

C O N T E N T S

	<i>Page</i>
OVERVIEW	19
CHAPTER 1. THE YEAR IN REVIEW AND THE YEARS AHEAD	25
Developments in 2005 and the Near-Term Outlook.....	25
Consumer Spending and Saving.....	25
Housing Prices	30
Residential Investment	31
Business Fixed Investment.....	31
Business Inventories	32
Government Purchases	33
Exports and Imports	34
Employment	35
Productivity.....	36
Wages and Prices.....	38
Financial Markets.....	41
The Long-Term Outlook Through 2011.....	42
Growth in GDP over the Long Term	43
Interest Rates over the Near and Long Term	46
The Composition of Income over the Long Term	46
Conclusion.....	47
CHAPTER 2. SKILLS FOR THE U.S. WORKFORCE.....	49
Educational Achievement in the United States.....	49
Workforce Skills and the U.S. Standard of Living	50
Educational Attainment	51
Math, Science, and Reading Skills in the United States and Around the World	54
School Accountability and No Child Left Behind	55
Immigrants in the U.S. Workforce	56
Immigrants in Science and Engineering	57
Regulation of Legal Immigration.....	59
Skilled Immigration and Innovation	61
Job Training	61
The Role of Community Colleges.....	62
Job Training Funding	63
Conclusion.....	63

CHAPTER 3. SAVING FOR RETIREMENT	65
What Does “Retirement Preparedness” Mean?	65
Estimates of Retirement Preparedness	66
The Risks to Retirement Preparedness.....	69
Are Low Saving Rates Putting Household Net Worth at Risk?	69
Defined-Benefit Pensions	74
Social Security	79
Conclusion.....	83
CHAPTER 4. IMPROVING INCENTIVES IN HEALTH CARE SPENDING	85
The Growth in Health Care Spending	85
Where Health Spending Has Grown.....	88
First-Dollar Insurance Inhibits Consumer Cost-Consciousness	91
Causes of First-Dollar Insurance Coverage	92
Consequences of First-Dollar Insurance Coverage	94
Consequences of Inefficient Health Care Spending.....	97
Private Spending	97
Public Spending	99
Strengthening the Role of Health Consumers Through Public Policy	100
Health Savings Accounts (HSAs)	100
Informed Consumers Are Better Consumers.....	104
Conclusion.....	106
CHAPTER 5. THE U.S. TAX SYSTEM IN INTERNATIONAL PERSPECTIVE	107
Fundamental Choices in Tax Systems.....	107
Designing a Tax System.....	108
Taxes Distort Economic Decisions	109
U.S. Tax Policy in International Perspective	112
International Comparison of Overall Tax Burdens	112
International Comparison of Tax Bases and Rate Structures.....	113
Recent International Tax Reforms	116
U.S. Tax Reforms: Past, Present, and Future.....	118
Twenty Years of Tax Reform	119
Potential Reforms to the Tax System	120
Conclusion.....	122
CHAPTER 6. THE U.S. CAPITAL ACCOUNT SURPLUS	125
Global Capital Flows—Principles.....	128
Global Capital Flows—Recent Patterns.....	130
Global Capital Exporters.....	132
The United States and Net Capital Inflows	136
Overview.....	136

Net Capital Importers—International Comparisons	138
U.S. Share of Global Flows and the Asset Composition of U.S. Capital Inflows.....	139
Causes of U.S. Capital Inflows.....	140
Low and Declining U.S. Saving	140
High U.S. Economic and Productivity Growth.....	142
Financial Market Size	143
Global Role of the U.S. Dollar.....	144
U.S. Capital Flow Sustainability.....	144
Conclusion.....	146
CHAPTER 7. THE HISTORY AND FUTURE OF INTERNATIONAL TRADE	149
A Retrospective on Trade.....	149
The Payoff to America from Global Economic Integration	155
Benefits to Consumers	155
Benefits to Firms and Their Workers.....	158
Taking Stock of the Benefits of Trade to America.....	160
The Policy Scene Today: Avenues to Further Liberalization.....	164
Prospective Gains from Further Liberalization	164
Avenues for Further Liberalization	168
Moving Beyond Goods Trade Liberalization	168
Conclusion.....	170
CHAPTER 8. THE U.S. AGRICULTURAL SECTOR	173
The U.S. Farm Sector Has Evolved Dramatically Over Time.....	174
The Average Farm Payment Recipient Is No Longer Poor.....	176
Production and Government Payments Are Concentrated on Large Farms	177
Issues in Current U.S. Farm Policy.....	178
Agricultural Production and Farm Program Benefits Are Increasingly Concentrated.....	178
Farmers Today Have Many Options for Managing the Risks They Face	180
Economic Costs of Commodity Support Programs.....	182
Trade Policy Issues.....	183
Trade Is Essential to the U.S. Agricultural Sector	184
Nonsubsidized Commodities Now Account for Most of U.S. Agricultural Exports.....	184
Trade Agreements Promote Reform of U.S. Commodity Support Programs	185
Benefits of Agricultural Trade Liberalization.....	186
Alternatives to Commodity Subsidies.....	188
Environmental Aspects of Agricultural Subsidies.....	189
Conclusion.....	192

