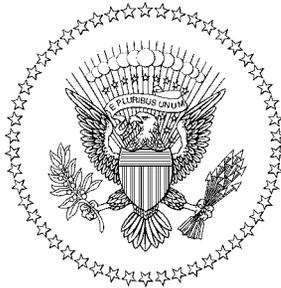


# Economic Report of the President



Transmitted to the Congress  
February 2006

together with  
THE ANNUAL REPORT  
of the  
COUNCIL OF ECONOMIC ADVISERS

UNITED STATES GOVERNMENT PRINTING OFFICE  
WASHINGTON : 2006

---

For sale by the Superintendent of Documents, U.S. Government Printing Office  
Internet: [bookstore.gpo.gov](http://bookstore.gpo.gov) Phone: (202) 512-1800 Fax: (202) 512-2250  
Mail Stop: SSOB, Washington, DC 20402-0001

ISBN 0-16-075418-6



# C O N T E N T S

---

	<i>Page</i>
ECONOMIC REPORT OF THE PRESIDENT.....	1
ANNUAL REPORT OF THE COUNCIL OF ECONOMIC ADVISERS*.....	7
CHAPTER 1. THE YEAR IN REVIEW AND THE YEARS AHEAD .....	25
CHAPTER 2. SKILLS FOR THE U.S. WORKFORCE.....	49
CHAPTER 3. SAVING FOR RETIREMENT .....	65
CHAPTER 4. IMPROVING INCENTIVES IN HEALTH CARE SPENDING.....	85
CHAPTER 5. THE U.S. TAX SYSTEM IN INTERNATIONAL PERSPECTIVE.....	107
CHAPTER 6. THE U.S. CAPITAL ACCOUNT SURPLUS.....	125
CHAPTER 7. THE HISTORY AND FUTURE OF INTERNATIONAL TRADE.....	149
CHAPTER 8. THE U.S. AGRICULTURAL SECTOR.....	173
CHAPTER 9. THE U.S. FINANCIAL SERVICES SECTOR .....	195
CHAPTER 10. THE ROLE OF INTELLECTUAL PROPERTY IN THE ECONOMY .....	211
CHAPTER 11. RECENT DEVELOPMENTS IN ENERGY.....	231
APPENDIX A. REPORT TO THE PRESIDENT ON THE ACTIVITIES OF THE COUNCIL OF ECONOMIC ADVISERS DURING 2005.....	259
APPENDIX B. STATISTICAL TABLES RELATING TO INCOME, EMPLOYMENT, AND PRODUCTION.....	273

---

*\* For a detailed table of contents of the Council's Report, see page 11*



**ECONOMIC REPORT  
OF THE PRESIDENT**



# ECONOMIC REPORT OF THE PRESIDENT

*To the Congress of the United States:*

The United States economy continues to demonstrate remarkable resilience, flexibility, and growth. Having previously endured a stock market collapse, recession, terrorist attacks, and corporate scandals, this year the economy showed strong growth and robust job creation in the face of higher energy prices and devastating natural disasters. This is the result of the hard work of America's workers, supported by pro-growth tax policies.

In 2005, the Nation's real gross domestic product (GDP) grew 3.5 percent for the year, above the historical average. About 2 million payroll jobs were added in 2005, and the unemployment rate dropped to 4.7 percent last month, well below the averages of the 1970s, 1980s, and 1990s. Real disposable personal income increased, and real household net worth reached an all-time high. This growth comes on top of an already strong expansion. More than 4.7 million payroll jobs have been added since August 2003.

Compared with the performance of other nations' economies, our economic growth is especially impressive. The United States has added more jobs in the past two-and-a-half years than Japan and the European Union combined. Real GDP growth in the United States has been faster than in any other major industrialized country since 2001, and America is forecasted to continue as the fastest-growing country over the next two years.

Our economy's fundamental strength comes from the ingenuity and hard work of our workers. Productivity—how much workers produce per hour—has accelerated since 2000. In the past five years, productivity has grown faster than in any other five-year period since the mid-1960s. The productivity of the United States is increasing faster than any other major industrialized country.

Productivity growth raises our standard of living and plays a central role in our competitiveness in the worldwide economy. Productivity growth will be even more important as new technologies accelerate global economic integration and as the American population ages.

We must now build on this fundamental strength by making robust investments in physical sciences, improving private incentives for research and development, and boosting math and science education and worker training. The American Competitiveness Initiative will help us remain a world leader in science and technology, which means good high-paying jobs for the American people.

We must also continue to pursue pro-growth economic policies and foster a culture of entrepreneurship. To adopt innovations effectively, our companies and workers need the incentives and flexibility that support a thriving free-market economy.

