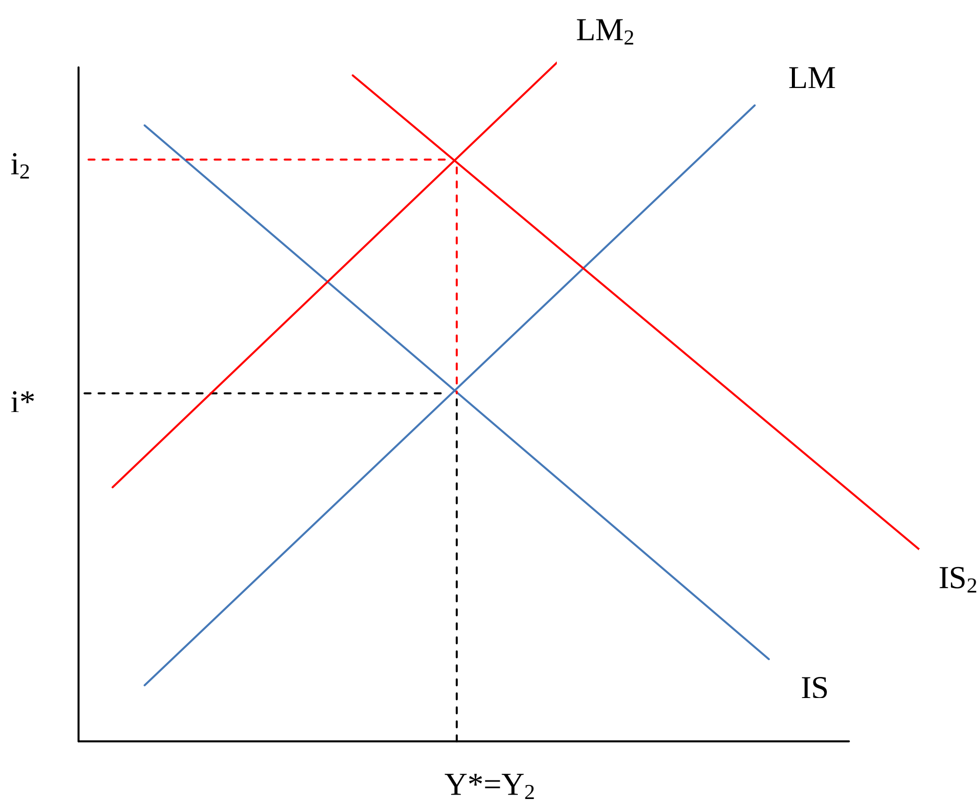
One example of monetary policy during this period was between June 1999 and May 2000 the Federal Reserve raised its target Federal Funds Rate by 175 basis points, from 4.75 percent to 6.5 percent. This increase in Federal Funds rates caused an increase in both treasury yields and corporate bonds yields. As the economy of 2000 initially was performing quite well, the unemployment rate remained low, around 4 percent, without causing excessive inflation or rising inflationary expectations. One noteworthy development was that a sharp increase in oil prices did cause the overall consumer price index (CPI) to increase by 3.4 percent between November 1999 and November 2000. Fortunately, this increase in oil prices did not affect many other prices as can be seen by the inflation rate, during that same time period, having risen only 2.6 percent.

In 2000, the monetary policy, as well as stock market developments, was not unusual for an economy experiencing such expansive growth. The 1990s as a whole showed an incredible bull market in which the Wilshire 5000 index (the most comprehensive index of US stock prices) quadrupled between 1989 and 1999. More than three-quarters of that “quadrupling” came after 1995. Unfortunately, however, in 2000 this upward trend ended and as of December 15, 2000 the Standard & Poor’s 500 index of large company stocks was down 11 percent. Additionally, the NASDAQ composite index, though having initially climbed 22 percent from January to March of 2000, had fallen 35 percent as of December 15, 2000. Overall, the stock market underperformed as total stock market wealth fell by 10 percent as of November 30, 2000, as opposed to the average annual increase of 17.75 percent of the previous decade.

One fiscal policy implemented during the time was tax deductions. As can be seen in the graph, as a result of these new tax deductions, consumers had a larger amount of disposable income and therefore consumer spending increased significantly, thus shifting the IS curve to the right, from IS to $IS_2$.

One of the monetary policies implemented during this time was the increased federal funds rate, the result of which can be seen in graph below as well. As the money supply moves in the opposite direction of the real interest rate, an increase in the federal funds rate will shift the LM curve to the left, from LM to $LM_2$.

The combined effect of these fiscal and monetary policies can be seen below. As the magnitude of the fiscal and monetary policies was comparable, the effect on the GDP level is ambiguous. As a result, the resulting GDP level,$Y_2$, is equal to the original GDP level of Y*. The interest rate increased from i* to $i_2$, as both the fiscal and the monetary policies, enacted at this time, increased the interest rate, the effect of which can be seen in the graph below.



In conclusion, though the "New Economy" appeared to be successful, it caused a great deal of social and economic issues such as an increase in income inequality between whites and ethnic minority groups, as a result of the high unemployment rates among ethnic minority groups and thus a lack of distribution of economic benefits to said minority groups, an increase in sprawl, due to the rapid growth of the economy which caused people to migrate to more metropolitan areas around the perimeters of cities, and it set the conditions for a devastating economic crash due to an overinvestment in risky businesses.

**Bibliography**

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