CHAPTER 9. THE U.S. FINANCIAL SERVICES SECTOR.....	195
The Economic Roles of Financial Services.....	195
Financial Services Address Information Problems in Lending and Investing	195
Other Benefits of Financial Services	198
The United States Enjoys a Comparative Advantage in Financial Services	199
Economic Growth and Stability	200
Financial Development and Economic Growth.....	200
Financial Services and Economic Stability.....	202
Policy Issues.....	204
Consumer Protection	204
Safety and Soundness	206
Conclusion.....	210
CHAPTER 10. THE ROLE OF INTELLECTUAL PROPERTY IN THE ECONOMY .	211
Knowledge Is Different from Other Types of Goods	212
Treating Knowledge as Intellectual Property.....	213
The Social Costs of an Intellectual Property System.....	213
Intellectual Property Rights Basics.....	215
Patents: Protecting a Particular Implementation of an Idea	216
Copyrights: Protecting the Expression of an Idea	216
Trademarks: Protecting the Symbol of an Idea, Product, or Service	217
Trade Secrets: Limited Protection for Knowledge Kept Secret	217
Intellectual Property, the American Economy, and Economic Growth	218
Intellectual Property and the American Economy	218
Intellectual Property Protection and Economic Growth	221
Intellectual Property Policy Challenges.....	222
Ensuring the Integrity of the Patent Process.....	222
Intellectual Property and International Trade	224
Technological Change and Intellectual Property Reform.....	227
Conclusion.....	229
CHAPTER 11. RECENT DEVELOPMENTS IN ENERGY	231
Energy Sources and Uses	232
Crude Oil.....	233
A Global Market in Crude Oil.....	233
Crude Oil Prices.....	234
The Strategic Petroleum Reserve	235
Future Price Expectations and Incentives for Nonconventional Fuels	236

Gasoline and Other Refined Products	238
Gasoline Prices	239
Refining Capacity and Trade	242
Price-Induced Substitution and Technological Change.....	243
Reform of the New Source Review Program	246
Natural Gas.....	246
Regionalized Natural Gas Markets	247
Natural Gas Prices.....	247
Liquefied Natural Gas.....	248
Prospects for Domestic Production of Natural Gas	251
Electricity.....	252
Electricity-Generation Technologies	252
The Real-Time Challenge of Electricity Markets.....	252
Real-Time Pricing and Other Reforms.....	253
Environmental Protection	254
Electricity Markets in Transition	256
Conclusion.....	257

APPENDIXES

A. Report to the President on the Activities of the Council of Economic Advisers During 2005.....	259
B. Statistical Tables Relating to Income, Employment, and Production	273

LIST OF TABLES

1-1. Administration Forecast	43
1-2. Supply-Side Components of Real GDP Growth, 1953–2011 ...	44
2-1. Average Annual Earnings by Education (2004 dollars).....	50
2-2. Educational Attainment by Race, Ethnicity, and Gender, 2004	53
2-3. Rankings of Selected Advanced Countries by Average Score on International Tests	55
3-1. The Median Value (in 1998 dollars) of Net Worth for Households Headed by a 25- to 34-Year Old—Differences by Homeownership, Marital Status, and Education.....	68
3-2. Median Value of Wealth-to-Income Ratios for Households Headed by a 25- to 34-Year Old—Differences by Homeownership, Marital Status, and Education	68
4-1. The Premiums Charged for Three Sample Health Insurance Plans with Different Patient Cost Sharing	102
7-1. Important Milestones in American Trade History.....	151

8-1.	100 Years of Structural Change in U.S. Agriculture	175
8-2.	Farm Income and Farm Operator Household Income by the USDA Farm Size Classification, 2004	177
8-3.	Distribution of Agricultural Production and Government Payments by the USDA Farm Size Classification, 2003	178
11-1.	Energy Sources and Uses, 2004	233