Maintaining a low tax burden is essential for our economic growth and competitiveness. Tax relief has helped our economy, and raising taxes will increase the burden on our families and small businesses. To keep our economy growing, Congress needs to make the tax relief permanent.

Two years ago, I called for cutting the budget deficit in half by 2009 by restraining spending and spurring economic growth. Every year of my presidency, we have reduced the growth of non-security discretionary spending, and last year Congress passed bills that cut this spending. This year, my budget will cut it again, and it will reduce or eliminate more than 140 programs that are performing poorly or not fulfilling essential priorities. By passing these reforms, we will save the American taxpayer another \$14 billion next year, and we will stay on track to cut the deficit in half by 2009.

Controlling discretionary spending alone is not enough, however. We have recently passed significant savings in mandatory spending programs. We need to do more because the only way to solve our Nation's fiscal challenges is to address the explosions in growth of entitlement programs like Social Security, Medicare, and Medicaid. I have called for a bipartisan commission to examine the full impact of the Baby Boom retirement and help us come up with bipartisan answers. The longer Congress waits to act, the more difficult the choices will become.

Working together, we accomplished other significant pro-growth reforms that will help our Nation's economy grow stronger and create more jobs. More remains to be done.

Growth in spending on health care has been more rapid than general inflation, straining consumers, employers, and government budgets. Two years ago, we created Health Savings Accounts (HSAs) to help give patients more control over their health care decisions and to make health care more available and affordable. This year, I am proposing to enhance HSAs to make them more widely available, valuable to consumers, and attractive to small businesses—and to make it easier for people to keep their insurance policies when they change jobs. Last year, we worked with Congress to pass a patient safety

bill that will help reduce medical errors. Getting doctors and patients the information they need on the quality, cost, and effectiveness of different treatments will help Americans get the highest quality and highest value care. This year, my Administration will push to make more information about price and quality available to consumers, and move forward on these and other policies to lower the cost of health care.

Our Nation's liability laws allow too many frivolous lawsuits and raise costs for consumers and businesses. A year ago, we worked with Congress to pass bipartisan class action reform to help curb lawsuit abuse. I urge Congress in the coming year to pass other essential legal reforms, including asbestos and medical liability reforms.

Energy prices have risen in the last year, but the underlying causes of high prices are long-standing. Last year, we passed the first major energy bill in over a decade. It encourages new technologies and updates government regulations. Over time, the new law will help increase the reliability of our energy supply and the efficient use of the energy we have. We must continue to find new ways to diversify our sources of energy. I have proposed the Advanced Energy Initiative to help increase research in alternative energy sources and technology and to make America less dependent on foreign sources of energy.

Because 95 percent of the world's customers live outside of our borders, opening international markets to our goods and services is critical for our economy. My Administration will continue to work tirelessly to open markets and knock down barriers to free and fair trade so that American farmers and workers can compete on a level playing field worldwide.

These and other issues are discussed in the 2006 Annual Report of the Council of Economic Advisers. This report is prepared by CEA to help policymakers understand the economic context of a variety of issues and trends as our Government makes decisions regarding our economic future. By adopting sound economic policies that build on our strengths, we will keep our economy moving forward and extend prosperity for all Americans.

A large, stylized handwritten signature in black ink, which appears to be "George W. Bush". The signature is written in a cursive, flowing style with a large initial "G" and "B".

THE WHITE HOUSE  
FEBRUARY 2006



THE ANNUAL REPORT  
OF THE  
COUNCIL OF ECONOMIC ADVISERS



LETTER OF TRANSMITTAL

COUNCIL OF ECONOMIC ADVISERS,  
*Washington, D.C., February 13, 2006*

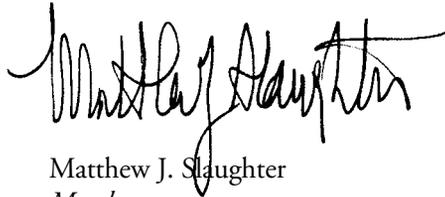
MR. PRESIDENT:

The Council of Economic Advisers herewith submits its 2006 Annual Report in accordance with the provisions of the Employment Act of 1946 as amended by the Full Employment and Balanced Growth Act of 1978.

Sincerely,

A handwritten signature in black ink, appearing to read 'K Baicker', with a long horizontal flourish extending to the right.

Katherine Baicker  
*Member*

A handwritten signature in black ink, appearing to read 'Matthew J. Slaughter', with a long horizontal flourish extending to the right.

Matthew J. Slaughter  
*Member*