LIST OF CHARTS

1-1.	Consumption & Net Worth (Relative to Disposable Personal Income)	30
1-2.	Business Fixed Investment and Cash Flow	33
1-3.	Productivity Growth During Cyclically-Comparable Business Cycle Intervals	37
1-4.	Inflation	38
1-5.	Survey and Market Measures of Expected Inflation in 2005 and 2006	40
1-6.	10-Year Treasury Yield	41
1-7.	Corporate Bond Yield Spreads	42
1-8.	Labor Force Participation Rate and Disabled Workers Relative to Population	45
2-1.	Educational Attainment by Age, 1947-2004	52
2-2.	Foreign-born Share of Employment by Education among Scientists and Engineers, 1996-2002	58
3-1.	Personal Saving as a Percentage of Disposable Personal Income	70
3-2.	Household Net Worth as a Percentage of Disposable Income ...	72
3-3.	Household Saving Rate as a Percentage of Disposable Income ..	72
3-4.	Funding Status of the Pension Benefit Guaranty Corporation ..	76
4-1.	National Health Expenditures as a Percentage of GDP	86
4-2.	Family Health Insurance Premiums 1999-2005	87
4-3.	Real Hourly Compensation of the Civilian Population	98
5-1.	Tax Revenues as a Percent of GDP for the OECD Countries in 2002	113
5-2.	Top Marginal Personal and Corporate Tax Rates for the OECD Countries in 2004	116
6-1.	Net Capital Inflows to the United States	126
6-2.	Largest Net Capital Importers and Exporters-2004	131
6-3.	Current Account Balances of Oil-Producing Countries	138
6-4.	Annual Growth and Current Account Balances - 1995-2004	139
6-5.	Gross National Saving Rates - 1995-2004	140
7-1.	Average U.S. Tariff on Dutiable Goods, 1930-2005	154
7-2.	Consumer and Import Price Growth, 1990-2004	156

7-3.	Average Tariffs Across Countries	166
8-1.	Farm Sector Inputs, Output, and Total Factor Productivity	175
8-2.	Farming Output and Share of U.S. GDP.....	176
8-3.	Value of Agricultural Production by Farm Size (1989 versus 2003).....	179
8-4.	Government Commodity Payments by Farm Size (1989 versus 2003)	180
8-5.	Composition of U.S. Farm Household Income by Source (household average)	181
8-6.	Net Direct Payments to Farmers	183
8-7.	Value of U.S. Agricultural Exports of Bulk and High-Value Commodities.....	185
9-1.	Share of GDP from Financial Services	200
9-2.	Long-Term Decline in Volatility of Macroeconomic Indicators.	203
10-1.	Intellectual Property Industries' Share of 2003 Gross Domestic Product.....	219
10-2.	Share of Assets in Current Market Value of Public U.S. Corporations	220
10-3.	Growth Rate of U.S. Exports	221
11-1.	World Proven Oil Reserves.....	234
11-2.	Estimated Production Costs of Alternatives to Conventional Oil.....	238
11-3.	U.S. Household Gasoline Expenditures	242
11-4.	U.S. Energy Intensity.....	244
11-5.	World Proven Natural Gas Reserves.....	249

LIST OF BOXES

1-1.	Economic Impact of the 2005 Hurricanes	26
3-1.	Earlier Attempts to Shore Up Social Security	81
4-1.	Tax Preferences for Employer Health Insurance Premiums.....	92
4-2.	Medical Liability Costs	95
5-1.	Fiscal Challenges Ahead	114
5-2.	Simple, Fair, and Pro-Growth: Proposals to Fix America's Tax System, Recommendations of the President's Advisory Panel on Federal Tax Reform	121
6-1.	Analyzing the Current and Capital Account Balances	129
6-2.	High Saving and Financial Sector Inefficiency	137
6-3.	The Link Between Fiscal and Trade Deficits	141
7-1.	The Regressive Nature of U.S. Tariffs.....	157
7-2.	Trade and Labor.....	161
7-3.	Trade and the Environment	163

7-4. U.S.-Asia Trade Relationship..... 166

8-1. New Zealand’s Abolition of Agricultural Subsidies 187

8-2. Policy Mechanisms for Addressing Agri-environmental Issues ... 190

8-3. A Market-Based Approach to Reduce Overfishing 192

9-1. Venture Capital and Innovation 201

9-2. Regulation Is Not Costless 205

10-1. Intellectual Property in the Early American Republic..... 214

10-2. The Free Software Licensing Movement 228

11-1. Energy Futures Markets 237

11-2. The Effects of Hurricanes Katrina and Rita on Energy
Supplies..... 239

11-3. Automobile Fuel Economy Standards 245

11-4. Cap-and-Trade Programs for Air Pollution..... 255